to reduce the sales of products of industrial countries. Less developed countries transmit fluctuations in their export earnings to industrial countries when a fall in earnings forces a contraction of imports. Less developed countries are important buyers of capital equipment, the demand for which is characteristically unstable in industrial countries. Even small changes in levels of output of equipment industries may be an important destabilizing influence in industrial countries.

Fluctuating prices and volumes of primary products moving into industrial countries also increase industrial production costs. Even though raw materials may represent only a small fraction of the cost of the final product, instability of raw material prices sometimes makes necessary price changes in the final product or the absorption of short-run profits and losses, thereby increasing risks. Thus, the costs associated with instability of primary commodities are borne both by the less developed and the industrial countries.

B. CAUSES OF COMMODITY INSTABILITY

The most important cause of instability of exchange earnings of the less developed countries is to be found in their heavy dependence upon a relatively few export products. Most of the less developed countries depend for 70 to 80 percent of export earnings upon two or three primary products. In some cases this dependence is as high as 90 percent or more as in the case of Chile's dependence on copper and nitrates and Colombia's dependence on coffee.[3] This dependence is not immutable and an important objective of economic development should be to broaden the export base as well as reduce relative dependence upon exports generally. Aside from this overall cause, we may identify three factors contributing to market instability of primary commodities; namely, (1) natural forces, (2) market structure, and (3) economic instability in industrial countries.

1. Natural causes

Weather and climate are the most easily identifiable natural factors. In one year a flood or drought may cut the harvest substantially and lead to a decline in volume. The next year a bumper crop, a result of plenty of rain and sunshine, can have a ruinous effect upon prices and export earnings. Plant diseases, storms, earthquakes, and other natural disasters also influence the market supply substantially.

Limited evidence suggests that instability resulting from natural causes is tending to decline. Insecticides and fungicides have been helpful in eliminating some crop diseases. Most crops are now produced in nearly every part of the world so that a natural disaster in the only producing area is no longer likely. Stocks are increasingly being employed for all products to offset fluctuations of this nature. Still, natural causes exercise a significant effect on volume and indirectly on price.

2. Market structure

Much of the instability in commodity trade is attributable to the world market structure of primary commodities. Both the supply and demand relationships to price tend to be highly inelastic in the short run. Consider the relation of price to quantity demanded for

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[3] The data can be found in issues of International Financial Statistics, and in International Trade, 1959, General Agreement on Tariffs and Trade, Geneva, 1960, appendix tables.