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In Favour of a Fund to Stabilise Commodity Exporters' Income

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Poor countries will remain vulnerable to external shocks from export prices or from natural disasters for some time. Indeed, the lowest income countries have an even higher incidence of such adverse events than other developing countries and tend to suffer larger damages when they occur. For the poorest countries, the rate of disasters between 1997 and 2001 ran at one every 2.5 years. Commodity price shocks, which struck on average every 3.3 years, are particularly severe for poor countries. One reason is that some 26 highly indebted countries have an export concentration of more than 50 per cent in three or fewer commodities, while 62 per cent of the total exports of the least developed countries are unprocessed primary commodities.

Vulnerability to Shocks

External shocks are very bad for growth and their secondary effects can top up to 14 per cent of GDP. These negative effects significantly increase poverty and impact adversely on fiscal and external balances. Terms-of-trade shock and adverse weather conditions have been shown to have played an important role in creating debt problems.

If a negative shock is expected to be reversed by a positive one, it would appear to make sense to finance the bad years out of savings. Commodity prices, however, are usually very slow to recover from adverse

shocks. In average it takes about 15 years before the effects, either positive or negative, are cancelled and prices return to normal.

This is why most Stabilisation Funds have failed. Positive shocks cause the stabilisation fund to become so well-endowed that the temptation to plunder it becomes irresistible, while a negative shock drives the Fund to insolvency. There has thus been a tendency to conclude that there is not much that can or should be done to stabilise commodity prices. If this is the case, exporting countries should behave as if any commodity shock was bound to be permanent and adjust accordingly.

A Realistic Stabilisation Strategy

This is a hasty and extreme conclusion. There is no reason why countries should not find ways to protect themselves; at least partially. Clearly, such protection would have to be finite but would include extra resources to cushion a long lasting shock. The goal is not some utopian stabilisation of prices; but smoother income for producers. Countries should be protected against deviation of commodity prices from a reference price linked to long-term market trends. For this purpose, a five year moving average of past prices is quite sufficient. This solution avoids the pitfalls of past stabilisation attempts based on a fixed, single price, while giving producer countries time to adjust to permanent shocks.

The cost of such a Fund can be calculated for each commodity. In the worst cases, such as cocoa and coffee; the median cost could be equal to about six months of exports. In a post-Monterrey world, where rich countries are committed to help poor countries; this is not a high cost. Poverty comes with a deadly companion: high uncertainty over the future. Helping poor countries to address this uncertainty should remain high on the agenda of donor countries.

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