

Taiwan. The main conclusion here is that countries which enjoy a comparative advantage in international financial services are likely to be more liberal in their home markets towards foreign-based firms. On the other hand, countries which do not have an international comparative advantage are more likely to be protectionist. However, with economic development the costs of protectionism and the benefits of international competition and specialization become increasingly obvious and pressures for liberalization develop in these countries.

Chapter 6 sums up the preceding analysis and concludes by discussing the policy initiatives which would seem appropriate today. First, the principles of comparative advantage apply to financial services just as they do to any other industry; there is therefore no greater justification for protectionism in financial services. Second, the principle of "national treatment" should be universally accepted as governing international trade in financial services. This means that there would be no distinction between the treatment of foreign and indigenous firms. It is likely that this principle will become the main objective of trade liberalization in the financial services sector.

On the whole, the book provides an insightful discussion on a complex topic and introduces plenty of empirical details. It falls short only in the lack of a more conceptual framework and of a more cogent and explicit policy stance.

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***How Commodity Futures Markets Work.*** By Basil S. Yamey, Richard L. Sandor and Brian Hindley. Thames Essay No. 42. London: Trade Policy Research Centre, 1985. Pp. ix, 71.

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Governments have been increasingly concerned about the instability of primary commodity prices since the end of World War I. The periodic collapses in commodity prices, such as occurred

in the early 1920s and during the Great Depression, have typically precipitated discussions on the establishment of international control schemes; and to-date there have been seventeen major agreements on nine commodities. The volatility of commodity prices in the early 1970s, coupled with the success of OPEC in raising the price of oil in 1973, has once again awakened interest in such proposals.

It was during the fourth session of UNCTAD held in Nairobi in May 1976 that resolutions calling for the establishment of an Integrated Programme for Commodities (IPC) were passed. Among other resolutions, the IPC proposed the setting up of buffer stocks to stabilize the prices of ten "core" commodities identified by UNCTAD as suitable for stockpiling. However, in all these deliberations not much attention was paid to futures markets. On the contrary, much confusion was created with regard to the role of futures markets in the context of commodity price stabilization. It was only when the debate on the IPC began to wane that attention was once again focused on futures markets. This development prompted the Trade Policy Research Centre to commission a paper on futures trading. The paper by Basil Yamey has since been revised and forms the core chapter (Chapter 2) of this Thames Essay. The establishment of the plywood futures market is the focus of Richard Sandor's contribution in Chapter 3. In Chapter 1, Brian Hindley introduces the discussion from a policy perspective by relating futures trading to the debate on the IPC, and to which we now turn.

Hindley discusses the economic consequences of commodity price stabilization, by means of buffer stock schemes, on futures trading, and on the economic functions that futures trading facilitates. The single most important purpose for the futures market is to provide price insurance to producers, handlers, and users of storable commodities. These market participants are subject to the risk of price changes while they hold stocks of the commodity or have uncovered commitments to supply the commodity or its products. One way of minimizing the risk of loss

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is to hedge against such risks by taking opposite positions in the futures markets. Herein lies the connection between price volatility and the use of futures contracts. However, as Hindley points out, a futures market is, in effect, "a sophisticated means of splitting the various functions involved in producing, storing and using commodities and of gathering and interpreting information so that there can be specialization in, and hence better performance of, each function". Essentially, it enables the market participant to use information available in the futures market without being burdened by the need simultaneously to undertake storage, a function another market participant may be better able to perform.

Buffer stock schemes and futures markets can be viewed as alternative means of reducing the risks borne by commodity producers and others as a result of fluctuating prices. In a buffer stock scheme, the buffer stock manager enters the market to buy a commodity when its price is low and sells it when it is high. In a futures market, the arbitrageur purchases the commodity when the price is low, stores it, and sells it later at the high price. In the process, he not only makes a profit for himself but also performs a useful function of evening out price differences. Given this, the fundamental question often asked is why the market (private traders) alone cannot stabilize price. Is there a source of market failure here which necessitates government intervention in the form of international control schemes to improve economic efficiency? The short-term nature of a typical futures contract does suggest that the structure of futures markets is defective. In fact, Newbery and Stiglitz (1981) are of the view that the absence of a complete set of risk and futures markets, stretching sufficiently far into the future (18 to 24 months forward) is a sufficiently important market failure, and this is what makes commodity price stabilization schemes so potentially attractive.

However, as Yamey points out, it is not easy to explain why futures trading exists in one commodity but not another, in one locality but not elsewhere. There must be a satisfactory level of

demand for hedging in a commodity in order for a futures contract in that commodity to attract much business. If a futures contract is unable to attract a sufficient volume of business it is non-viable in relation to the efficiency of operation and the costs to users. It is for this reason that many futures markets, particularly those for longer-term contracts, fail to be established. Yamey further suggests that contract design is important in attracting hedging interests. He cites the example of the plywood futures contract (Richard Sandor's contribution in Chapter 3) of the Chicago Board of Trade as one which owes much of its success to contract design.

Another reason for intervention, rightly challenged by Hindley, is the presumption that the buffer stock manager can do a better job of stabilizing prices because of the resources available to him to acquire more and better information and to use the information more efficiently. The buffer stock manager faces the same difficulty as the private trader in predicting the course of future prices. There is therefore no prior reason to suppose that the buffer stock manager can improve on the performance of private traders stabilizing prices by simple buying and selling operations. In fact, Hindley contends that neither a priori reasoning nor historical evidence suggest that he will succeed in stabilizing prices. Even if he succeeds, price stabilization may still not be desirable from the producers' point of view. Here the argument that price stability may result in income instability applies, assuming that the ultimate objective of price stabilization is the stabilization of producers' income.

Economists are wary of buffer stock schemes not only because of their potential of developing into cartels but also because of their negative effects on futures trading. The condition of price variability is necessary for an active futures market. Yamey cites a study of fifty-one commodities which demonstrates that those with the greatest price variability had the most active futures markets. If buffer stock price stabilization schemes were successful, futures trading would be undermined because the facilities for

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hedging against the risk of price movements would be made redundant. Whatever the defects of futures markets, buffer stocks schemes cannot be superior to them in performing the functions that futures trading facilitates. Futures markets are indispensable to commodity trading and should not be sacrificed. In general, where agreements to intervene are operative, the ability of futures markets to survive is largely dependent on the range within which prices are allowed to fluctuate.

Perhaps Hindley should also have examined the effects of futures trading on commodity price stabilization. In the past, economists concerned with price stabilization have ignored the presence of futures markets, and, according to McKinnon (1967), this neglect is a fundamental reason why so many international commodity agreements (ICAs) have failed in the past. In his view, futures markets dramatically alter the impact of price stabilization schemes. This is because the existence of risk-sharing and risk-reducing institutions implies that the social cost of risk may be considerably less than it would be if the risks were borne only by producers. Consequently, if these risk-sharing options are ignored there is a danger that the benefits of price stabilization will be over-stated. Secondly, price stabilization changes the nature of risks and risk-sharing. The availability of risk-sharing arrangements implies that individuals have additional instruments to respond to changes in risks, and these instruments interact in a complex way to modify the impact of price stabilization on both supply and producer welfare. Newbery and Stiglitz have also shown that an unbiased futures market (that is, one in which the futures price is an unbiased estimator of the future cash price) provides superior income insurance to price stabilization over the period for which the futures market is open. The reason is that an agent does better if he is free to choose the amount of price insurance (optimal hedge) as opposed to having a pre-determined amount forced upon him.

Nevertheless, it should be pointed out that futures markets are not necessarily superior to

price stabilization schemes. This is because in the absence of a complete set of risk markets the private market may provide insufficient stabilization. There is thus a prima-facie case for further stabilization by government beyond the level provided by the market. Therefore, it would appear reasonable to conclude that commodity futures markets and ICAs are not mutually exclusive arrangements except when ICAs aim virtually to eliminate significant price fluctuations.

#### REFERENCES

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***Export-oriented Industrialization: The ASEAN Experience.* By Mohamed Ariff and Hal Hill. Sydney: Allen and Unwin, 1985. Pp xv, 270.**

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Backed by extensive data, this study provides a comprehensive account of the processes of industrialization between 1960 and 1980 in the five original ASEAN countries. While a great deal has been written on industrialization in the developing countries, the number of detailed empirical studies with theoretical discussions on the processes involved is limited. On this count alone, this study must be regarded as an important contribution to our understanding of the scope and limitations of export-oriented industrialization in the developing countries in general, and in the ASEAN countries in particular.

Structured around the twin themes of changing comparative advantage and the political