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LATIN AMERICA AND COMMODITY FUTURES MARKETS TODAY */

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I. INTRODUCTION

This study is one of a series of reports prepared by the International Trade and Development Division of ECLAC on the use of futures markets as a price stabilization mechanism. The present study draws upon the contents of the preceding reports in this series in an effort to make a further contribution to the analysis of this subject.1/

The above-mentioned reports have provided an extensive analysis of the conceptual aspects, characteristics, functions, operations and development of commodity futures markets, as well as of the main ways in which they are utilized by the countries of the region and the principal obstacles hindering them from making a more extensive use of those markets.

Using those contributions as a point of departure, this study begins by evaluating the role performed by the exchanges at the present time and assessing the specific factors which play a major part in determining their accessibility. Using this analysis as a basis, it then goes on to formulate suggestions as to how access to these markets may be facilitated. Within this framework, four basic aspects of the subject are discussed: participation in futures exchanges in general, local exchanges, financial assistance, and technical assistance. A separate section of the document is devoted to each of these topics.

In order to complement the above-mentioned reports with a discussion of actual experiences, the information used in the preparation of this document was primarily obtained through direct contacts with agents involved in the field of futures trading. The documentary research work was for the most part confined to the publications issued by those agents and the ECLAC reports referred to above.

At this point a substantive observation is called for which concerns the work as a whole. Due to the fact that futures markets have incorporated financial instruments within the same operational framework as that of commodity contracts, trading in these two types of instruments is conducted on a similar basis in terms of both their role in risk management and the technical and financial capabilities required for their utilization. Although this study focuses on commodity futures markets, the fact that such futures are in many cases used in combination with financial futures often makes it necessary to extend the discussion to include both types of instruments.

Furthermore, some of the instruments used for managing risk in commodity trading fall outside the framework of the exchanges' operations but are in some cases nonetheless used in combination with futures contracts as part of an overall strategy or plan. It therefore becomes necessary to refer to such instruments at some points in this study, and thus to extend the scope of the discussion beyond the bounds of the original topic.

These forays into other subject areas reflect the fact that although commodity futures markets were once the principal means of transferring risk, they are rapidly becoming just one of many mechanisms for implementing more comprehensive and integral risk-transference strategies.

II. PARTICIPATION IN THE EXCHANGES

As noted earlier, other studies have described the operational procedures of futures markets and the functions they perform as well as examining their advantages and the obstacles that have generally limited the Latin American countries' participation in those markets. Bearing this in mind, the present section will be devoted to a description of the current situation with respect to their participation, the forms it takes and its frequency. To this end, it is first necessary to outline a number of factors which currently promote or hinder the use of futures markets by Latin American countries.

A. UTILIZATION

In examining the factors which promote the utilization of the exchanges, it should first of all be noted that the main such incentive --the instability of international prices-- has been strengthened by the lack of results from commodity agreements, especially as regards their economic provisions. This circumstance inevitably entails less State intervention in the regulation of commodity trade in both exporting and importing countries.

This phenomenon may be regarded as the external counterpart to the moves towards liberalization and deregulation which are now being made by so many countries in the region and which in the aggregate represent a sustained trend towards the privatization of price and financial risks. The lifting of controls on sales of commodities to other countries, the privatization of formerly nationalized export activities, the reduced degree of government intervention in the operations of State-owned exporting enterprises and the relaxation of exchange controls are policies which involve a gradual withdrawal of the State from the management of commodity price risk and its transfer of this responsibility to private agents, who must then themselves seek means of transferring their risk.

The search for mechanisms of risk management in general has also been spurred by recent events and circumstances in the financial world many of which affect the agents involved in commodity trading. One example is the need for agents taking out loans at floating rates to hedge against interest-rate variations. This appears to be becoming increasingly frequent both in the case of external debt obligations, their renegotiation and transfer, and in the case of project financing. Frequently cited examples in this connection are the new commitments assumed under the Brady Plan and the transfer of external liabilities from the public to the private sector as a consequence of the privatization of business enterprises.

Another case in point is the multilateral lending agencies' adoption of the practice of denominating their loans in a "basket" of hard currencies, since this motivates debtors to establish positions which will permit them to transfer the risk of variations in the parities of these currencies.

On the other side of the scale, however, there are also a number of relatively new circumstances which hinder the countries' participation in futures exchanges. These factors must therefore be added to the list of the more long-standing obstacles in this connection which have been analysed in other studies, and possible means of overcoming them will be discussed later on in this essay. One such factor is the instability of relative prices characteristic of hyperinflationary processes, which is usually coupled with highly variable nominal and real exchange rates. This type of process generates levels of risk that are far in excess of what can be managed within the framework of futures exchanges, and under such conditions participation in the exchanges either simply becomes futile or may give rise to large losses.

These new factors, in combination with the advantages and barriers which have always existed with respect to the utilization of the exchanges, determine the extent of the Latin American and Caribbean countries' involvement in these markets. Thus, it has been observed that in situations where processes of risk privatization are coupled with economic stability, the greatest amount of progress has been made in overcoming such obstacles and the level of participation in the exchanges is at its highest. Conversely, in situations where there is a high degree of instability and where risk management is primarily carried out by the State, the least progress has been made towards surmounting such barriers and participation is much more limited.

It may be deduced from the above that both now and in the near future, the degree of interest shown by the countries in overcoming these barriers and intensifying their involvement in futures exchanges will very probably be a function of two contextual variables: the reduction of the State's role in risk management and economic stability.

This correlation has, however, been negatively influenced by recurrent episodes of intervention in futures markets for purposes of price maintenance or speculation --rather than of risk transfer-- which have resulted in large financial losses.

B. OPERATIONS

In operational terms, the most frequent use made of the exchanges continues to be that of setting prices. In many cases this involves the use of mechanisms, either through intermediaries (i.e., traders) or by means of what are known as "executable orders", that permit exporters to establish the price of a sale beforehand, which then may or may not be passed on to the producer.

During the present decade these mechanisms have swiftly come into widespread use for sales of coffee, sugar, grains and some metals despite the fact that they do not reduce the uncertainty associated with the variation of the differential between the exchange quotation and the spot price and that they pave the way for speculation in the closing dates of sale prices.2/

The next most frequent operation appears to be that of direct hedging through futures contracts. This type of operation is mainly engaged in by large exporters, especially those which are closely linked to companies in other countries. Thus, it is not surprising that in cases where the volume of exports is large and where multinational corporations are heavily involved, a higher proportion of commodity sales are hedged on the exchanges.

The use of the exchanges by the countries of the region to hedge imports is, however, very limited despite the large volume of such trade, particularly in the case of grain and petroleum. It has not been until recently that companies having prior experience in dealing on the exchanges as exporters of mining products have begun to trade on the petroleum exchanges.

Participation by the Latin American countries in options markets is still quite limited, however. The reasons usually given for this situation are a lack of familiarity with these markets and the fact that many regional traders feel that the price of these instruments is too high. Generally speaking, options trading is undertaken in very specific cases where the agent wishes to lock in a price for a longer period than that covered by futures contracts. These operations are usually undertaken as part of a broader risk-management strategy in which they are used in combination with commodity and financial futures.

This latter approach —i.e., comprehensive strategies for managing multiple risks— is the most highly refined and offers the greatest benefits of those used in the region. It is primarily used by a number of large exporting firms as part of their medium-term management plans. The operations used by such firms include hedges in futures exchanges and options on exports and imports and, to a lesser extent, interest-rate and currency hedges. All the operations are closely linked to merchandise flows. Significant by-products of these integrated approaches include the companies' ability to inspire greater confidence among exchange operators and the financial community and to realize considerable savings in terms of technical training and market information.

As regards speculative operations, the precautionary measures taken by the regulatory agencies, informal accounts of experiences in this connection, and the observation that long positions are frequently taken by regional exporters give reason to believe that the extent to which Latin American traders engage in operations for the purpose of realizing speculative gains is far from negligible. Nevertheless, the prevailing belief in the exchange community is that speculation was more frequent in the recent past than it is now.

Finally, trading in the market aimed at forcing up export prices appears to have been definitely discarded as an option, even by firms which handle a large enough volume of physical merchandise and financial resources and have sufficient experience to enable them —either on their own or by acting in conjunction with other similar firms— to be relatively successful in exerting pressure on exchange quotations if they so desired.

In view of the above, and bearing in mind the opinions of a wide spectrum of traders, a substantial increase in the volume of trading undertaken by the countries of the region on futures exchanges may be expected in the following areas: the hedging of financial risk (first and foremost), the hedging of commodity sales by both State-owned and privatized export firms and by export co-operatives, the hedging of petroleum imports, and the purchase of options by the more experienced traders.

III. LOCAL EXCHANGES

In some instances quotations on the exchanges of the developed countries have been unrepresentative of the prices at which the physical merchandise produced in some areas of Latin America is traded. Under such circumstances, the variability of the basis (the differential between the two prices) may be greater than that of futures quotations, in which case hedging on international futures markets becomes ineffective.3/

This situation provides the grounds for one of the arguments in favour of local exchanges, since on such exchanges the characteristics of the contracts and the influence of the underlying "fundamentals" (the supply and demand of physicals) are such that changes in futures quotations closely correspond to changes in the prices of the physical merchandise, thereby making better hedges possible.

Local futures exchanges are highly useful and are more viable when a large proportion of the product in question is consumed domestically. Such exchanges help to make the national markets more transparent and attract buyers and sellers who do not trade on the exchanges of the developed countries --both of which are persuasive arguments for considering the possibility of establishing such exchanges.

On the other side of the coin, there are also significant obstacles to the operation of such exchanges. Firstly, the instability of domestic prices and changes in commercial and foreign-exchange regulations have often caused trading volumes to drop to negligible levels. A second problem is the lack of liquidity caused by the absence of speculators on these exchanges due to the instability referred to above and to prejudices against speculative activity coupled with a lack of information.

Finally, there also seems to be some concern on the part of long-standing users of the international exchanges as to the impact which the establishment of local exchanges might have in terms of the reaction of traders in the corresponding products on the exchanges of the developed countries.

In addition to all these factors, the potential traders and regulatory agencies are, for the most part, not very familiar with the way in which futures exchanges operate. It has been observed, however, that as economic conditions are perceived as becoming more stable and as commercial and foreign-exchange regulations become more favourable and less variable, there is increasing interest not only in participating in the international exchanges but also in promoting or re-establishing efficiently-operating local commodity exchanges. It is also clear, however, that any deterioration of the above-mentioned conditions would immediately result in a reversal of this trend.4/

In this regard it should be noted that financial futures contracts are beginning to be established in local marketplaces. The legal basis and regulations for their operation and the critical mass of speculators needed to provide liquidity may serve as a good foundation for the subsequent establishment of commodity contracts in those instances where they appear to be viable and advantageous.

In the countries where such conditions already exist, as well as in those where they may be established in the future, however, a great deal of work remains to be done in the field of education, both in terms of general information (i.e., regarding the advantages afforded by the existence of futures exchanges and by participation in them) and the technical training of traders, regulators and supervisory personnel.

IV. FINANCIAL ASSISTANCE

The financing of margins has been described as one of the main barriers to participation in the exchanges by developing countries.5/ In order to examine the existing or possible options for dealing with this problem, we must first discuss some of its main characteristics.

Margins are a form of guarantee and include an initial sum, which is paid at the time a position is opened on an exchange, and another, variable sum which may be either positive or negative depending on whether the market moves in the same or the opposite direction as the position in question.

One relevant feature of this problem is related to the fact that margins are, as stated above, a type of guarantee. Thus, the greater the presence and stability of a participant and the more confidence a participant inspires, the fewer difficulties that agent will have in obtaining margin financing. The clearest expression of this situation may be "principal-to-principal" transactions, which are primarily guaranteed by the confidence existing between the agents involved. There are some export firms in Latin America whose market share, financial standing and reputation for reliability and stability in the exchanges place them in this position, and they are thus called upon to deposit funds only when the volume of their transactions or margin calls exceed previously agreed upon limits.

In other cases, brokerage houses themselves will finance a substantial part of established clients' margin calls or will automatically offset positions that are moving in opposite directions when such clients are holding a number of contracts. Well-known clients may also sometimes obtain bank financing for initial margins and margin calls.

As a rule, traders which enjoy the confidence of the exchanges' members obtain financing to cover their margins by one or another of the means discussed above. They may nevertheless encounter difficulties, however, in securing immediate access to funds in the currency in which the markets operate when margin calls exceed the pre-established limits or when they find it necessary to offset their positions.

The obstacles to be faced are more formidable in the case of new participants, participants who trade on the exchanges only sporadically and those whose trading volumes are relatively small. Generally speaking, these are participants which either because of their own standing or because of the conditions prevailing in their countries (instability and frequent changes in regulations) do not inspire sufficient confidence among the members of the exchange in question. These participants are obliged to finance their operations with their own funds, which must be held in locations and instruments which ensure their immediate availability.

Exporters in this position which trade regularly on the exchanges nonetheless feel that the costs of hedging, as compared to the benefits it affords, are almost insignificant in terms of the sums involved.

Given the above factors, the main purpose of setting up guarantee mechanisms or funds for financing margins would be to provide greater access to the exchanges for new participants which do not enjoy the confidence of the exchanges' members, are usually concerned about the possibility that the market may move against their positions, and have difficulty in maintaining a pool of entirely liquid foreign exchange.

The multilateral lending agencies are not currently considering the possibility of establishing this type of credit facility. Nevertheless, they not only acknowledge the benefits of using the exchanges for risk management, but actually recommend their utilization for this purpose and especially for minimizing the impact of variations in the parities of the basket of currencies in which many of their loans are made.

The only encouraging development along these lines has been the recent creation by the World Bank of a risk-management unit within its International Commodity Markets Division in an attempt to increase developing countries' access to short- and medium-term price risk transfer mechanisms. Thus far, this unit has engaged in research, technical co-operation and training activities, but there are plans for the establishment of guarantees which will permit the use of medium-term instruments outside the framework of the exchanges (such as commodity bonds, gold bonds and swaps).

The fact that the World Bank does not make any provision for margin financing —whereas it does provide for other types of financial assistance— in spite of its awareness of the needs that can be met by the futures exchanges, provides an indication of how little possibility there is of this type of operation being established by a multilateral agency.

Various reasons for this situation can be suggested, and all of them are related to the nature of the operations in question. Firstly, the amount of margin financing that will be needed cannot be determined beforehand, since by definition a margin may change on each trading day. Secondly, the sums loaned may be lost, and such losses will only be recovered in the form of the prices of the physical merchandise —a fact that could make the implementation of this type of operation very difficult. Finally, the fact that these operations involve short-term capital could represent another obstacle, since development institutions do not normally provide this type of financing.

For all of these reasons, given the terms in which the problem of margin financing by Latin American participants has been handled so far, attention should be shifted to other means of significantly easing the above-mentioned difficulties. Within the framework of the exchanges, one alternative is to trade in options, since their cost does not vary and they offer advantages similar to those afforded by the establishment of positions in the futures market. However, as noted earlier, the price of options has discouraged a wider use of these instruments.

Among other possible means of overcoming the problems posed by margin financing, consideration should be given to measures aimed at reducing the substantial difficulties and costs involved in the maintenance of participants' own resources in hard currencies in foreign accounts. First of all, because the expenses involved in participating in the futures exchanges are generally not provided for in the exchange regulations of the countries of the region, the foreign exchange needed to cover such expenses cannot be purchased in the countries' official markets and is therefore more expensive than the foreign exchange obtained from physical sales. In some instances the difficulty of obtaining foreign exchange rapidly has made it necessary for traders to close positions in order to cover their margins, occasioning considerable losses.6/

The "grey-market" character of this category of foreign exchange also poses an accounting problem as regards the losses incurred when positions are closed below the purchase price or the gains realized when they are closed above that price, since such losses have a negative effect on a company's profits statement and such gains entail tax disadvantages. This situation has come to represent an insuperable obstacle to participation in the exchanges by large State enterprises in the region when their management is subject to particularly close scrutiny by the public or by higher government authorities.

All things considered, at the present time the most feasible course of action for alleviating the problems posed by margin financing appears to be the adjustment of controls and regulations so as to permit a sufficiently free flow of foreign exchange to meet the requirements of hedging operations. Such legal modifications ought to help lessen the tax and accounting problems referred to above as well. The possibility of exercising some measure of control over the types of operations conducted --so as to minimize speculation-- and over the brokerage houses dealt with would be beneficial side-effects of such adjustments.

It has been found that in order to create the conditions under which such measures can be adopted and can be effective, a great deal of work is required in terms of familiarizing the relevant groups with the characteristics and uses of the exchanges and as regards technical assistance and advisory services in this field.

V. TECHNICAL ASSISTANCE

There is abundant evidence of the need for co-operation in this area in the countries of the region, both in the form of training and advisory assistance. All the previous documents in this series, the observations made by agents involved in various aspects of the field, and the analysis presented in the preceding chapters bring out the fact that the lack of such co-operation is one of the main obstacles to a greater use of the exchanges by the countries of Latin America and the Caribbean.

In the following discussion an attempt will be made to determine the specific forms of technical assistance which are called for and the ways in which these needs are being addressed. Once the shortcomings which exist in the respect have been identified, suggestions will be made as to how these needs might be met more satisfactorily. These suggestions will refer to demand-side aspects such as organization and orientation and to such supply-side elements as modifications in the types of co-operation currently being made available.

A. CONSCIOUSNESS-RAISING

One of the various forms of technical assistance that is required is an overall effort to heighten the relevant actors' awareness of the exchanges and of the actual benefits they can provide in terms of risk management. Such an effort is all the more necessary because the general lack of information in this regard is compounded by widespread prejudices and concerns on the part of private and public policy-makers and economic/financial opinion-makers. In many cases such prejudices and concerns are based on bad experiences with failed attempts at speculation or price manipulation. Specific examples include the losses suffered by PANCAFE, in Central America; the losses sustained in the case of the Compañía Refinadora de Azúcar de Viña del Mar (CRAV), in Chile; and those arising out of the so-called "Brazilian hedges" in the case of Brazil.7/

This type of educational effort is generally carried out by means of information activities undertaken by the exchanges and their associations,8/

by some organizations of exporters (e.g., GEPLACEA), and by brokerage firms. The latter also usually make a special effort to overcome the problems of credibility occasioned by their status as profit-making enterprises that stand to gain from an increased utilization of the exchanges. All of these activities usually reach no more than a small percentage of the relevant groups, tend to be concentrated in the countries where futures markets are located, and often turn into exercises in "preaching to converts".

In view of these shortcomings and given the extent of the preconceptions and lack of information referred to above, these educational activities fall far short of what is needed in order to be effective in increasing the Latin American and Caribbean countries' use of the exchanges. Since in some cases the need for such activities is acute, it is important that some suggestions should be made concerning their implementation.

Firstly, the target group for which these information activities are designed should not be confined solely to potential users but should instead include all those sectors whose opinions or actions influence potential users' decisions as to whether or not to utilize the exchanges. These include associations and groups of private commodity exporters and importers, executives of public and private firms having links with the external sector, members of the financial sector (the Central Bank as well as private, development and foreign trade banks), policy-makers and decision-makers in the relevant spheres of government, and economic/financial opinion-makers (members of academic and technical institutions and of the specialized media).

This type of undertaking can scarcely be carried out on the same basis as information activities have been conducted so far --i.e., solely through the efforts of brokerage firms, the exchanges of the developed countries and regional associations of producers and/or exporters. The active collaboration of national organizations is required as well. The participation of such organizations would add to the credibility and effectiveness of the undertaking, especially if they include professionals and bodies in the countries of the region which regularly use the exchanges successfully for purposes of risk management.

B. TRAINING

Another form of technical assistance is the training in exchange operations which is required by the technical staff of bodies that participate in the exchanges. This training covers everything from basic information to the skills and knowledge needed to devise complex, comprehensive risk-management strategies.

On a formal basis, this type of training has begun to be offered within specialized programmes of study for the degrees in business administration awarded by some private universities in Chile and Argentina. This is a very new development, since until recently training in this area had primarily focused on the stock exchanges. Because they are so new, the effectiveness of these courses has not yet been evaluated, although their usefulness has been clearly recognized.

Within the sphere of what may be considered formal training, some business administration institutes, such as the Central American Institute of Business Management, also offer short seminars on futures trading. For the most part these seminars, which are usually between three and five days in length, provide a brief description of the nature of commodity and financial futures and options markets and then go on to concentrate on case studies and practical exercises.

Outside the region, especially in the United States, a wide range of short courses or seminars are offered. They also focus on practical examples and, as a rule, their aim is to prepare the participants to sit for the National Commodity Futures Examination. Such seminars are often held by brokerage houses, and the Futures Industry Institute (FII) also offers four such seminars in Chicago and eight in New York each year. Both the FII and the brokerage houses make an effort to make this type of training available to persons outside the United States. The FII organizes seminars in Europe and in Singapore, and at least one brokerage house holds Spanish-language seminars in Miami for Latin American students.

A substantial portion of the technical personnel working in the area of futures operations have attended a seminar of this type at some point in their careers. They are almost unanimously of the opinion, however, that the level of training provided by such seminars is not high enough to prepare them to do their jobs properly, and they have therefore had to supplement it with other types of training, usually in the form of internships.

Recently, however, more advanced and more highly specialized short seminars have begun to be offered. Those focusing on commodities are held by the exchanges (or at least by the NYCSCE and the NYCE) and their association (the FII). Generally speaking, their motivation for doing so is to promote options trading, and the seminars therefore concentrate on these markets. The courses offered by the New York Cotton Exchange --where orange juice contracts are traded-- are usually held in the United States, but the NYCE has also made an effort to hold some courses that have this same focus in Brazil.

In 1990 the FII and the European Institute of Business Administration have organized advanced seminars in which the Chicago, London and Paris futures exchanges are participating. These five-day seminars focus on the analysis and formulation of financial risk management strategies and are designed for specialists who trade or manage large portfolios of stocks and bonds and who take positions in a variety of hard currencies. So far, there have apparently been no Latin American participants in these seminars.

Most instruction in the use of the exchanges is not provided through formal education, however, but rather through on-the-job training. One of the forms such training takes is that of internships or special programmes conducted in the user firms themselves. Another very widely-used option is the provision of training for technical staff as one of the services offered by brokerage houses to their clients --usually in the form of consulting-service and training packages in which the latter component is a combination of instruction, internships and practical exercises.

For the last four years the World Bank has also been organizing these types of programmes. The first such programmes were conducted by the Office of the Treasurer and focused on the management of financial risk. Several months ago similar activities were initiated with regard to commodities, following the Bank's creation of a Risk Management Unit within its Commodities Division for this purpose. In both cases World Bank experts as well as specialists from private firms or academic institutions which have been contacted by the Bank participate in these programmes.

Finally, international bodies and firms have on occasion arranged for internships in an exchange for individuals whom they propose as candidates. The New York Mercantile Exchange (NYME) and the London exchanges have co-operated in this sort of activity.

It is generally felt that the training of an operator must include instructional visits to the exchanges, marketing firms and brokerage houses. However, inasmuch as these visits are generally quite costly, the number of technicians sent on them is usually kept to a minimum. User firms, especially State enterprises, are therefore reluctant to send staff members on such training tours for two reasons: because of the cost of doing so and because of the possibility that, given the shortage of skilled personnel in this field, once they are trained such staff members may be offered more attractive job opportunities.

Bearing the above factors in mind, a number of suggestions may be made as to how a larger number of technical personnel might be trained at a lower cost. First of all, training activities in the Latin American and Caribbean countries ought to be expanded. These activities could be conducted at a national, subregional or regional level.

As part of this undertaking, the number of organizations offering such training should be increased and the activities they carry out should be expanded. This effort should primarily be directed towards non-profit organizations such as universities, research centres, business institutes and bilateral, multilateral and non-governmental international organizations. All of these organizations could either provide direct training or could be responsible for organizing courses and seminars.

As regards the content of such training, there appears to be a need to expand the levels, specializations and degrees of intensiveness of the instruction. Due to the complexity of the subject, basic courses should go beyond the objective of furnishing training in the execution of day-to-day transactions in order to provide a more complete view of the role of the exchanges in comprehensive marketing and risk-management strategies so as to produce "trader-strategists" rather than simply operators.

This point merits some further discussion because few Latin American firms have full strategy planning teams in which the work done by executive personnel serves as a framework for the activities of operational staff. Instead, the usual arrangement is for the staff in charge of trading to receive instructions directly from high-ranking executives in the firm. In these cases decisions are usually based on the simple observation of daily price movements, the information furnished by brokerage houses on the basis of their own analyses of the international market, and on often unreliable commercial and financial information, much of which is frequently composed of rumors, guesswork and wishful thinking.

The same sort of gap exists at the more advanced levels of formal training as well. Such training needs to be broadened in order to keep step with the increasing complexity of exchange operations as new information systems, instruments and forms of trading are developed and as the momentum generated by trading activity leads to an ever more diverse and more sophisticated use of the exchanges.

Attention needs to be called to the fact that the most successful experiences have been those in which training has been tailored to the specific needs of user institutions, and it is therefore important for programme designers to bear in mind the need to combine general instruction with some degree of specialization.

The more advanced training activities should therefore be structured on the basis of three objectives: specialization, updating and retraining, and a more indepth study of exchange operations. It is very likely that the collaboration of institutions and experts from developed countries will be needed in efforts of this sort and that it would be more feasible to organize them on a subregional or regional level.

In addition to the two levels of training discussed above —basic and advanced/specialized— there is a third level whose aim is to increase the efficiency and effectiveness of participation in the exchanges. Such training should be geared to the needs of the management levels of user institutions and enterprises. In one sense this type of training could be regarded as a consciousness-raising activity, but it differs from such activities in that the information required in order to approve a risk-management strategy and to allocate the necessary human and financial resources has to be more broadly-based and more highly structured.

This type of training is almost always included among the steps taken in order to set up the risk-management infrastructure of organizations which participate regularly and successfully in futures exchanges. It is usually implemented in one of two ways. In some cases specific portions of the seminars or courses included in technical-assistance packages are tailored to the needs of management levels. In other cases, this task is performed by those members of a firm who already have such training.

Both approaches have been successful in achieving the necessary degree of participation by executive levels in the planning of risk-management strategies. These experiences therefore speak for themselves, and no further comments in this connection are necessary except for a few commonsense observations. Firstly, it should be noted that this type of activity may be essential in order for all the other training activities to produce the desired results. Secondly, it follows from the above that the sooner such training is carried out, the less difficult it will be to achieve those objectives. Finally, in deciding when and how to conduct such training, the fact should be borne in mind that for the executive levels of an enterprise, the generation of confidence is of paramount importance.

C. ADVISORY ASSISTANCE

Advisory activities in this field have traditionally been provided by the brokerage firms. As mentioned earlier, in many cases such services are furnished as part of a package which also includes training components. Once the working teams and infrastructure for exchange operations are in place, these firms usually go on to provide other services, such as the supply of market information and analyses and refresher courses or presentations to bring staff members up to date on new instruments and operational procedures as they are developed.

The client-broker relationship created in the course of initial training and consulting activities is quite flexible. Although the brokerage houses are primarily interested in increasing their clientele, these services are usually paid for, and in some cases it is explicitly stated that they do not imply any subsequent obligation. Furthermore, the larger and more established users generally operate through several different brokerage houses (from two to four, as a rule), and the brokerage firm which has provided the initial technical assistance may not necessarily be one of them.

Nonetheless, the available information indicates that as a result of the relationship formed in the course of these initial activities, the firms which conduct them are usually then retained as brokers. The reason for this appears to be not only that the client has gained confidence in the firm, but also that the firm has come to have confidence in the client, which may make it more inclined to provide the client with margin financing later on.

Some new developments with respect to advisory activities should be mentioned at this point. The widest-ranging of these are the activities being carried out by the World Bank, which may or may not be combined with training. The Bank began its advisory activities in the area of financial risk management in one country of the region and has since included several others among the 10 or 15 recipient developing countries. These activities deal with the management of liabilities, but the knowledge and information obtained by this means has proved useful for the management of assets (reserves) as well.

As mentioned earlier, the World Bank's advisory activities in the area of commodity risk management were initiated more recently, but seven countries, three of which are in Latin America, are already participating in this initiative. What perhaps makes this development particularly interesting is that these activities deal with a broader and longer-term form of management than its advisory activities traditionally have. In two of those countries these activities cover hedges on imports rather than solely on exports, and in all cases they concern medium-term risk management instruments that are not traded on the exchanges.

A more limited and less structured but nonetheless noteworthy phenomenon which could be described as a form of horizontal co-operation is the spontaneous initiation of transfers of technical expertise among regional bodies through training/advisory activities or simply by means of direct communication. The known cases of such transfers have arisen out of important advances achieved by the experts of one country and their willingness to share their experience with experts in another. Such transfers have taken place between firms that trade on commodity exchanges, between government bodies concerned with financial affairs and between the staff of local exchanges in different countries.9/

Contacts among participants in exercises in horizontal co-operation have been established on a casual basis, and the information so transferred has been relatively unstructured. It is interesting to note that members of United States brokerage houses have acted as intermediaries for some transfers of this type.

Finally, staff members of the exchanges have also provided advisory services. Their advisory assistance with respect to exchange operations has played a particularly important role in connection with the modification of legislation and of the controls maintained by government authorities and central banks. The very willing collaboration provided in this area by the relevant authorities in the United States, and especially the Commodities Futures Trading Commission (CFTC), has also been especially valuable.

A number of suggestions concerning advisory assistance may be formulated on the basis of the above considerations. Firstly, by its very nature this type of activity is of a longer-term, more continuous nature than training, and mechanisms should therefore be designed to ensure that advisors will be accessible on an ongoing basis, in contrast to the sporadic or one-time contacts usually required in the case of training.

Secondly, due to the cost, requirements in terms of credibility, and importance of information transfers, these horizontal co-operation activities should be strengthened, broadened and provided with a more permanent structure. This applies both to what might be regarded as multilateral activities (in which international bodies take part) and to bilateral activities (carried out by organizations in different countries), and even to those conducted by institutions within the same country.

The third suggestion refers to the need to expand the substantive content of advisory assistance and to increase its level of detail. This type of assistance should be made more comprehensive in at least two senses. Firstly, it should be aimed at generating an independent capability to formulate integral risk management strategies, rather than being confined to assistance at specific points in time concerning the right moment to "get in" or "get out" of a market. It follows from the above that, when the situation so warrants, advisory assistance should cover instruments (both within and outside the framework of the exchanges), operations and markets which can be used for purposes of financial and import-related risk management, rather than focusing solely on the use of the exchanges for managing the risk associated with a given export.

The other sphere in which the content of advisory activities needs to be more exhaustive is that of the modification of controls and legislation, information systems, market analysis and information, and background information on traders, including brokerage firms.

To this end, advisory packages should be developed whose coverage extends beyond the areas in which brokerage houses customarily specialize, although this does not mean that they would be excluded from taking part in such efforts. However, participants in these activities should also include scholars and technical experts, personnel on the staff of the exchanges, employees of government supervisory agencies, and any other individuals whose expertise might be called for in specific instances.

Multilateral organizations are particularly well suited to the task of putting together such packages, whether or not they include training activities, by virtue of their knowledge of and access to the countries and sources of advisory assistance and the confidence and credibility enjoyed by these bodies, which by definition are non-profit organizations. As discussed earlier, the work being done by the World Bank could well come to represent a pioneering effort in this direction.

VI. CONCLUDING REMARKS AND POSSIBLE LINES OF ACTION

Although the subject of access to the exchanges and their possible usefulness in stabilizing the incomes of the countries of the region encompasses a range of elements, situations and motivations, all the aspects of the subject discussed here involve areas in which technical assistance is clearly needed. In this section, some possible approaches in this regard will be suggested.

In the preceding sections, specific needs for assistance in achieving the following objectives were identified:

— To modify the relevant regulations, requirements and legislation in order to streamline the foreign exchange flows needed in order to cover margins;

— To set up local exchanges, operate in them, and regulate their operations;

— To foster an increased awareness of the role of futures exchanges in marketing and risk-management strategies;

— To train the technical staff in charge of operations, the personnel entrusted with the task of designing comprehensive strategies, and the executives responsible for approving them;

— To provide advisory services in the above areas and in the field of market information and analysis.

The content of these technical assistance tasks has already been outlined in previous sections, and the following discussion will therefore be devoted to the proposal of certain lines along which action might be taken in order to carry them out.

First, however, it should be noted that staff members of the futures exchanges and of their association, of brokerage houses and of user institutions have expressly informed at least three of the organizations working in this field (UNCTAD, the World Bank and ECLAC) of their willingness to co-operate in such initiatives as general or specific consciousness-raising activities, training efforts and advisory services co-ordinated or promoted by international agencies.

This having been said, a first line of action could be the formation of national or subregional groups to promote, organize and perform the above-mentioned technical assistance activities. These groups should have the sponsorship of prestigious organizations within their own economic/financial community and should be able to draw upon the active collaboration of professionals having substantial experience in the use of the exchanges for purposes of risk management. Sponsoring organizations could be private or State-run financial or sectoral firms, associations, foundations or technical centres. The only requirement should be that the sponsoring organizations be widely enough known and have the necessary stature to enable them to mobilize all the relevant target groups.

It would be the task of these national or subregional groups to establish and maintain the necessary relationships with other similar groups, the exchanges and their associations, brokerage firms, international organizations and experts that can support or collaborate in their activities.

There is no need to elaborate here upon the benefits that would be obtained if these national groups were to form a network of contacts among themselves. The establishment of such a network would, of course, entail the co-ordination and facilitation of transfers, and this task constitutes the second suggested line of action. The body taking responsibility for this task would need to be informed about the advances, obstacles and general situation with respect to participation in the futures exchanges in the different countries. The co-ordinating agency would also need to have information about the availability of technical assistance and about the characteristics of the sources of such assistance, and would therefore require their collaboration.

On the basis of such information, the co-ordinating agency would be able to identify specific needs for technical assistance, determine the most appropriate way to meet those needs, and ascertain which sources, either within or outside the region, would be most suitable to contact for that purpose.

The third proposed line of action is the intensification of transfers through this co-ordinated network in order to make it possible for such groups to share information on substantive aspects of the subject. Within the framework of what may be described as a more independent and more highly developed form of horizontal co-operation, these transfers, as in the case of advisory assistance activities, could involve: modes of operation and instruments, information systems, market analysis and information, and background information on service providers. The benefits to be derived from this initiative should not be undermined by concern about there being any cost associated with the sharing of information among competitors, since such transfers should not include information on either the type or value of operations.

In any event, any initial doubts on that score ought to be dispelled once the benefits of facilitating exchange operations through the establishment of reliable information flows become apparent. The efficiency and success of exchange operations --and, hence, the scope and continuance of participation in the exchanges-- may well hinge on this factor.

Notes

1/ The reports in question are those prepared by Messrs. Regúnaga (1990a and b), López Huebe (1990), Bande and Mardones (1990), and ECLAC (1990) which are listed in the bibliography.

2/ For a full discussion of this mechanism, see ECLAC (1990).

3/ This topic is discussed in detail in Regúnaga (1990a).

4/ The regulations of the recently opened "dollar bill" grain exchange in Buenos Aires expressly states that any modification of the existing foreign-exchange regulations will immediately lead to the settlement of all positions.

5/ See the studies by Regúnaga (1990), López Huebe (1990), Bande and Mardones (1990), and ECLAC (1990) cited earlier.

6/ A recent IMF study states that "Recent experience ... has shown that potentially large trading losses are possible if internal controls are inadequate". IMF, Managing Financial Risks in Indebted Developing Countries.

7/ PANCAFE was an experiment in price maintenance via the exchanges carried out by Latin American coffee-producing countries; in the case of CRAV, a broad-based speculative operation appears to have been involved; the term "Brazilian hedge" refers to a form of "reverse hedging" which is actually a type of speculation.

8/ One association which conducts such activities is the Futures Industry Association of the United States.

9/ In the first two cases Chile was the source of the transfer and Bolivia and Argentina were the recipients. In the last case, Brazil was the source and Chile the recipient. Although no detailed information is available on the topic, given the interest shown by GEPLACEA in the utilization of the sugar exchange and in view of the contacts made among its members in the course of its activities, it is likely that horizontal technical co-operation activities are also taking place within that framework.

ANNEXES

INFORMATION SOURCES

I. INTERVIEWS

A. INTERNATIONAL ORGANIZATIONS

ARIAS, HERNANDO, Vice President for Official Agencies (Vice-Presidente de Organismos Oficiales), Latin American Bank for Exports.

CABRERA, WALTER, ECLAC office in Washington, participant in the Second Advanced Seminar on International Sugar Marketing organized by GEPLACEA.

CLAESSENS, STIJN, Chief, Risk Management Unit, International Commodity Markets Division, World Bank.

FAROOQ, JANET, Commodities Division, UNCTAD.

LASA, EUGENIA, Department of Official Agencies, Latin American Bank for Exports.

TUNIK, DAVID, Office for Latin America and the Caribbean, Technical Co-operation Division, UNCTAD/GATT International Trade Centre.

VARELA, ANA GRACIELA, Economic Analyst, Department of Official Agencies, Latin American Bank for Exports.

B. GOVERNMENTAL ORGANIZATIONS

GARCES, FRANCISCO, Director, International Department, Central Bank of Chile.

LOPEZ, GUSTAVO MARIA, Director of Economic Research, Junta Nacional de Granos (National Grain Board), Argentina.

LOPEZ, NORA DE, External Sales Department, Consejo Salvadoreño del Café (Salvadoran Coffee Council).

PINEDA, RUBEN, Executive Director, Consejo Salvadoreño del Café.

C. USER ORGANIZATIONS

BATRES, CARLOS, Representative, General Foods, Inc., San Salvador.

CACERES, EDUARDO, Consultant, Exportadora de Café J.A. Salaverría y Cía., San Salvador.

CASTELLANOS, RAFAEL, Representative, Amerop Sugar Corporation and Westway Mercuria Trading Corporation, San Salvador.

DAVILA, JUAN PABLO, Chief, Futures Department, Corporación Nacional del Cobre de Chile (National Copper Corporation of Chile), Santiago.

DELGADO, ROBERTO, General Manager, Exportadora de Café Llach S.A. de C.V., San Salvador.

GIAMBRUNI, FERNANDO, Chief, Interest Rates and Exchange Parities Desk, Department of Risk Management, Banco de la Nación Argentina.

GONZALES, EDUARDO, Chief, Grain and Oilseeds Desk, Department of Risk Management, Banco de la Nación Argentina.

LINDO, ARTURO, Trader, Coffee International, Inc., Miami.

MIRO, DANIEL, Economic Advisor, Cámara de la Industria Aceitera de la República Argentina.

ORREGO, PATRICIO, Chief, Futures Markets Department, Empresa Nacional de Minería (National Mining Corporation), Santiago.

SORCABURU, EUGENIO, Advisor to the Board of Directors and Co-ordinator of the project for the organization of a department of risk management, Banco de la Nación Argentina.

D. EXCHANGES

BOWE, ROBERT J., Senior Vice-President, Coffee, Sugar and Cocoa Exchange, Inc., New York.

BURKE, LOUIS, Marketing Executive, New York Mercantile Exchange.

DAVIES, ROBERT R., Senior Vice-President, New York Mercantile Exchange.

DENGARD, JOHN, Executive Director, Futures Industry Association, Washington, D.C.

ETCHEPARE, CARLOS R., Director of Economic Research, Buenos Aires Grain Exchange.

O'NEILLY, JOSEPH H., Chairman, New York Cotton Exchange.

PONTON, ROGELIO T., Manager, Forward Market, Bolsa de Comercio de Rosario.

TOSINI, PAULA A., Vice-President, Futures Industry Institute, Washington, D.C.

E. BROKERAGE FIRMS

CHAVEZ, HORACIO, Account Executive, Latin American Futures Department, Dean Witter Reynolds, Inc., New York.

MARTINI, HUGO, Representative, Regency, S.A., Buenos Aires.

PALMA, JOSE GABRIEL, Managing Director, Futuros S.A., Santiago.

PEREZ, ROLANDO A., First Vice-President, Latin American Futures Department, Dean Witter Reynolds, Inc., New York.

WOLFSKILL, TONY, Agricultural/Energy Product Manager, Merril Lynch, New York.

II. INSTRUCTIONAL MATERIAL */

Bolsa de Cereales de Buenos Aires.

Coffee, Sugar and Cocoa Exchange, Inc. of New York.

Dean Witter Reynolds, Inc.

Futures Industry Institute.

Merril Lynch, Inc.

New York Cotton Exchange.

New York Mercantile Exchange.

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*/ Instructional materials and explanatory or promotional pamphlets prepared by the above organizations are included.

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