SEEKING A NEW ACCOMMODATION

IN WORLD COMMODITY MARKETS

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The Trilateral Commission
This report has been prepared for the Trilateral Commission and is released under its auspices. It was discussed at the Trilateral Executive Committee meeting held in Paris, Nov. 29 - Dec. 2, 1975, and the Statement issued by the Executive Committee in Paris was based in part upon it. The authors, who are experts from North America, Western Europe and Japan, have been free to present their own views. The Commission will utilize the report in making any proposals or recommendations of its own. It is making the report available for wider distribution as a contribution to informed discussion and handling of the issues treated.

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A Report of the Trilateral Task Force on Commodities Issues to the Executive Committee of The Trilateral Commission

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The Trilateral Process

The report which follows is the joint responsibility of the three rapporteurs of the Trilateral Task Force on Commodities Issues, with Mr. Carl E. Beigie serving as principal drafter. The rapporteurs were aided in their task by extensive consultations. In each case, the consultants spoke for themselves as individuals and not as representatives of any institutions with which they are associated. Those consulted included the following:

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SUMMARY OF THE REPORT OF
THE TRILATERAL TASK FORCE ON COMMODITIES ISSUES

Seeking a New Accommodation
in World Commodity Markets

The principal commodities issues of recent years have raised fundamental challenges to the international economic and political system. A failure to respond to these issues constructively would result in adverse consequences for all nations, whether commodity importers or exporters, whether industrialized or non-industrialized. There is a basic mutuality of interests regarding commodity issues. Recognition of this mutuality of interests should lead to changed perceptions as individual countries seek to accommodate national objectives within an increasingly integrated world economy and a natural environment that is creating more demanding challenges and constraints.

This report puts forward a broad range of recommendations to deal with a variety of causes of commodity market disruptions and to fashion a new accommodation between commodity producers and consumers. These recommendations, in their general thrust if not their specific features, constitute a package in the sense that each has an important role in contributing to an international environment in which all nations regard a liberal, multilateral trading system to be in their best long-term interests.

Resource exhaustion is often seen as a major potential source of commodity market disruption. Rapid increases in population and economic growth have placed increasing strains on the world's resource endowment. There has been inadequate recognition in recent years of the world's ability to overcome these strains through the application of technical skills, financial resources, and incentives to avoid waste. Still, the costs of supplying basic commodity needs may be rising, and perceptions that resource exhaustion problems exist are important in the determination of national resource policies. A primary recommendation of this report is that an information and research center be created at the international level to provide independent expert assessments of current and potential commodity market problems.

The most pressing needs for policy action, however, lie in the related areas of instability in commodity prices, contrived shortages, and structural problems. If disruptions in world commodity markets arising from these problems are to be overcome, a new bargain must be struck.
between commodity importers and exporters. The elements of this bargain must reflect commodity-importing nations' interests in access to supplies and a predictable environment for investments to expand supplies, and it must also reflect commodity-exporting nations' interests in access to markets and stability in export earnings.

The elements of such a bargain are contained in the recommendations offered in this report. The following recommendations respond in particular to the interests of commodity exporters:

- There should be a meaningful commitment to seek workable methods for stabilizing commodity markets (which, it is argued, would bring significant benefits for commodity-importing nations as well).
- There should be a reduction in trade barriers that limit opportunities for processing of primary products prior to export.
- Assistance should be given for nations with resource development potential to become more involved in the ownership and management of resource projects.

The following recommendations respond in particular to the interests of commodity importers:

- Commodity agreements should include the creation of buffer stocks to be used to stabilize supplies to markets.
- Export controls should be brought under international rules.
- Contrived market disruptions should be subject to international sanction.
- Resource firms should know the terms and conditions for investment in host countries that will be adhered to by both sides over time.

For stabilizing export earnings, this report supports compensatory financing arrangements in preference to schemes such as direct indexation, which are based on doubtful logic. It strongly recommends that commodities be approached on a case-by-case basis in order to allow the maximum flexibility in achieving international policy objectives.

The basic challenges for Trilateral countries are to bring non-industrialized commodity exporters more fully into the world economic system and to demonstrate a greater awareness of the importance of collective responsibilities in making that system work, especially on the part of those Trilateral nations that are commodity exporters. A failure to meet these challenges would create grave consequences for the economic prosperity and political stability of all nations.
I. Introduction

This report examines certain general issues that have arisen in international commodity markets in recent years. Its purpose is to clarify these issues and to provide an integrated series of policy proposals responsive to the goals of more balanced economic expansion for commodity exporters, greater security of supplies and predictability of prices for importers, and improved efficiency in the development and use of the world’s commodity supply potential for the benefit of all nations.*

Prior to the early 1970’s, commodity issues were generally those of surpluses, declining terms of trade for exporters, and the erosion of profit margins as costs rose faster than prices. Then came a series of developments that turned the situation completely around. Shortages began to emerge, at first for a limited range of commodities but soon across virtually the entire commodity spectrum. International prices shot upward to levels as much as three and four times what they had been, surplus stocks were quickly run down, and profits soared. The history of world commodity markets is replete with examples of marked swings in prices and in the availability of supplies. Two developments during the latest episode of shortages, however, mark this period as different:

- First, a relatively new form of trade restriction emerged — export controls in peacetime for the purpose of shielding domestic consumers in producer nations from reduced supplies and sharply higher prices resulting from international market developments.** These export controls, as in the example of restrictions on U.S. shipments of soybeans even to traditional customers, are not covered effectively under the rules currently governing international economic transactions.
- Second, world commodity markets became politicized, with producer nations in the so-called “Third World” threatening to make future commodity supplies conditional upon fundamental reforms in the international economic system. Initial perceptions of the

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*It should be recognized at the outset that the distinction between commodity importers and exporters is not the same as the distinction between industrialized and developing countries. Among Trilateral countries, for instance, some are substantial exporters of a variety of commodities (e.g., Canada and the United States); others are mainly importers (e.g., Japan); all are net importers of some commodities and net exporters of others.

**As C. Fred Bergsten has noted, export controls actually have a long history. Current use of these controls is, however, a significant new obstacle in the process of trade liberalization. See C. Fred Bergsten, Complicating the GATT: Toward New International Rules to Govern Export Controls (Washington: British-North American Committee, 1974).
implications of this development among the industrial nations were formed in the context of the partial and temporary oil export embargo by OAPEC (to serve political ends) and the subsequent sharp increase in the world oil price imposed by OPEC (to serve economic ends).

These two developments have raised a number of basic policy issues that continue to be discussed and debated in such forums as the multilateral trade negotiations within the GATT and the Paris-based Conference on International Economic Cooperation (CIEC). The sense of urgency, even crisis, that surrounded these issues in 1974, however, has now given way to a far different atmosphere as public concern has shifted to the broader problems of unemployment and inflation. Shortages have again been replaced by surpluses as a result of the most serious economic recession of the postwar era. The prices of many commodities have declined significantly from the peaks reached in 1974 or early 1975, and further downward pressure is being exerted by a continuation of depressed market conditions.

It would be a mistake for Trilateral countries to dismiss commodity issues as solely the result of short-term, cyclical phenomena. Cyclical fluctuations have certainly contributed to an environment in which the seriousness of issues is easily exaggerated; but these issues now reflect fundamental challenges to the basic structure of international economic and political relations as it has evolved in the postwar era. The most important of these challenges are the following:

- The notion that market forces should be relied upon to determine output, prices, and the international distribution of income is under widespread attack. Commodity-exporting nations regard markets for their products as being manipulated and biased against their interests; concern over the rate at which finite resources are being exhausted has reinforced claims that current market prices do not reflect accurately the future scarcity value of these resources; and sudden, dramatic swings in the price and availability of commodities have generated pressures for coordinated international action to stabilize markets.

- The idea that trade liberalization is to the mutual advantage of all participating nations is being qualified in the case of a variety of commodities. Resource development and raw material trade are being treated increasingly as special categories of economic activity, especially in industrialized nations. Export controls, differential

pricing schemes, and requirements for processing prior to shipment abroad have been proliferating, reflecting an attitude that natural resources are the foundation of national economic growth prospects and that national considerations should override international responsibilities and opportunities in policies concerning commodities. It is unlikely that further liberalization of import barriers can progress very far if increased restrictions on exports of commodities are being imposed at the same time.

- The principle that the international economic system should be modified through a process of gradual, incremental reform is being rejected by commodity exporters among the non-industrialized nations, who argue for drastic change and have stated an intention to use whatever power they can mobilize to bring about such change.

- The objective of multilateralism in trade relations is in danger of being sacrificed as nations dependent on commodity imports face internal political pressure to make the best possible arrangements for ensuring future access to supplies.

Similar challenges to the international economic system have arisen before in other contexts. In the context of recent disruptions in world commodity markets, however, these challenges appear more serious, and meeting them appears more difficult. For example, an apparent trend towards increased capital requirements for resource development combined with the possibility that the world has entered a period of capital scarcity may mean that commodity supply problems will persist even in the absence of "resource nationalism." Rapid inflation, particularly in the costs of food and energy, has placed severe import-financing burdens on already hard-pressed developing nations with limited resource-export potential, adding to pressures for immediate reforms in the international economic system. Inflation and economic stagnation in the industrialized nations have generated deep internal tensions, encouraging inward-looking, conservative policies and resistance to responding generously to demands from the non-industrialized world.

The basic theme of this report is that there is a mutuality of interests regarding commodity issues in the international economic and political system. Recognition of this mutuality of interests should lead to changed perceptions and attitudes as individual countries seek to accommodate national objectives within an increasingly integrated world economy and a natural environment that is creating more demanding challenges and constraints. Nations in the developing category must be just as concerned about the future availability of commodity supplies as

*To cite one dramatic example, copper prices had fallen in early 1976 to roughly one-third their 1974 peak.*
those in the developed category, since both require, or will require, imports to sustain the economic development process. Also, it would be shortsighted for any nations to expect to be able to isolate themselves from world commodity developments and at the same time to see the broader world economy evolve in an orderly, constructive direction. If conditions suitable for reasonably stable and balanced economic performance are to be restored, industrialized commodity-importing nations must respond with greater flexibility and understanding to the aspirations of non-industrialized commodity-exporting nations which feel they have been prevented from sharing adequately in the development of the world economy; non-industrialized commodity-exporting nations must realize that there are narrow limits on the effective use of “commodity power” and that it is in their long-term best interests to respond affirmatively to concrete proposals for integrating them more fully into the world economy; and industrialized commodity-exporting nations must recognize that the benefits they have received from their participation in the world economy create clear responsibilities to consider the broader international consequences of domestic policy decisions concerning resource development and trade.

This report is divided into three main sections, after a brief definition of “commodities.” The first outlines a framework for categorizing commodity issues and examines some of their major causes and implications. In the following section, consideration is given to alternative approaches that might be adopted by nations, either individually or collectively, and to the probable consequences of these approaches. The final section contains a series of recommendations for policy initiatives that would represent a constructive, coordinated international response to commodity issues. In keeping with the perception that these issues have many dimensions that must be related to the broader challenges facing the international community, these recommendations are fairly wide-ranging, covering the topics of information needs, commodity price stabilization, international trade and investment reform, and aid to less-developed countries.

The report has not been prepared by pessimists. It looks to the future as a period in which new opportunities will arise for the efficient use of the world’s natural endowment of resources in ways that are consistent with greater equity in the distribution of the benefits from this endowment. At the same time, this report does not reflect unguarded optimism about the political will and ability of nations to respond affirmatively to these new opportunities. If the international community waits to act until the full dimensions of the challenges are apparent, it will be too late to avoid harsh consequences.

II. A Definition of “Commodities”

The approach employed in this report is to consider general issues, with specific commodity references used only occasionally for purposes of illustration. Nevertheless, it is useful to consider some criteria used in subdividing commodities and distinguishing them from other types of products. Overall, the term “commodities” is used here to refer to primary products that enter into trade among nations — including energy and non-energy minerals, agricultural products, and forest products. There are several reasons why commodities are treated differently than other products that enter into trade. Probably the most basic reason is that commodity supplies are linked to land, tying them to the concept of territory, over which nation-states exercise sovereignty. As a general proposition, the demand for, and the supply of, most commodities are rather unresponsive to changes in price over short periods of time, so that quite sharp fluctuations in price can be generated by fairly modest changes in overall market conditions. Moreover, the time required to expand supplies is often lengthy, although this property varies widely among individual commodities. Although the value of all commodity consumption represents no more than about ten percent of annual economic activity in industrialized nations, and even though substitutes exist for any particular commodity, commodities are sometimes distinguished as “core” products.

Commodities from different sources are interchangeable in use, except to the extent that there are variations in well-defined physical properties (e.g., hardness of wheat or sulphur content of coal). Commodity supplies come from sources with widely varying cost conditions. Land differs in terms of potential crop yields; mineral deposits differ in terms of depth and ore concentrations; and oil reservoirs differ in terms of depth, permeability, and natural pressure. Moreover, locations differ in terms of relative distances to major markets and wage rates that must be paid to attract workers. These variations in supply conditions give rise to what are known as “rents,” which reflect the difference between the cost of producing from a particular location and the general market price. The allocation of these rents among governments, companies, workers, and consumers is not something that can be determined with reference to an economic efficiency model alone; it also reflects the relative distribution of power among these various groups.

Commodities are traditionally subdivided according to a variety of criteria, but no single set of conventional criteria is fully satisfactory for policy purposes. For example, the distinction between “renewable”
III. BASIC CAUSES OF COMMODITY MARKET DISRUPTIONS

Four basic categories of causes of disruptions are examined here: resource exhaustion, cyclical or temporary phenomena, contrived shortages, and structural problems.

A. RESOURCE EXHAUSTION

Any finite resource is a potential candidate for exhaustion — in the sense either of being used up or of being exploited to its physical limit. In recent years there has been a renewal of interest in the exhaustion issue stemming from widely publicized forecasts that the world is quickly “running out” of essential resources in the growth process. Forecasts of the imminent exhaustion of critical raw materials have been made throughout history, yet the discovery of new sources of supply, improvements in technology, resource substitution, and increased capital investment in the production process have combined to enable economic growth to proceed without serious constraints being imposed by the ultimate finiteness of the world’s resource base. Long before exhaustion takes place, clear signals of an emerging problem would be given by a persistent rise in real costs. In contrast, the “commodities problem” has traditionally been perceived as one of deteriorating terms of trade for raw materials and primary products, creating handicaps in the economic development of nations heavily reliant on exports of these products for their foreign exchange earnings.

Still, there are considerable risks to simple extrapolation of past trends indefinitely into the future. Rapid rates of growth in population and economic activity in the postwar period have created massive demands upon the world’s supply of natural resources. Technological advances, discoveries of new supplies, and the substitution process continue and would be stimulated by higher real prices. These developments, however, often occur in discrete jumps that may not be well-timed in terms of the needs of the highly complex, and fragile, modern world economy. The research surveyed and the experts consulted during the preparation of this report support a conclusion that the world is in

"Estimates of what these demands would be if per capita world consumption were to be raised to a significantly higher proportion of that in the industrialized nations are meaningless. Effective demand is based on claims on economic output generated — only a small percentage of which comes from raw material extraction and primary processing. These claims might be redistributed, but they cannot be effectively augmented in total without a parallel expansion of output produced."
little danger of approaching an absolute physical limit on resource
development in the foreseeable future." Increased commodity supplies
will continue to be available at some price. What that price will be is
the subject of uncertainty and debate.

No general assessment can capture all of the numerous factors that
will affect future costs for supplying specific commodities. Some
observations, however, are relevant to a broad range of commodities.

- Inflation has seriously distorted calculations of future costs. Adjust-
  ments to inflation take place through an uneven process; and
  until all these adjustments have been made, it is difficult to obtain
  an accurate picture of future cost prospects. Most resource activities
  are relatively capital intensive, so their costs are particularly sensi-
  tive to sharp rises in interest rates that result from inflation.
  Furthermore, construction equipment prices and construction wages
  have spurted ahead of general prices and wages in recent years;
  and it is not clear whether this should be taken as a permanent
  development or a sign of temporary imbalance that will be
  corrected over time.

- In order to meet increased demand for many commodities, res-
  ources of lower quality or more remote from major markets must
  be exploited. Thus, the amount of capital employed per unit of
  output appears to be increasing. Moreover, work in remote areas
  appears to require the payment of significant wage premiums in
  order to attract labor, particularly in the industrialized countries.

- There is a serious decline in the acreage of the highest-quality
  arable land available for agriculture in many of the industrial
  nations. The expansion of cities, roads, and airports is forcing
  these nations to exploit lower-quality land for growing food,
  bringing the increased costs associated with more intensive farming
  techniques.

- Even where the potential exists for a major expansion of output
  (as in the case of agricultural production in many developing
  nations), costs will be high. For example, irrigation and fertilization
  costs have increased because the energy to run the pumps, to
  desalinate the water, and to produce the fertilizer has increased so
  dramatically in price. As a general point, energy is closely linked
  to the future cost and availability of most commodities. Assuming
  a long enough time to develop new technologies and a high enough
  price to encourage increased output, there should be no absolute

limits on energy availability. The contrived shortages and high
prices of oil created by OPEC, however, have generated what
might appear to be a natural-shortage-type situation for a variety
of energy-intensive commodities, with progressively rising delivered
unit costs over time. This situation may persist for as much as two
decades until alternative energy supplies are found and developed
on a large scale.

The overall short-term outlook is for some further moderation in
commodity prices as output is expanded in response to the higher
prices of recent years. Over time, however, commodity prices in general
are more likely to rise at a somewhat faster pace than the overall
inflation rate than to rise less rapidly or at about the same pace. Condi-
tions will no doubt vary widely among commodities, and much depends
upon the future course of energy prices. The outlook to which this
report subscribes is that there is a positive need for commodity prices
in general to rise to encourage more efficient use and to provide greater
supply incentives than in the earlier postwar period.

Perceptions at a policy level of a potential problem of resource
exhaustion are important in themselves. If these perceptions are that an
exhaustion problem in fact exists, conflicts are likely to arise from a
struggle to secure, or to preserve, available resource supplies. Nations in
possession of indigenous supplies might be tempted to hoard them for
their own future use; and those without these supplies might feel forced
to conclude whatever arrangements they can to secure them, whether
or not these arrangements are compatible with existing international
rules and obligations. Furthermore, fears that exhaustion problems are
on the near horizon would give resource-surplus nations exceptional
economic and political leverage.

The most serious policy issues, however, are likely to be more
subtle:

- Rising real costs for commodities would show up both in persistent
  inflationary pressures and greater difficulty in achieving target
  rates of growth in living standards. Neither of these developments
  would be conducive to a generous response by the industrialized
  nations to the pressures for greater equality in economic opportu-
  nities being exerted by the non-industrialized nations.

- As progressively more costly locations and methods are brought
  into production, the magnitude and range of "rents" is likely to
  increase because of the greater diversity in cost conditions
  encountered. The struggle to secure a larger share of these "rents"
  will involve governments and producing firms in complex negotia-

*An informative survey of world mineral resources can be found in the January
tions and confrontations that could easily disrupt the investment and production process.*

- Industrialized commodity-producing nations may be more inclined to try to reduce the risks for themselves that an important resource they possess will be exhausted or will begin to rise sharply in cost. If so, production for export markets could be curtailed.
- An individual producer nation, especially one heavily dependent on a limited range of commodities for its export earnings, is likely to perceive the “running out” issue quite differently from the international community as a whole. Once that nation’s resources have been developed to capacity (Venezuelan and Iranian oil appear to be examples) or, in the case of “renewable” resources, exploited to their effective limit, the nation then has to find other ways of providing for its additional foreign exchange needs. Unless it has been able to use the revenues from past sales to develop a viable economic base for the time when resource exhaustion takes place, it is likely to restrict the current rate of development in the hope that higher prices will be available in the future.

A point that generated considerable debate during the preparation of this report (and one that goes to the heart of the “limits to growth” controversy) is whether current market prices provide a reasonably accurate reflection of the future scarcity value of resources. It is generally agreed that market prices do not, in the absence of an appropriate tax, reflect the full costs to society of pollution and environmental degradation. It is also agreed that government regulations often distort seriously the market process, as in the case of regulation of interstate sales of natural gas in the United States, which kept prices too low to provide adequate incentives to find new supplies or to avoid the wasteful use of existing supplies. The more contentious question, however, is whether the “market” places a correct assessment on the prospects for future technological advances, new discoveries, and opportunities for resource substitution. It is impossible to give a simple “yes” or “no” answer to this question for commodities in general. The relative stability in the real prices of most commodities, and even declines in many cases, over long periods of time, is given as evidence that this issue is not serious. Sharply higher prices for a variety of commodities in recent years do not provide sufficient grounds for taking a different view, since other factors than market imperfections, particularly the general rate of inflation, may be responsible. Still, this issue will not be resolved at a policy level by references to economic logic or past history alone; the future will have to be shown to parallel the past, and until it does, concerns about basic changes in cost trends may provoke actions that make these concerns self-fulfilling prophecies.

In sum, concerns about near-term resource exhaustion should be treated with considerable skepticism in determining current policy directions. Nevertheless, these concerns are widespread, and thus the primary recommendation of this report in this area, as spelled out later, is for the establishment of an independent information collection and dissemination center to monitor worldwide commodity trends.

B. CYCLICAL OR TEMPORARY PHENOMENA

Cyclical or temporary factors create imbalances between supply and demand that can be expected to reverse themselves with the passage of time. Commodity markets have historically been subject to pronounced fluctuations, but in recent years two developments have combined to make these fluctuations particularly severe.

First, there has been an unusually great similarity in the timing of business cycles in the major economies of the world. As a result, the magnitude of fluctuations in overall growth has been amplified. In 1972 and 1973, aggregate real economic growth surged forward at a rate nearly two percentage points above the postwar average for the OECD nations, and the increase in demand in this period was even larger, producing a sharp acceleration in inflationary pressures. Then, in 1974-75, the world economy experienced the most serious recession of the postwar period. During these past four years, the synchronized movement of all major economies produced a generalized “boom psychology” in the upturn (that led to widespread inventory building and hoarding) and a somewhat less pronounced “bust psychology” in the downturn (that led to a running down of inventories and other stocks). Therefore, the impact of fluctuations in demand at the producer level has been far more volatile than indicated by swings in the levels of overall economic activity.

Second, the incidence of “temporary” factors affecting commodity supplies appears to be increasing. Adverse weather conditions, for example, have plagued agricultural output in different parts of the world with disturbing regularity, and work stoppages have become a prevalent factor affecting supply conditions. The impact of localized

*On a more technical point, governments in producing countries are more likely to favor restricting the rate of production of “non-renewable” resources if prices are expected to rise. In a situation of constant costs, non-industrialized countries especially would usually be interested in maximizing output, and thus foreign exchange earnings; with rising costs for alternative sources of supply, however, these countries would, acting rationally, be more interested in maximizing the “rents” they could earn, which would mean a slower pace of production.
temporary phenomena has become increasingly widespread, with greater integration of the world economy through increased trade, improved means of transportation and communication, and the activities of multinational enterprises.

The impact of cyclical or temporary fluctuations in commodity markets has been particularly adverse for the less-developed nations. As consumers, they have found that in periods of shortages they are unable to obtain sufficient financing to bid against the developed nations for the scarce supplies that to them often represent subsistence. As producers, they find that periods of shortages, during which they usually get only a portion of “windfall” gains from high prices, are almost inevitably followed by periods of glut and low prices; and these sharp fluctuations play havoc with export earnings and development plans.

Disruptions of the cyclical or temporary variety have raised a number of international policy issues. Some producing nations, especially those in the developed world, have placed various forms of restrictions on exports in an attempt to protect domestic consumers from the full brut of reduced supplies and higher prices during periods of short-term shortages. Some consuming nations, again especially those in the developed world, have added to stocks during periods of shortages and run them down in periods of surplus, thereby adding to the instability of commodity markets.

The stabilization of commodity markets has long been an objective of producer nations, particularly those in the non-industrialized category. Private producer firms, however, generally react negatively to proposals for market stabilization, arguing that they have never worked in the past and fearing the implications of greater government intervention in these markets. This report strongly endorses attempts to devise stabilization measures that have a chance of working, subject to certain general principles and conditions. These principles and conditions, and possible approaches to stabilization, are described later. Here, four points are made that together suggest the advantages of increased stability in commodity markets for importers and exporters and for governments and private firms.

First, there has been a steady shift in the composition of final demand in the major economies of the world. Primary and secondary industries have declined in relation to tertiary (e.g., service) industries. As a result, the impact of even modest cyclical variations in aggregate demand on industrial markets has been increasing. This means a greater vulnerability to world cyclical developments for economies heavily dependent upon commodities for their export earnings. It also means that commodity price inflation tends to accelerate more quickly in business upturns, with this inflation then working its way through the industrial cost structure.

Second, the import demands of non-industrialized commodity exporters are generally constrained by their foreign exchange earnings. This tends to aggravate global economic instability, particularly if the major economies are moving in roughly parallel directions. During upturns, higher export earnings release pent-up demand in the non-industrialized countries, adding to inflationary pressures; during downturns, export earnings tend to be sharply reduced and imports tend to fall off, unless financed by potentially high-risk credits, adding to unemployment pressures in the industrialized countries.

Third, short-term commodity shortages give rise to temporary, but highly visible, “windfall gains” as higher prices ration available supplies. There is a tendency for governments, and the general public, to perceive these “windfalls” as being more long-term than they are, and efforts to capture them (e.g., through higher fixed taxes or royalties) have the effect of increasing long-term production costs, especially when applied to most producers. These “windfalls” also add to pressures for expropriation.

Fourth, at a more subtle level, institutional changes in some industrialized countries (Canada being a prime example) have tended to make it more difficult to reverse the impact on prices of short-term commodity shortages. The growing practice of incorporating cost-of-living clauses in wages and other forms of income means that higher prices arising from temporary phenomena, especially when they are widespread, tend to become imbedded into permanently higher costs of production.

C. CONTRIVED SHORTAGES

The success of the OPEC cartel in enforcing a dramatic increase in the world oil price has led to concerns that similar efforts will be made in other commodities. A number of producer associations have been formed (e.g., in bauxite, copper, and iron ore), and prospects are that there will be more. There is a tendency to regard all producer associations as cartels, having the intention of increasing artificially the margin between price and production costs in order to generate monopoly returns. This may be the explicit or implicit motive in some cases, but there are other stated objectives as well, such as the following:

- to stabilize market prices;
- to prevent market prices from falling below production costs;
- to offset the market power of private firms;
to respond to other market imperfections, such as barriers to exports in processed form;
to exchange information and to coordinate technical and other developments.

Constrained shortages, in the sense of systematic withholding of supplies from market, are not necessarily brought about by a formal association of producers. They may result from the actions of a dominant firm or producer government (phosphates) or an informal grouping (manganese). Furthermore, discretionary actions may be aimed not at restricting quantities consumed but at raising the effective price received (e.g., the Jamaican increase in taxes on bauxite) or at encouraging processing domestically (e.g., recent Australian measures affecting iron ore and, more generally, Canadian legislation concerning the potential use of export controls).

There are obvious limits on the power of producers to restrict supplies and raise prices artificially. These limits are a function of the potential cost of bringing alternative sources of supply into production, of possibilities for substitution of alternative products to satisfy commodity needs, and of the ability of consumers to moderate their demand in response to higher prices. As a practical matter, these limits constrain the long-term flexibility of producers of most commodities; the OPEC experience should be regarded as unique rather than as a situation that can be generalized. Constrained shortages may, however, work for a period of time, during which considerable disruption might be caused in consuming nations. Therefore, this source of disruption cannot be dismissed as a policy issue.

Constrained shortages involving private firms and governments in industrialized nations should be made subject to effective international investigation and action. In the case of non-industrialized countries, however, it is necessary to consider this issue from a broader political perspective. It is understandable that the resource-producing nations of the less-developed world should regard with frustration and anger the fact that the disparities between the living standards of the rich and the poor have been expanding even while these producers are selling off the resources that constitute their main source of export earnings. These nations now view themselves as having a new source of power to react to this situation — the ability, no matter how limited it may be in the long run, to disrupt, at least temporarily, the delicate balance that exists between surplus and shortage in the high-consumption nations of the world. It is unrealistic to suppose that they will not try to use this power of disruption if it appears to be the only possibility for achieving progress in reducing international disparities in income and opportunities. A positive response to this challenge should be a primary goal in the striking of a new bargain in world commodity markets.

**D. STRUCTURAL PROBLEMS**

A variety of economic, political, and institutional factors are currently preventing the expansion of supplies that would otherwise be possible. Once the problems outlined here are recognized as having a significant effect on the availability and the price of important commodities, policy initiatives to correct them might be anticipated, but these initiatives are likely to take a fairly long time to produce concrete results.

The major cause of structural shortages in the extractive industries is an unattractive investment environment. The financial resources that must be committed to finding, developing, and delivering new supplies of these products have risen dramatically as low-cost sources close to markets have been depleted and as inflation has borne particularly heavily on the inputs required for these projects. Moreover, a characteristic of many of the new technologies for expanding resource supplies (e.g., oil from tar sands or shale) is that the period between the time large expenditures are made and the time that earnings start to flow has been extended considerably. This problem is compounded when new transportation facilities must be provided to bring the output of these projects to market, as in the case of the Alaskan oil and gas undertakings. When major new infrastructure facilities are necessary, large-scale resource projects are required to justify the expense of these infrastructure investments, and the scale involved adds to the riskiness of the resource venture.

The chances of projects being expropriated have risen in the current world political environment, but there are more subtle risks with which companies must be concerned. For example, the high profits that are the reward for success in the development of new supplies are increasingly vulnerable to higher taxes and royalties while, at the same time, companies are still expected to bear the costs of unsuccessful exploratory activities. These exploratory activities, in turn, have increased massively in cost since the days of the lone prospector and the independent "wildcatter." A serious gap has arisen between how companies and governments perceive profits and profitability prospects. There is a danger of a vicious circle developing: Faced with a considerable shortening in the expected duration of their rights to earn returns from resource ventures, companies are likely to perceive the need to restrict their activities to projects that can generate a rapid payback; the high profits from these projects would then attract the attention of governments,
who would look upon expropriation as particularly attractive, further
shortening the expected duration of returns for private developers.

Another type of risk involves the problem of projecting prices
(and costs) over the life of a project in the current unstable economic
and political environment. A key dimension of this problem, which is
seen most clearly in the case of petroleum, is that a growing spread
between production costs and price gives rise to the possibility that
prices will be undercut, thereby placing a project that had appeared
profitable in jeopardy.

Another type of structural problem concerns delays in the decision-
making process. Environmental concerns, even though often quite
legitimate; fears about the broader economic effects of a major resource
project (e.g., in terms of its demands on regional labor markets or its
effects on the exchange rate); and bureaucratic inertia have combined
to retard the investment process. In the same vein, jurisdictional disputes
and uncertainties are responsible for additional delays. Companies seek-
ing offshore drilling licenses often confront two, or even three, jurisdic-
tions claiming authority in the area (e.g., on the continental shelf off
the east coast of North America or in the Celtic Sea). In the case of
the deep seabed of the oceans, where massive quantities of certain
minerals are located, companies as yet have no one to go to for licensing
authority.*

This list of structural problems could be expanded considerably to
include factors such as controls on prices that yield returns that are too
low to attract financing for new investment; inadequate flows of savings
into resource projects because, say, of preferential lending rates for com-
peting uses of funds; income support programs that provide disincentives
for workers to seek employment in remote areas where resources are
to be found; and a failure to provide the transportation and related in-
frastucture required to open up new regions for development. While
the causes of structural problems vary both in kind and in degree among
commodities, the most general causes are major changes in the com-
plexity of the investment decision process and an environment for
resource investment decisions that lacks an adequate concern for
the future availability of commodity supplies.

In preparing this report, the rapporteurs have been struck with
the dimensions of the capital needs for responding effectively to the
challenge of ensuring adequate commodity supplies for future economic
growth. The use of lower-grade ores need not raise unit output costs

*The issue of the development of these mineral resources is discussed in the report
on the trilateral task force on the oceans. See A New Regime for the Oceans, The

significantly, provided capital is available to permit more efficient
capital-intensive methods of production to be employed; agricultural out-
put can be expanded considerably, provided capital is available to
improve water utilization, to supply necessary storage facilities and
machinery, etc. In the face of massive capital needs, private sources of
capital that they are being greeted with, at best, an unstable invest-
ment climate. The search for a new equilibrium regarding the institu-
tional and economic environment for investment decisions is needed to
attack one of the most basic roots of commodity market disruptions
anticipated in the future, and a positive response from those nations
with production potential is essential if a meaningful new bargain is to
be struck.

IV. ALTERNATIVE POLICY
APPROACHES AND CONSEQUENCES

An effective policy response to the commodity issues reviewed in
the previous section of this report must be comprehensive and must be
perceived as balancing the interests and objectives of producers and
consumers, and of industrialized and non-industrialized nations. This
balancing must take place against a background of marked differences
among nations.

Consider first the Trilateral countries. Canada, a major net exporter
of a variety of primary products, will clearly tend to view commodity
issues differently from Japan, which relies on imports to meet the vast
majority of its primary product needs. While the United States must
depend increasingly on imports to satisfy its requirements for certain
primary products, it still possesses ample supplies of many resources
and is a major exporter of certain important commodities such as
grains and coal. Europe is more reliant on primary product imports
than the United States, but the European Community has established
reasonably constructive arrangements with former colonies, including a
number of important producer nations.

While there are these significant differences among the Trilateral
nations in terms of resource vulnerabilities, similarities within this group
should not be minimized. Existing trade patterns and links have brought
about a substantial degree of integration of these economies, and the entire group would be affected adversely should any of them be subjected to protracted dislocations because of an inability to obtain essential commodity supplies.

Among the developing nations outside the Communist bloc, those with significant export potential in primary products will naturally emphasize obtaining the most favorable terms for their resources. The view taken in this report is that this objective should be interpreted broadly, with the provision of greater opportunities to diversify economic activities and to improve or at least stabilize terms of trade being a more appropriate approach to the objective than the short-term maximization of export receipts for specific commodities through measures designed to create contrived shortages. Net commodity importers among the less-developed nations will be critically affected by the resolution of commodity issues. They require primary product imports at reasonable prices for subsistence, as well as for development purposes.

The Communist nations bring yet another perspective on commodity issues. The former isolation of these nations, arising from the goal of sustaining the maximum possible degree of self-sufficiency, is giving way to a somewhat greater degree of involvement in the broader world economy. From the standpoint of commodity supplies, China and the Siberian region are potentially important providers of energy and other commodities, especially to Japan. On the demand side, the Soviet Union has become a major competitor for grain supplies in world markets and the cause of serious concern among developing countries and Japan in terms of its impact on the price and availability of grain imports.

It is difficult to know what role the Communist nations will play in world commodity markets in coming years. The scope for trade between the CMEA nations and the West remains limited, as self-sufficiency within the CMEA group appears to be a continuing goal. Still, efforts must be made to bring the Communist nations into the process whereby a new accommodation in world commodity markets is sought, especially given their increasing involvement in these markets. In particular, there must be new rules covering participation in commodity agreements and buffer stock arrangements by state-planned economies.

The costs of a failure to reach a new accommodation in world commodity markets are easily documented. Options for unilateral action by an individual commodity-importing country would be limited and costly, but such options do exist. Stockpiles of materials might be accumulated in the hope of easing the burden of prospective shortages on the domestic economy, but only at the expense of placing further pressures on world commodity markets. Vigorous conservation measures might be adopted to restrict demand, but at the sacrifice of living standards and economic expansion. Domestic production of substitute sources of supply might be subsidized, but at the sacrifice of efficiency and thus real income levels. And efforts to retaliate against nations restricting supplies might be attempted, but such efforts would not be very successful in most instances, unless retaliatory measures were to be adopted in common by a number of countries.

Concerted actions among importers would provide a wider and more effective range of options in terms of providing both a bargaining coalition and a fallback position in the event that international accommodation between producers and consumers were to fail. Stockpiles could be accumulated and production potential expanded more efficiently within a group of countries; countermeasures to the actions of nations restricting supplies could be applied more effectively; and efforts to split producer cartels would have improved odds for success.

It should be recalled that industrialized nations (including South Africa) account for about 60 percent of world exports of primary products (excluding petroleum), and that the combination of their technical and financial resources could be applied with considerable effectiveness to the task of developing alternatives to restricted supplies. At the same time, these resources would have to be diverted from their most efficient employment, so serious costs would be involved. More importantly, it would be exceptionally difficult to reach agreement on concerted actions among the industrialized nations, given the differences noted earlier in this section. The three major net exporters of minerals — Australia, Canada, and South Africa — either give little indication of being willing to participate in such agreements, except on terms similar to those sought by the developing countries, or, in the case of South Africa, there are grave domestic problems that could disrupt supplies at almost any time.

The costs of a failure to reach accommodation would also be quite high for producer nations, although it is understandable that certain non-industrialized nations within this group might be willing to bear these costs out of a sense of frustration with the lack of progress made in improving their long-term economic prospects. If an inability to reach a new accommodation were to persist, the danger faced by these countries is that their access to markets, technology, management skills, and even certain primary products might be further restricted and that they would find the development of substitutes and alternative sources of supply by importers reducing their potential markets.
The most serious costs of a lack of accommodation, however, are likely to be observed in terms of instability in the broader international economic and political spheres. Rather than producing well-defined “blocks” of consumer and producer nations, a lack of accommodation here would be more likely to result in an acceleration of a trend away from multilateral approaches in international relations. Certain industrialized nations, out of either economic necessity or a particular sense of responsibility to the needs of certain less-developed countries, could be expected to seek accommodation within discriminatory arrangements with these countries. Other nations would respond with their own special arrangements, which might take a variety of forms. The result could easily be a world of “economic warfare,” with discriminatory and retaliatory measures proliferating, with efforts to ensure domestic self-sufficiency diverting massive amounts of productive resources from their most efficient employment, with low rates of economic expansion, and with higher rates of inflation.

While the high costs of a failure to reach a new accommodation should be clear, the problems involved in seeking that accommodation, especially in the current economic environment, must also be recognized. Appeals for “striking new bargains” between consuming and producing nations sound logical and attractive, but the reasons these “new bargains” have not been struck in the past are deeply imbedded in the attitudes and the perceptions of those to whom governments in the industrial nations must respond, as well as in certain basic economic realities. New bargains require adjustments that are resisted in a comfortably affluent environment. When that affluence is threatened, initial reactions tend to be defensive rather than accommodating.

A new accommodation between consumer and producer nations will require some international redistribution of employment opportunities, and possibly of income, and it is this redistribution that will lead to resistance. Evidence of resistance can be found in the difficulty that industrial nations are having adjusting to changing economic conditions generated within their own economies — an important factor in the high inflation rates being observed in these nations simultaneously with high rates of unemployment. Thus the search for a new accommodation must be conceived as offering an opportunity to return to a more stable economic environment both domestically and internationally, and in this sense all nations share responsibilities.

V. RECOMMENDATIONS: TOWARDS A NEW BALANCE OF RESPONSIBILITIES

This section puts forward an integrated series of broad recommendations that would constitute a constructive response to commodity market disruptions. Five points of reference have been kept in mind in framing these recommendations. First, what is regarded as necessary is an approach that goes beyond modest incremental changes in the current international system. Second, there is an emphasis upon consistency between the approaches suggested on commodity issues and those that would be appropriate for other issues confronting the international system. The priorities implicit in these recommendations have been set with the specific context of commodity issues in mind, and these priorities might be re-ordered in a broader context for international reform. Third, it is felt that recommendations should, as a pragmatic matter, go beyond broad generalities without becoming excessively specific. Implementation of these recommendations will require painstaking negotiations on precise details and mechanics. Fourth, while efficiency and equity are regarded as equally important objectives, these recommendations seek to make a clear distinction between the two concepts. Fifth, it is regarded as important that there should be both the appearance and the reality of balance in the responsibilities of consumer and producer nations in the commodities area.

These recommendations are presented under six major headings: general principles, information collection and research, commodity price stabilization, trade reform, investment matters, and development assistance. The order should not be regarded as implying a ranking of priorities.

A. GENERAL PRINCIPLES

The importance of problems confronting the international community in dealing with commodity issues merits the incorporation of general principles in basic documents of appropriate international institutions and of meaningful codes or rules of conduct to implement these principles. The recommended principles are as follows:

• National sovereignty carries the right to control the rate of utilization, and to secure the development benefits from, resources located within national boundaries; resources located outside na-
tional jurisdictions (e.g., those of the deep seabed) should be developed under international license for the benefit of all nations, taking into account the desirability of avoiding sudden or large disruptions of existing markets.

- In determining the pace at which their proven resources are to be utilized, nations have an international obligation to consider the hardships that might result for other nations from discretionary acts to reduce the rate of utilization. Renegotiation of existing commitments should follow agreed international procedures.

- Access to commodity supplies should be available to all on a non-discriminatory basis subject only to exceptions negotiated internationally in advance. These exceptions might include a) provisions for preferential treatment of domestic customers in the event of temporary shortages; b) provisions for preferential treatment of traditional foreign customers or to take into account contractual obligations in the event of temporary shortages, provided that the general terms of such arrangements were registered with an appropriate international institution in advance; c) provisions for discriminatory treatment as an internationally agreed method for penalizing participants in measures giving rise to contrived shortages, especially instances involving embargoes.

- Commodity-exporting nations have the right to expect the degree of freedom of access to supplies to be matched generally by the degree of freedom of access to markets in commodity-importing nations, with the stage of processing prior to export being determined to the fullest possible extent by comparative cost considerations.

- Access to supplies should be taken to include all forms of inputs into the economic growth process (e.g., technology, specialized machinery, etc.), with non-discrimination rules applying except for instances involving national security as determined by internationally agreed procedures.

- All nations have a responsibility to contribute to both a predictable investment environment, on the one hand, and stable market conditions, on the other.

- Disputes involving long-term supply contracts and foreign investment in resource exploration and development projects should be submitted to a hearing before a neutral international body.

- All nations, with the greatest responsibility resting with those having the highest income standards, should cooperate in the finance and operation of commodity buffer stocks established under international guidelines.

- Domestic commodity price or income stabilization programs should be compatible with internationally agreed commodity programs and guidelines.

B. INFORMATION COLLECTION AND RESEARCH

Effective policy-making in an area as complex as commodity supplies requires better information than is currently available for most commodities. An international information and research center for commodities should be established along the following lines:

Organization

The center should be a non-national, non-political institution. It should be staffed and supervised by experts, and while the goal should be to achieve a reasonably balanced representation between producer and consumer and between industrial and other countries in the nationalities of those employed by the center, there should be no rigid formula, and all employees should be as independent as possible from political pressure. Decisions regarding the activities of the center should generally be taken without formal voting, with reliance instead on a process designed to maximize the role of professional analysis and judgment. Financing of the center's work should be on an automatic basis for periods of at least five years. Its day-to-day operations should be supervised by a director who would be appointed for at least a five-year term and who would be someone with a long-established reputation for independent, professional judgment. This director would report to an executive committee that would be representative of, but not representing in an official capacity, the nations sponsoring, and adhering to the rules of, the center. This center might be patterned after, and possibly even affiliated with, the World Bank or the GATT.

Functions

The center should serve first as an information clearinghouse. It therefore should not duplicate work of existing groups, such as FAO or the International Lead and Zinc Study Group. Participation in the center, which would entitle the participants to all information received, would require nations to submit regular reports, according to a prescribed format, covering such topics as commodity consumption, commodity production rates, capital spending on resource-related projects (in place, under way, or planned), and inventories. The center would also serve a forecasting function and would undertake technological research and surveys, including an analysis of the anticipated environmental consequences of technological alternatives and planned investments. The
center would publish its reports and studies, although the timing of publication releases would take into account their possible impact on commodity-market behavior. It is felt that the center should have the responsibility of investigating, and of reporting on, charges of contrived shortages and of making recommendations concerning instances it identifies of important examples of structural problems, including national practices and policies leading to the wasteful use of resources. The center should not, however, be responsible for any enforcement activities concerning its recommendations.

C. COMMODITY PRICE STABILIZATION

This report supports the use of commodity agreements for the purpose of stabilizing prices under certain conditions and subject to specific internationally agreed principles. The report does not regard such agreements as a substitute for more effective coordination of national economic policies to reduce the marked cyclical imbalances that have disrupted commodity markets in recent years. In fact, such coordination, if successful, would be one of the most important steps that industrialized nations could take to assist non-industrialized commodity exporters. Moreover, this report does not suggest that commodity agreements should be the only means for achieving the objective of stabilizing commodity markets. Long-term purchase commitments, for example, would have similar effects, although they might add to instability in the open market when supply, rather than demand, fluctuations are the main source of disruption.

During the preparation of this report, some participants in the task force, particularly those with specific commodity experience, expressed deep reservations about the prospects for successful implementation of commodity agreements except within a very limited scope. Some questioned whether short-term fluctuations in price should necessarily be dampened. A traditional argument for commodity agreements is that they help stabilize the revenue flow to producer nations heavily reliant on one or a few primary products for their export earnings. It is by no means clear, however, that stable prices will produce stable incomes. They would not if there are major fluctuations in supplies.

The position taken here is that agreements to keep commodity price fluctuations within a range narrower than that experienced over the past five years would be in the interests of both producers and consumers. These agreements, supported by the use of buffer stocks, should follow these general principles:
- Commodity agreements should be confined to the single objective of stabilizing price fluctuations caused by temporary shortages. (The objective of income stabilization is discussed later.)
- While stability, or at least reasonable predictability, in commodity prices should be sought over the medium term (three to five years, say), measures to achieve this result should be sufficiently flexible so that prices are responsive to market forces over the longer term.
- There should be a case-by-case approach to determine whether or not a particular product should be made subject to a commodity agreement, and the decision in this matter should rest with the consumers and producers involved rather than with some "umbrella" organization. This principle follows from a perception that the effectiveness of commodity price stabilization arrangements depends upon a wide variety of factors that differ significantly among commodities. These factors include the degree of concentration of production, the economic situation of the producers, the economic importance of the commodity to consumers, the opportunities for substituting other commodities, and the cost of carrying buffer stocks.
- An international organization should serve as a registration and monitoring center for commodity agreements negotiated among producers and consumers. One of the functions of this center, which might be attached to the information center recommended earlier, would be to establish general criteria for these agreements that would have to be satisfied before a registration would be approved.
- Buffer stocks should be a necessary feature of any commodity agreement, and the creation and administration of these stocks should follow guidelines established by the organization registering the agreements.
- The appropriate size of buffer stocks would have to be determined on a case-by-case basis. For some commodities (e.g., grains) stocks would have to be large enough to serve the objective of price stabilization as well as to provide emergency relief; for others (e.g., most metals) these stocks might only have to be large enough to moderate extreme fluctuations in demand or supply.
- Commodity agreements should be subject to periodic review to ensure that their terms and operations are responsive to long-term market forces.
- While buffer stocks should be administered internationally, this should not preclude individual nations from undertaking their own supplementary buffer stock programs. The conditions should be imposed, however, that these national stocks be "visible" that no additions to them from imports be made when international stocks

24

25
are being sold off and that no sales be made for export when international stocks are being accumulated.

Commodity agreements and buffer stocks have been the subject of extensive research and comment in recent years, and the proposals made, and the issues raised, are too numerous to permit more than a brief examination here. There are, however, two basic issues that underlie policy differences among nations on market stabilization measures — integrated approaches and indexation.

Integrated approaches to commodity-market stabilization, supported by UNCTAD, involve both a comprehensive package covering arrangements for a broad range of commodities and a common fund for financing buffer stocks for a variety of commodities. Positions on such approaches are determined at least as much by political as by economic considerations. Among weaker nations, there is naturally a desire to achieve greater strength through unity by tying together a diversity of specific commodities into a common negotiating strategy. Among stronger nations, there is just as naturally a desire to divide commodities so as to maximize leverage, in the case of importers, or so as to gain the greatest possible advantages from a dominant market position, in the case of exporters. The view of this report is that wide-ranging integrated approaches are likely to be a prescription for protracted delays in making meaningful progress on commodity issues.

It has been argued throughout this report that commodities should be approached on a case-by-case basis. What is needed is a firm commitment to the principle of promoting commodity-market stabilization, a set of guidelines for commodity agreements, a centralized agency with consumer and producer representation to register and monitor them, and a framework of rules for integrating other measures for achieving market stabilization. Essentially the same needs apply with respect to buffer stocks.

In short, while accepting the importance of a common purpose — greater market stabilization in the interests of both consumers and producers — and of internationally agreed rules and procedures, this report strongly recommends that diversity and flexibility be permitted to the maximum possible degree in seeking that purpose.

The second basic issue concerning commodity agreements is whether commodity prices should be "indexed" directly to some measure of inflation, such as the prices of manufactured products. Developing countries have argued that they should. This report recommends against indexation of specific commodity prices.*

There are numerous question marks about the logic of direct indexation.* One is the difficulty in determining an appropriate measure for the index and the base to which it should apply. Also, it is very unlikely that any direct indexation scheme could be devised that would, given an objective of income stabilization or redistribution, achieve results consistent with those sought on welfare grounds. There would be a great deal of spillover to nations not in need of aid. The basic problem, however, involves the ramifications of direct indexation for commodity markets. If the real terms of trade for a commodity are improving, attempts to hold prices to a rigid indexed level will eventually result in shortages, so that price will then have to rise. Alternatively, if the real terms of trade are deteriorating, an indexed price could be sustained only by the continuous accumulation of surpluses or agreements to restrict output by producers. While such restrictions might be a useful short-term adjustment measure, they do not contribute effectively to long-term development goals. It is in this longer-term context that recommendations concerning trade reform and aid are made below.

D. TRADE REFORM

This report places primary emphasis upon trade reform as a response to commodity supply issues and regards this emphasis as appropriate from the standpoint of both producer and consumer interests. A package approach to trade reform is necessary. It is inconsistent and impractical to argue that restrictions on exports should be controlled in the interests of equitable access to supplies without also arguing that restrictions on imports should be reduced in the interests of equitable access to markets.**

General Principles

- The multilateral, most-favored-nation principles of GATT should be applied in the same way to exports as to imports.
- The level and structure of tariffs and non-tariff distortions should not prevent the balanced economic development of any nation adhering to international trading rules.
- Regionalization of trading arrangements should be avoided unless there is a failure to reach international agreement on basically similar terms. The Lomé Agreement between the European Community and certain less-developed commodity-producing nations is an example, although this report views the agreement as a

*Some of these points have been recognized in a July 1975 report of UNCTAD's "Expert Group on Indexation." See UNCTAD Document TD/B/563.
**This section draws heavily from Bergsten, op. cit.
constructive prototype for a broader international agreement.

- In the event of temporary shortages, “escape clause” provisions should be permitted as an exception to rules regarding non-discrimination in access to supplies, provided these provisions are made known in advance and follow internationally-agreed guidelines.
- Subsidies in the form of preferential prices for domestic customers in producer nations should be permitted only if these subsidies do not provide an artificial incentive for the relocation of production activities. An exception to this principle, similar to the “infant industry” argument for tariffs, would be made for less-developed countries on the condition that preferential domestic prices would be phased out according to a firm schedule.

**Specific Proposals**

- The tariff schedules of industrialized nations provide for an “escalation” of tariff rates as the degree to which imports are processed increases. (See Tables 1 and 2.) This escalation, which is especially pronounced when going from raw materials to semi-processed materials, is an artificial barrier to the industrial development and diversification of less-developed, commodity-producing nations. This barrier, and non-tariff distortions that have the same effect, should be sharply reduced, and progress in this area should begin promptly, without necessarily waiting for the completion of all phases of the current round of GATT negotiations.
- Generalized preferences for exports of less-developed countries should be made more meaningful by reducing the list of exemptions to these preferences and by relaxing the quantitative limits beyond which preferential rates no longer apply. Again, these initiatives should not be delayed by the current GATT negotiations.

### TABLE 1.
**INDUSTRIAL TARIFF AVERAGES BY COMMODITY GROUP, a 1973**

<table>
<thead>
<tr>
<th>Commodity Group</th>
<th>EC</th>
<th>US</th>
<th>Japan</th>
<th>Canada</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Materials</td>
<td>1.7</td>
<td>5.6</td>
<td>2.2</td>
<td>3.4</td>
</tr>
<tr>
<td>Semi-Finished Manufactures</td>
<td>8.9</td>
<td>9.8</td>
<td>9.6</td>
<td>7.2</td>
</tr>
<tr>
<td>Finished Manufactures</td>
<td>8.3</td>
<td>13.1</td>
<td>11.3</td>
<td>10.5</td>
</tr>
</tbody>
</table>

a. Simple (unweighted) arithmetic average of all most-favored-nation duty rates applying to tariff lines within a commodity group.


### TABLE 2.
**IMPORT TARIFFS BY STAGE OF PROCESSING, EARLY 1973**

<table>
<thead>
<tr>
<th>Commodity and Stage of Processing</th>
<th>EC</th>
<th>US</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iron and Steel</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ores and concentrates</td>
<td>0.0</td>
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<td>7.8</td>
<td>10.2</td>
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a. Approximate ad valorem rates based on the following prices: copper at 46¢/lb., zinc at 63¢/lb., lead at 9.9¢/lb. Prices of these commodities tend to fluctuate dramatically, which affects the tariff rate as well.

Sources: The rates for ores and concentrates are from national tariff schedules. All other rates are from GATT Tariff Study, Summary Table No. 2, Tariff and Trade Profile, by Industrial Product Category, as reported in Louis Silver, HRI Observations No. 6: The Pursuit of Further Processing of Canada’s Natural Resources (Montreal: C.D. Howe Research Institute, January 1975), p. 6.
ERRATA

Three entries and the footnote in Table 2 on page 29 should be changed to read as follows:

<table>
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<th>US</th>
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| Copper: ores and concentrates | 1.1
| Zinc: ores and concentrates   | 3.0
| Lead: ores and concentrates   | 4.5

---

a. Approximate ad valorem rates based on the following London metal prices as of the end of March 1973: copper at 69c/lb., zinc at 22.5c/lb., lead at 9.9c/lb. Prices of these commodities tend to fluctuate dramatically, which affects the tariff rates as well.
E. INVESTMENT MATTERS

Investment is the principal means of relieving supply shortages, regardless of their cause. In recent years, however, two major problem areas have emerged in which barriers are being created to the expansion of investment in important resource sectors: the massive scale of financing required to expand output (especially in the extractive industries) and an increasingly unstable investment environment within the producing nations (industrialized and non-industrialized). The recommendations in this section are directed to these two major problem areas.

There is a need for careful study of new forms of business organization to respond to basic changes in the magnitude and the risk of major resource undertakings. In some cases this may involve large-scale joint ventures among two or more private enterprises; in others, government involvement in a risk-sharing capacity with firms in the private sector may be necessary. These new approaches, especially those involving mixed private and public sector ventures, will raise important issues concerning the speed of decision-making, attitudes towards risk, and pricing actions. The subject merits further study by the Trilateral Commission.

Multinational enterprises (MNEs) are generally a constructive and dynamic force for the efficient mobilization of financial, managerial, and technological resources on a world scale. There have been instances of improper conduct by some of these companies, although it is generally recognized that only a small minority have been involved. There is a need for more effective international coordination of the economic regulations governing their activities.

The most basic investment issues stem from the unstable investment environment created by confrontations between MNEs and host-country governments (in both industrialized and non-industrialized nations). This unstable environment has contributed to the structural problems outlined in Chapter III of this report. A resolution of this problem must take three key factors into account. First of all, no responsible private enterprise is going to invest the amount of funds required for a modern extractive operation (to say nothing of a highly-risky exploration venture) unless it is confident that it has a reasonable chance of recovering these funds together with a competitive rate of return. Second, governments are under increasing pressure both to capture the “economic rents” associated with the development of the nation’s resources and to acquire a greater share of authority over the management of resource projects within their territory. Third, inflation at rates unanticipated at the time a resource project is initiated is likely to create pressures on the host country to renegotiate or to terminate the agreement.

The goal of establishing a more stable investment environment for resource projects is one that should be shared by all parties — investment companies, host countries, and commodity-importing nations. Progress in creating such an environment should be regarded by host countries as one of the necessary quid pro quos for receiving the benefits of other recommendations in this report. The following specific recommendations are made under this section:

- An independent information and research center should be established (along the lines suggested in a report to the United Nations in 1974) to provide unbiased analysis of the nature and operations of multinational enterprises and to make concrete proposals for the coordination of national regulations affecting them.
- An organization patterned along the lines of the GATT should be established for investment, with particular emphasis upon direct investment. Membership should be available to any nation willing to accept the terms and conditions set forth, which should include a code of conduct for enterprises and host-country governments, recognition of the principle of prompt and fair compensation in the event of expropriation, and agreement to submit disputes to an international body (such as the World Bank’s International Center for the Settlement of Investment Disputes).
- There should be an increase in the authorized capital of the International Finance Corporation and provision made for allowing this capital to be used to help host countries acquire equity participation in resource projects according to terms agreed upon in advance of the original investment. There should also be an increase in financial assistance to the United Nations Development Program in support of resource exploration in developing countries.
- An international insurance agency should be established to underwrite a portion of the risk of expropriation without fair compensation, provided the enterprise securing the insurance has received the formal approval of the host country on the details of the project, including terms of host-country participation.
- Consideration should be given to the establishment of tax treaties between home and host countries such that tax credits given by host countries for multinational enterprises to engage in certain activities (e.g., research and development, education, and job

For an interesting case study of one such project, see Judith Maxwell, Developing New Energy Sources: The Syncrude Case, HRI Observations No. 10 (Montreal: C.D. Howe Research Institute, November 1975).
F. DEVELOPMENT ASSISTANCE

Several of the recommendations above, principally in the area of trade reform, would create new opportunities for increasing the incomes of less-developed nations. These recommendations have as their primary goal the removal of imperfections and artificial barriers in the international economic system, consistent with the view of this report that efficiency is an appropriate starting point for addressing commodity issues.

As perceived by the less-developed countries, however, a resolution of commodity supply issues must be sought within a much broader context of achieving a more equitable distribution of income between the rich and the poor nations of the world. While recognizing the importance of these broader income redistribution issues, which the rapporteurs regard as meriting further study by the Trilateral Commission, this report takes the position that there are narrow limits on the amount of redistribution that can be expected through decisions affecting individual commodity prices.

- The distribution of commodity production potential is inherently unequal, and artificially higher commodity prices are more likely to widen income inequalities than to lessen them.
- The share of income spent on commodities, directly and indirectly, tends to be greater at low incomes than at high incomes. Thus, artificially higher commodity prices run the risk of "taking income from the poor in rich countries to support the rich in poor countries."
- Higher incomes, per se, do not ensure a viable development process. Furthermore, higher incomes do not, in and of themselves, address the problems faced by nations with resources that are being depleted. Therefore, the greater benefits will accrue to nations able to look forward to improved long-term development prospects.

The report makes two development assistance recommendations related but not necessarily confined to commodity issues.

- The export earnings of less-developed countries should be stabilized through the use of compensatory financing programs. The prefer-

*There is an IMF Compensatory Financing Facility in existence, but it is limited in both size and compensation.

The export stabilization scheme, or Stabex, is the most unique feature of the Lomé Convention. The Convention was concluded on February 28, 1975, between the European Community and 46 developing countries in Africa, the Caribbean, and the Pacific (ACP), with a duration of five years. Stabex covers 18 commodities (but only one mineral — iron ore). A different scheme is applied to sugar. The ACP countries will receive compensation if their annual export earnings from any of the covered commodities fall by more than 7.5 percent below a rolling average of the previous four years (2.5 percent for the poorest 24 countries). The compensation is in the form of an interest-free grant (or grant for the poorest 24), to be repaid when receipts are higher than the moving average, provided these higher receipts are due to higher prices, not just to higher quantities. A fund of U.S. (a unit of account equal to one U.S. dollar prior to the currency realignments in late 1971) 375 million is available in yearly tranches of U.S. 75 million, though a 20 percent claim on the following year's tranche is permitted. The finance for Stabex represents only about one-ninth the total aid under the Lomé Convention (U.S. 3.39 billion), and averages out to less than two million dollars per country per year.
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