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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The CIPEC Countries And The Free World Copper Market

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April 1970

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
April 1970

INTELLIGENCE MEMORANDUM

The CIPEC Countries And The Free World Copper Market

Introduction

Contrary to repeated forecasts of a weakening world copper market, prices have remained very high. On the supply side, this condition partly reflects delays in foreign-financed expansion projects in Chile, Zambia, Congo (Kinshasa), and Peru. These four developing countries dominate world copper exports, accounting for 70% to 80% of the total during the 1960s. In recent years, they have adopted increasingly nationalistic policies and have arranged for cooperative action through the Intergovernmental Council of Copper Exporting Countries (CIPEC) -- actions that promise to have a further impact on world copper supplies. This memorandum examines CIPEC copper policies in the 1960s, their impact on world copper supply and prices, and their probable evolution and effects during the next several years.

Background

1. The world copper market has three fairly distinct parts: the United States, the rest of the Free World, and the Communist countries. The United States accounts for about 30% of Free World mine output and 35% to 40% of Free World copper consumption. Domestic output meets about 90% of US requirements except during abnormal periods like 1967-68, when strike disruptions brought a marked rise in imports despite increased use of domestic scrap and inventory reduction. Most other Free World copper is consumed in Western Europe and Japan, which

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

together account for only about 6% of Free World mine output. Developing countries in Latin America and Africa (mainly Chile, Peru, Zambia, and the Congo) produce about two-thirds of the Free World copper mined outside the United States but use only negligible amounts themselves. Copper output in Communist countries is somewhat less than one-fourth of the Free World total. Traditionally, there has been relatively little copper trade between the two areas, but in recent years sharply increased Chinese purchases have added to pressure on Free World supplies and prices.

2. Before the recent government takeovers in the Congo, Chile, and Zambia, the Free World copper industry was dominated by an oligopoly of large private companies, mostly US-owned but representing British, Belgian, South African, Australian, and Canadian interests as well. In the United States, about 60% of mine output is from three vertically integrated companies (Kennecott, Phelps Dodge, and Anaconda) and some 90% of refining capacity is controlled by these companies plus American Smelting and Refining and American Metal Climax. These five firms also have substantial interests abroad. Until nationalization, US firms controlled 85% of Chile's mining capacity and owned most of one of Zambia's two important companies. South African and British interests controlled the other Zambian company, and a Belgian corporation owned the Congolese mines. US companies still dominate Peru's copper industry and, together with West European and increasingly active Japanese companies, hold large interests in the Philippines, Bougainville, Australia, Canada, and South Africa.

3. The copper industry historically has had great difficulty adjusting supply to demand. Because of the long leadtime required for new mines, the frequently large individual additions to capacity, and the tendency of producers to start expansion programs at about the same time, capacity usually has grown in spurts -- oftentimes after demand already had peaked. Although demand has grown fairly steadily and prices have trended upward during much of the postwar period, periodic surpluses nevertheless have prompted efforts to shore up prices. As recently as the early 1960s, there was an extended period of market weakness that compelled sizable production cutbacks and direct market intervention by producers in an effort to

maintain prices close to the desired 30 cents a pound.

4. Copper demand began to surge ahead of supply in 1964 because of the Vietnam War and worldwide economic boom. Pressure on supplies weakened with the onset of the US and West European slowdowns in late 1966, but a tendency toward lower prices was reversed by the US industry-wide strike, which lasted from July 1967 to April 1968. Subsequent recovery of economic growth in industrial countries as well as continued heavy war requirements has kept demand strong. There were also supply pressures from speculative demands associated with Western monetary crises and from net Communist purchases, which increased from about 30,000 tons* in 1967 to 150,000 tons in 1968 and 215,000 tons in 1969.

5. Capacity limitations, strikes, natural disasters, and political difficulties all have adversely affected supply since the mid-1960s. Free World mine output rose about 3½% annually during 1964-66, when mines operated at an average of 94% of capacity, but the US copper strike caused a 7% decline in 1967 output. Free World mine output regained the 1966 level in 1968 and rose by 9% in 1969, re-establishing the basic growth trend of the mid-1960s (see Figure 1). For the entire 1964-69 period, annual growth in mine output averaged only about 3½% while consumption increased almost 5% annually. To help meet demand, greater use was made of scrap (about one-fifth of consumption in recent years), and inventories at every level were depleted. Moreover, during 1964-67 the US government released some 850,000 tons from its copper stockpile, which has subsequently remained at only one-third of its quota.

6. The Free World has had a two-tiered price system since January 1964 because US producers and, for a time, major foreign producers maintained comparatively low, controlled prices. Heartened by their success in stabilizing prices in the face of slack demand in the early 1960s, the foreign producers adopted US-type producer pricing in January 1964 in place of prices based on London Metal Exchange (LME) quotations. Their system, designed to promote

* *Tonnages are given in short tons throughout this memorandum.*

price stability, lasted about two years. During this time the LME price climbed from 30 to 85 cents while major foreign producers raised their price only from 30 to 42 cents. The producing countries had accepted the arrangement because the initial surge in the LME price was considered temporary and accelerated substitution of other materials was feared. By March 1966, however, it had become clear that the heavy demand and higher prices were more than transitory, and the Chilean government directed companies operating there to raise their prices by 20 cents a pound. During the next few months, African and Canadian producers also abandoned the producer price system, and by August all major producers except the United States again were selling at the LME price.

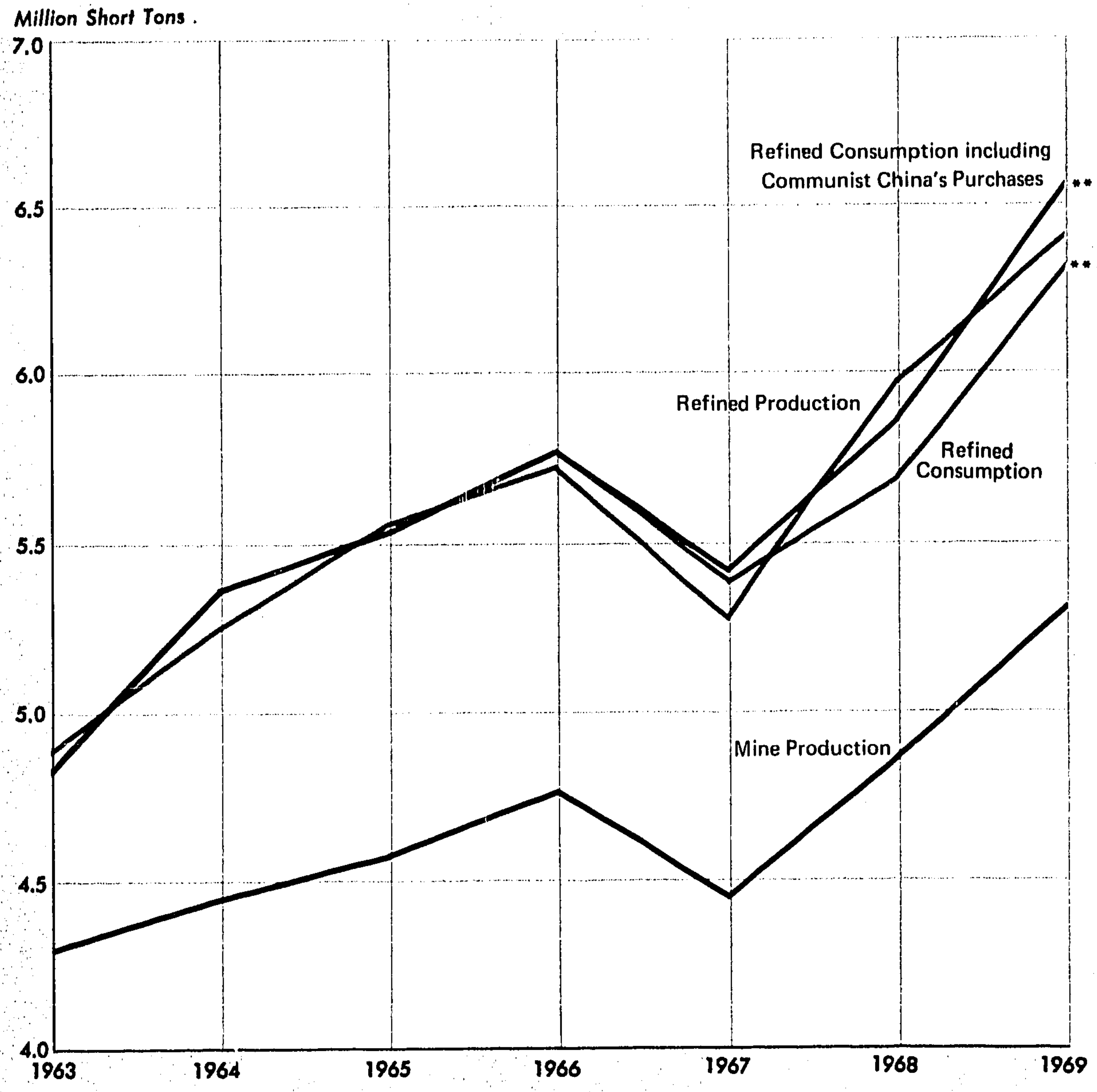
7. Although most foreign copper sales are made under long-term contracts, the main price determinant is the LME cash quotation on the day of delivery. Because the LME actually handles only a small part of Free World copper trade and is used for hedging, day-to-day price fluctuations often are sharp. Despite wide price fluctuations, foreign producers greatly increased their earnings by returning to LME pricing. Since March 1966, LME prices have averaged 60 cents, compared with an average US producer price of 42 cents. After dipping from an average of 69 cents in 1966 to 51 cents in 1967, the LME price almost regained the earlier peak in 1969 and has averaged more than 75 cents thus far in 1970 (see Figure 2). The US producer price was raised only twice during 1966-68, from 36 to 42 cents. Five major price hikes in one year boosted the price to 56 cents by January 1970, but the spread from the LME price remained wide. When US producers raised their price to 60 cents in early April 1970, the LME price stood at about 80 cents.

Politics and Policies in CIPEC Countries

8. Sluggish capacity growth in the countries now comprising CIPEC has contributed to the copper shortages of the past six years. This lag was not caused by lack of copper resources but by political instability and increasingly nationalistic policies. The countries' aim has been to profit more from their mineral wealth. In general, they have succeeded. Even moves that discouraged foreign mining companies from expanding have brought rewards, by

Figure 1

Free World Copper Production and Consumption*



*Differences between refined copper production and mine production represent mainly production from scrap. Differences between refined copper production and consumption reflect inventory changes for producers and traders, but not fabricators. Consumption includes copper refined from both primary and secondary materials but excludes direct use of scrap.

** Estimated

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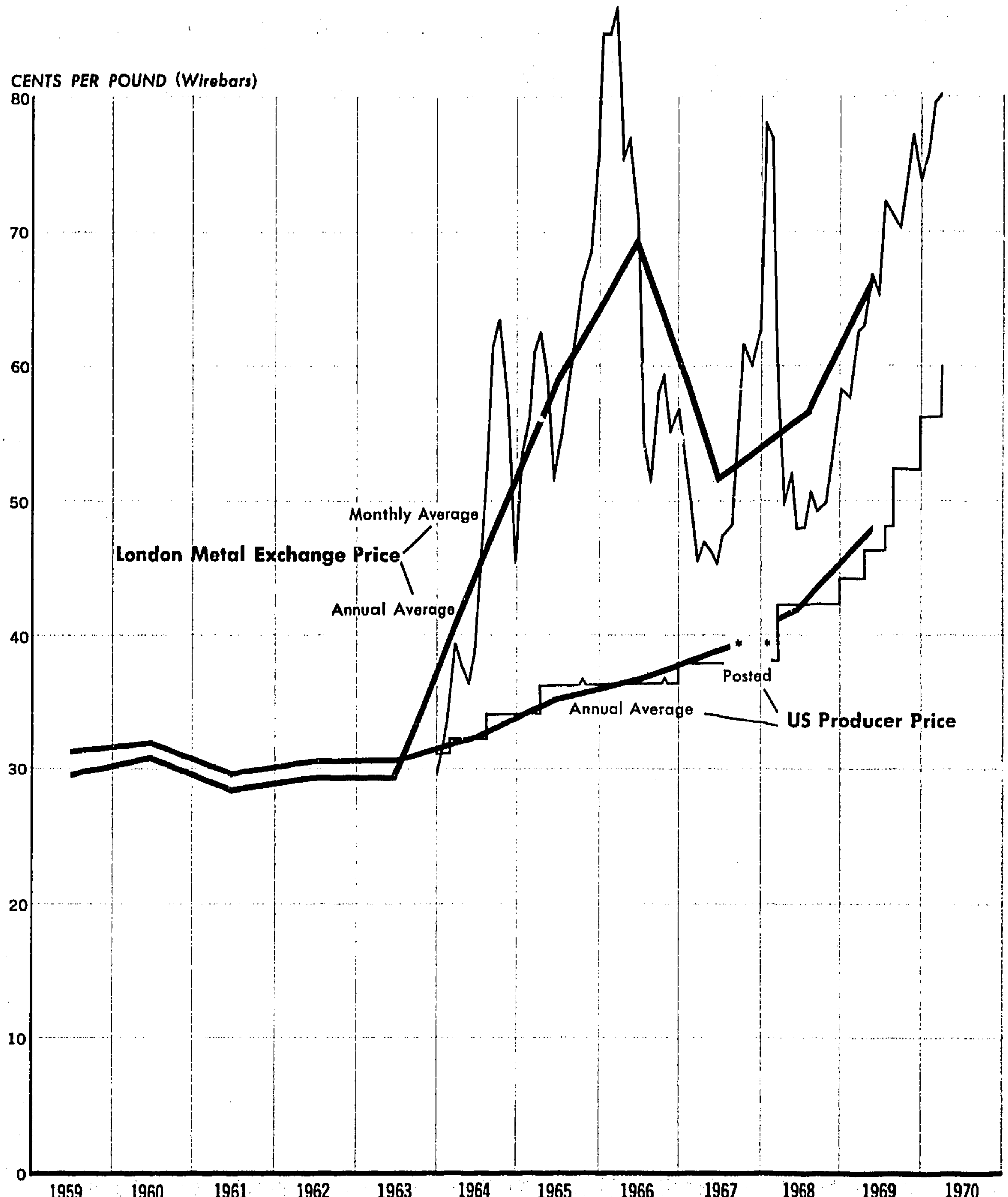
Copper Prices

Figure 2



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* No posted price during strike.

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contributing to the world copper shortage and the consequent record rise in prices.

9. Prior to the mid-1960s, the producing countries relied primarily on tax and foreign exchange policies to obtain a satisfactory share of copper revenues. These policies varied considerably among the four countries in nature and timing. In Chile, for example, confiscatory policies nearly bankrupted the foreign-owned copper companies in the early 1950s and reduced the country's share of world production. A more favorable mining code brought substantial additions to capacity in the late 1950s, but the investment climate worsened in the early 1960s when political attacks on the companies resumed. As tensions grew, it became apparent that further major expansion would have to await the outcome of the 1964 election. In Peru, in contrast, copper development has become an important issue only recently. Peru generally has accorded foreign copper companies more generous financial treatment than has Chile, probably because nationalistic hostility focused on the recently expropriated International Petroleum Company (IPC). In the Congo and Zambia, concern about relations with the foreign-owned copper industry was overshadowed until a few years ago by problems attending independence. Nevertheless, political uncertainty and popular opposition to the foreign mining companies delayed new investment in copper development.

Nationalization Moves

10. The shift in policy emphasis from profit-sharing to government ownership began with the "Chileanization" program that Frei proposed in the 1964 presidential campaign as an alternative to the Marxist candidate's nationalization scheme. The program and implementing agreements with foreign companies called for partial government ownership*

* *Under the copper agreements, the Chilean government acquired a 51% interest in Kennecott's mine and a 25% interest in two new mines being developed by Anaconda and Cerro Corporation. In order to retain full ownership of its two operating mines (which accounted for some 70% of its copper production and profits), Anaconda agreed to much larger investments and lesser tax benefits than did Kennecott.* 25X1

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and large new company investments in exchange for reduced and nondiscriminatory tax rates. The agreements, formally approved in 1967 after a long delay in the Chilean Congress, were to last 20 years. Encouraged by this government guarantee, the US copper companies readily agreed to participate in a $750 million program to almost double Chile's copper output by 1972. Despite rapid progress under the investment program and high Chilean earnings, political pressures for nationalization grew and the Frei government broke the copper agreements in mid-1969. Anaconda was forced to turn over a 51% equity in its two producing mines and agreed to sell the remainder sometime during 1972-81. In addition, Anaconda's and Kennecott's profits have been subjected to higher, progressive tax rates whenever copper prices exceed 40 cents a pound.

11. The Congo is the only CIPEC country that already has wholly nationalized a foreign copper enterprise. The government acquired an 18% equity-interest in the Belgian concern Union Miniere du Haut Katanga (UMHK) -- the sole producer -- in 1960, when the Congo won independence, and it assumed full control of the properties in 1967.* Under a 25-year management contract signed when compensation was finally arranged in September 1969, a UMHK affiliate that has operated the mines since their nationalization will receive 6% of sales revenue less marketing expenses during the next 15 years and a 1% fee thereafter. The extra initial fee in effect represents compensation to UMHK and could yield between $300 million and $500 million. The only foreign firm to invest in Congolese copper since seizure of UMHK's properties is the Nippon Mining Company. In its quest to secure long-term copper supplies, the Japanese firm has formed a joint company with the Congolese government (which has a 15% interest) and plans to invest some $40 million by 1972 to exploit its two concessions.

12. The Zambian government did not seek ownership rights in the copper industry until 1969, although it began to pressure the companies for higher taxes much earlier and in 1968 restricted foreign exchange remittances to 50% of net profits.

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In a surprise move on 11 August, President Kaunda "invited" the foreign mining firms to offer the government 51% interests. The two companies involved are Roan Selection Trust (RST) -- 80% to 85% owned by American Metals Climax and other US shareholders -- and Zambian Anglo-American Corporation (Zamanglo) -- mostly South African and British owned.* Together, they produce 98% of Zambian copper. In November the three parties agreed "in principle" on compensation based on book value, the companies received 10-year management contracts, and the foreign exchange restriction was lifted. Two recent policy changes may lure other copper companies to Zambia, depending on their reading of the future investment climate. All mineral concessions, originally held in perpetuity by RST and Zamanglo, have reverted to the state. The government has given the companies 25-year leases only for their operating mines and thus can offer concessions to other investors. Perhaps equally important is the shift to taxation based on profits rather than gross sales value -- a system that could encourage development of poorer ore bodies.

13. Peru's government has not nationalized any copper enterprises, but it decreed in September 1969 that all undeveloped concessions issued before June 1965 would revert to the state unless their holders submitted development plans by 31 December and adhered to them. Development of all the concessions would cost well in excess of $1 billion and more than triple Peru's copper output. All foreign mining companies submitted the required plans despite an investment atmosphere chilled by the uncompensated expropriation of IPC, a sweeping agrarian reform, and the Velasco government's continuing "revolutionary" image. In January the Southern Peru Copper Company (SPCC), which produces two-thirds of Peru's copper, negotiated a seemingly favorable contract for developing its large Cuajone concession and is seeking project financing in Japan and Western Europe as well as in the United States. To meet opposition from radical elements that viewed the SPCC contract as a sellout, however, Velasco promised that all other contracts would involve tougher terms, possibly including state participation. His recent speech

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advocating nationalization of all foreign investment after an "acceptable amount" of profit recovery will make foreign financing of major projects more difficult.

Creation of CIPEC

14. Recognizing a common dependence on copper revenues, representatives of Chile, Zambia, the Congo, and Peru met in Lusaka in 1967 to consider what could be done to safeguard market "equilibrium." They agreed to establish CIPEC, with a permanent headquarters and staff in Paris, a governing board of two representatives from each country that meets semiannually, and a top policy-making body -- the Conference of Mining Ministers -- that meets biannually. CIPEC's basic objective is obtaining "legitimate increased revenues" for its members. Efforts thus far have involved primarily in-depth market studies, exchange of information, and consultation on copper policies.

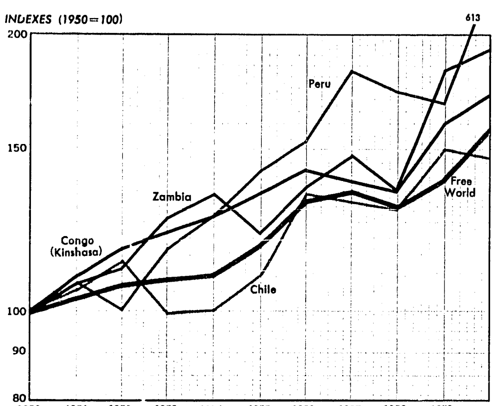
15. The CIPEC countries undoubtedly would like to prevent a major price decline from recent high levels. They have been considering various price stabilization schemes, including formation of a "copper bank" (preferably with help from international financial organizations), simple quadripartite price-fixing, and, if necessary, production or sales cutbacks. At the same time, CIPEC members have opposed consultations between producer and consumer nations, presumably preferring to first test their ability to sustain high copper prices. Although the tight market has made CIPEC intervention unnecessary thus far, its potential has caused much concern among copper consumers.

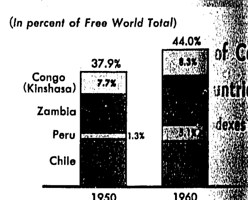
Trends in Copper Supply and Investment Patterns

16. Free World mine output grew an average of only a little more than 3% annually during 1961-69, as against somewhat more than 4½% during 1951-60. In the earlier period, CIPEC countries helped to boost the growth rate by expanding output at an average of about 6½% annually, while in the later period their 2½% expansion rate helped to drag it down (see Figure 3). By 1969 their share of Free World output had slipped to 41%, compared with 44% in 1960. Although they lost part of their market to other producers in the 1960s, the CIPEC countries still accounted for 70% of the shipments of net

Figure 3

Growth of Copper Mine Production
CIPEC Countries and Free World Total
Indexes of Copper Content





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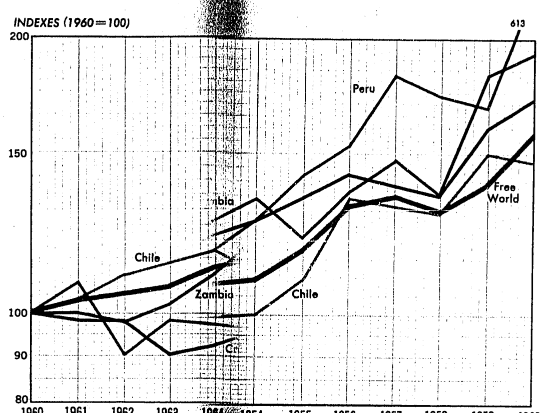

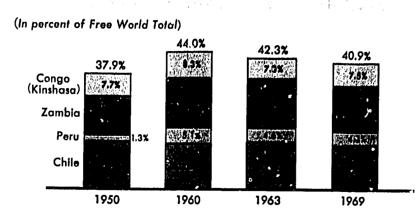

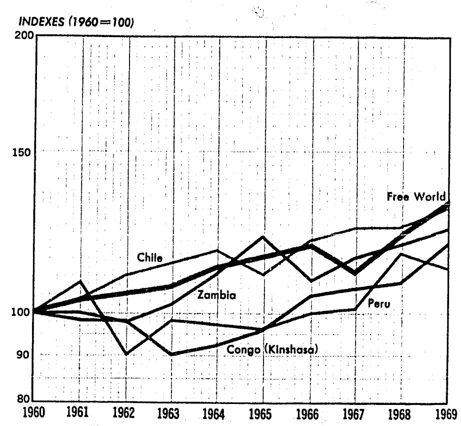

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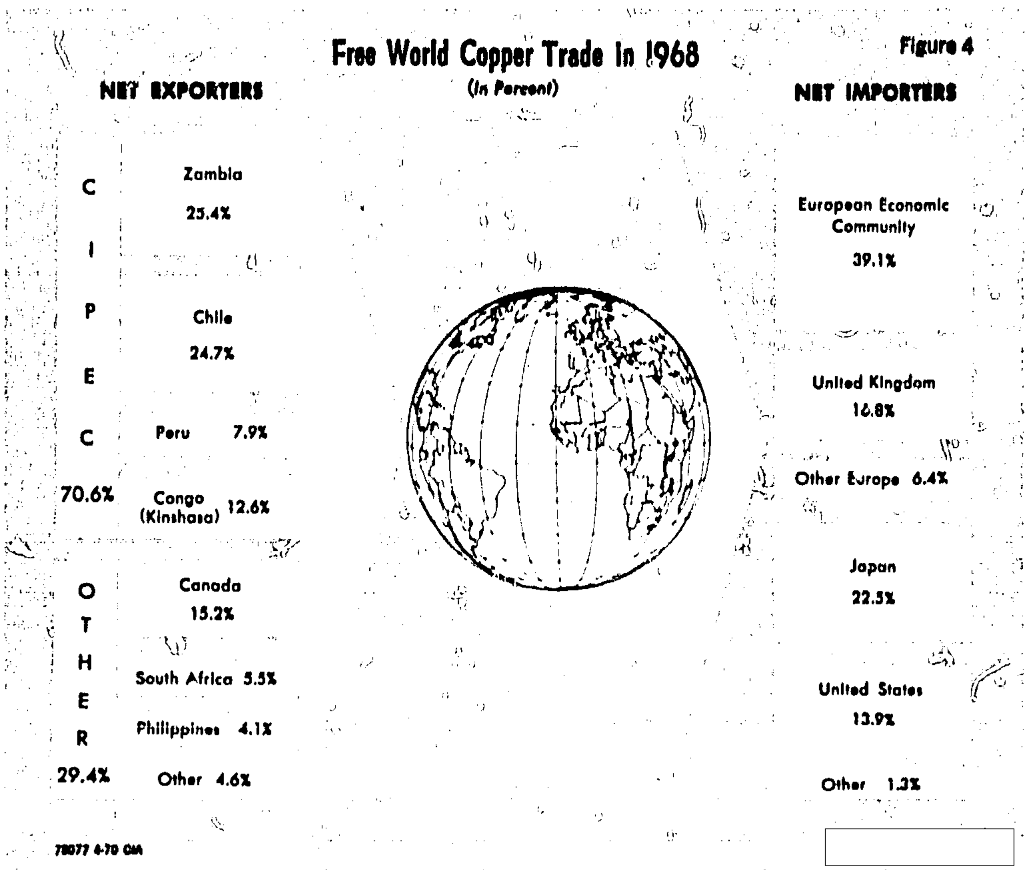
exporting nations in 1968 (see Figure 4). The remainder came largely from Canada (15% of the total), South Africa (5%), and the Philippines (4%). CIPEC countries remain especially important in supplying Western Europe -- the main importing area -- and are meeting more and more of Japan's growing needs. Even the United States, the world's largest copper producer, depends largely on CIPEC countries for its imports.



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17. Free World copper mine capacity is expected to increase fairly rapidly during 1970-73. Scheduled projects would increase CIPEC countries' capacity by about 29% and that of other producers by almost 40% (see the table). As a result, the CIPEC countries' share of Free World capacity is expected to decline further, from 40% to 38%. Chile will account for nearly all the rise in capacity and should again become the group's largest producer this year or next. Only minor projects are under way in Zambia, Peru, and the Congo, and major new projects could not produce as early as 1973 because of the long leadtime required.

Estimated Changes in Free World Copper Mining Capacity
1970-73

	Annual Production Capacity (Thousand Short Tons, Copper Content)			Percent of Total Capacity	
	Estimated End of 1969	Scheduled Additions During 1970-73	Scheduled End of 1973	Estimated End of 1969	Scheduled End of 1973
CIPEC countries	2,305	670	2,975	39½	37½
Zambia	825	100	925	14	11½
Chile	830	470	1,300	14	16½
Congo (Kinshasa)	400	55	455	7	6
Peru	250	45	295	4½	3½
Other countries	3,525	1,405	4,930	60½	62½
United States	1,775	460	2,235	30½	28½
Canada	710	210	920	12	11½
Mexico	80	100	180	1½	2½
Japan	135	20	155	2½	2
Philippines	135	115	250	2½	3
Australia	150	35	185	2½	2½
South Africa and South West Africa	175	35	210	3	2½
Indonesia	Negl.	80	80	Negl.	1
Bougainville	Negl.	200	200	Negl.	2½
Europe	220	50	270	3½	3½
Other	145	100	245	2½	3
Total	*5,830*	*2,075*	*7,905*	*100*	*100*

18. Although CIPEC countries possess the major share of known copper reserves, including many of the richest deposits, political uncertainties have continued to delay their development. These uncertainties, together with mining innovations and high prices, have stimulated investment in copper deposits elsewhere, including some previously considered uneconomic. For example, US mine capacity is expected to rise by almost one-fourth during 1970-73, with much of the increase stemming from exploitation of low-grade ores.*

19. CIPEC countries' copper exports could increase by some 500,000 tons (or more than 25%) during 1970-73, if all planned new capacity came in and were fully exploited. The countries' share of total net exports nevertheless would decline somewhat if copper development plans were realized in other exporting areas such as the Philippines, Indonesia, and Bougainville. Although Canada plans to boost capacity by about 30%, its export share may change little because of substantially increased domestic demand. South Africa's share of the world market probably will decrease, since no major expansion projects are under way, and Australia -- although potentially important -- is unlikely to become a large exporter by 1973. Barring exceptional production interruptions, CIPEC nations probably will provide some 65% of Free World exports by 1973, as against 70% in 1968 and 77% as recently as 1965. Chile's share of the market should increase from its present level of 25%, while Zambia, the Congo, and Peru probably will fall below their present shares of 25%, 13%, and 8%, respectively.

20. In the longer run, the CIPEC countries' role as a copper supplier can be expected to deteriorate markedly if investor incentives are not strengthened. Their scheduled average increase in mining capacity during 1970-73 of about 6½% annually (compared with 8½% for other Free World countries) is due almost entirely to Chilean investments under

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way before the recent nationalization moves. No new projects are being considered in Chile. New copper investments in Zambia and the Congo are only beginning to be discussed. Even in Peru, where private foreign companies probably could triple copper output within 5 to 10 years, development is being slowed and may be halted by the unstable investment climate.

21. By the middle and late 1970s, areas now considered comparatively safe from adverse policy changes -- notably Canada, Australia, Botswana, and some Far Eastern areas -- are likely to bulk much larger in world copper trade. Recently discovered copper deposits in certain Latin American and African countries (for example, Argentina) also have aroused the interest of foreign firms. But prospective risks and profits probably will be weighed carefully before large amounts of capital are invested even in these countries.

Prospects for the Free World Market

22. Copper market trends during the next several years cannot be predicted with much confidence, considering that past projections frequently have proved wrong and that many uncertainties lie ahead. Many industry and government estimates now point to market balance by the end of 1970 and increasingly large surplus supplies during the next several years. Underlying these forecasts are such assumptions as the following:

> Mining capacity will rise about as scheduled, with very large additions coming in during the next year or so.
>
> Production will be maintained at near-capacity levels.
>
> Demand growth will slacken over the short term because of the US economic slowdown.
>
> Demand during the next several years will grow at an average rate of not more than 4½% (the average since World War II).

If these assumptions proved valid, supply probably would substantially exceed demand and prices would fall substantially.

23. It does seem reasonable to expect a softening market during the next year or so. But a reasonably strong case can be made that the surplus will not last long and that the market may remain fairly tight over the long term. This view rests on the following assumptions:

As in the past, copper expansion programs will rarely be completed on schedule.

As in the past, production will be disturbed by strikes, natural disasters, technical difficulties, and political factors.

Inventory rebuilding (and perhaps additions to US strategic stockpiles) will offset a good part of reduced industrial demand in the short term.

The growth of consumption during the 1970-73 period as a whole will exceed the long-term norm (as it did in 1964-69 despite very high prices and severe supply bottlenecks) even if Vietnam War requirements continue to decrease gradually.

Under these assumptions, supply would at best merely keep up with the growth of demand during 1970-73 and might fall considerably short of it.

24. Over most of the 1970s, Free World copper demand should remain fairly strong, expanding at a more rapid rate than GNP. The major copper-consuming industries are expected to be among the fastest growing in the 1970s, and new uses for copper are likely to continue developing rapidly. Moreover, because the easiest, most profitable substitutions of other materials already have taken place, copper use probably will not slow much even if prices remain high. Rising consumption in China and in Free World developing countries also could add considerably to demand in the years ahead.

25. Since the CIPEC countries have grown accustomed to high and sharply rising copper revenues, any appreciable weakening of the market would promptly test their price-fixing capabilities. These countries almost certainly want to maintain a considerably higher price than the private copper companies would be satisfied with. Their view of a

"break-even" price is based on short-term budgetary, balance-of-payments, and development needs rather than profit margins. The Chilean government, for example, judges that a 60-cent price is needed to balance its 1970 budget, and this estimate probably will rise as the budget is implemented.

26. The CIPEC countries should have little difficulty in counteracting a moderate, temporary softening of the market if they can agree on what to do. However, if more severe market weakness necessitated large or prolonged production cutbacks, their price support efforts would be very costly and perhaps even less palatable politically than revenue losses from declining prices. Moreover, intergovernmental policy differences (which have been conspicuous in schemes for regulating prices or supplies for oil and other commodities) and CIPEC's lack of marketing experience could reduce the effectiveness of price stabilization maneuvers over both the short and long term. If high copper prices could be sustained, Western Europe and Japan would continue to bear the brunt. US copper prices might not be much affected by CIPEC's actions because domestic producers may well raise output faster than consumption in the early 1970s, thereby further reducing import requirements.

27. The CIPEC countries' most important impact on the world copper market over the next decade may be in restraining growth in production capacity. Because of the CIPEC countries' policies, foreign investors already have become wary of risking large amounts of capital in politically insecure countries, even though their copper resources are generally superior. Concentration on more stable areas such as the United States, Canada, and Australia, while better assuring a reasonable return on investment, probably will entail larger exploration costs, even longer lead-times, and higher production costs. As a result, the task of increasing supply in line with demand growth and affording consumers some relief from high copper prices will be even more difficult than in the past.

28. Because of the deteriorating investment climate in important copper-producing countries, new approaches may have to be used to assure adequate copper supplies over the long run. Private copper companies may, for example, devise fairly

elaborate shared-risk schemes among themselves to lessen the impact of a government takeover or other confiscatory measures. Some companies also are moderating their attitudes concerning joint ventures, in the hope of lessening the likelihood of expropriation. Even so, sufficient private capital may not be forthcoming without more adequate investment insurance and other government guarantees. In particular, copper companies can be expected to push for improved government insurance against forced sell-outs, arbitrary and immediate shifts in tax laws, and other risks not now covered.

Conclusions

29. Political disturbances and rising nationalism in the CIPEC countries have contributed to the tight world copper supply and may impede further development of their copper resources. Political opposition to foreign ownership, unfavorable tax policies, and instability delayed new projects in the early 1960s, and nationalization moves in Chile, the Congo, and Zambia in 1967-69 further dampened the investment climate. Although Peru has not nationalized copper companies, it is pressing them hard to go ahead with major investments, and probably will insist at the least on partial state ownership in new mines.

30. Copper output in the CIPEC countries has responded to some extent to the strong demand generated since 1963 by Vietnam War requirements and generally rapid economic growth in industrial countries. But their copper expansion remained below the Free World average in 1964-69, as in the early 1960s, whereas it was a major contributor to the large rise in Free World output in the 1950s. CIPEC output consequently slipped from 44% of the Free World total in 1960 to 41% in 1969.

31. Because of large additions to Chilean mining capacity initiated under Frei's short-lived copper agreements, CIPEC's position as a world copper supplier will deteriorate only moderately in the next few years Total Free World mining capacity is scheduled to increase substantially, and the tight supply conditions contributing to continued high prices consequently could ease in

the short run. If market weakness threatens, however, CIPEC countries can be expected to test their combined ability to stabilize prices, perhaps at as high a level as 60 to 65 cents a pound. They probably would have little technical difficulty doing so in the face of a temporary and moderate market slump. The economic and political costs of withholding large amounts of copper over a fairly long period, however, would severely strain CIPEC's abilities and could bring about its collapse.

32. Prospects for long-term relief from high copper prices are not particularly favorable. The recent strength of copper demand in the face of high prices probably indicates that further substitution is hindered by technical factors, including production techniques and quality requirements. Private copper producers appear to be less fearful than previously of losing markets to other materials. Furthermore, CIPEC governments can be expected to show far less concern for long-term market expansion than immediate budget and balance-of-payments needs.

33. Increasingly nationalistic and unstable government policies in the CIPEC countries have prompted a shift to development in more stable but often higher cost areas, which also will tend to keep prices high. Barring major finds in countries like Australia and Canada, copper may again be in short supply by the mid-1970s unless more adequate safeguards are found for foreign investments in CIPEC countries and other less developed areas. Because capital requirements are large and lead-times often exceed the life of government policies in the developing countries, a workable solution may depend on the willingness of importing nations to underwrite some of the investment risks.