CIA/OER/S-06822-75 RECENT DEVELOPMENTS IN INTERNATIONAL COMMODITY AGREEMENTS MAR 75 SECRET/NFD/CD

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CIA Control #9547/75

CIA/OER/S-06822-75

14 March 1975

MEMORANDUM FOR: Dr. Samuel Rosenblatt
Assistant Director
Council on International Economic Policy

SUBJECT : Recent Developments in International Commodity Agreements

1. Attached per our recent telephone conversation is a compendium of recent developments pertaining to international commodity agreements that should be of assistance in your contribution to the Economic Policy Board Commodity Study. We have included developments in the following commodities: tin, copper, rubber, EC Stabex Agreement for iron ore, tungsten, mercury, coffee and sugar. Each commodity section is separately classified.

2. If you require any further assistance on this matter, please do not hesitate to call.

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Chief
Agriculture and Materials Branch
Industrial Nations Division
Office of Economic Research

Attachments:
As stated

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Distribution: (S-6822)
Orig. & 1 - Addressee
1 - D/I
1 - D/OER, SA/ER
1 - St/P
2 - Jerry Crawford, Treasury
2 - I/AM [redacted]
1 - [redacted]

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INTERNATIONAL TIN AGREEMENT

Tin is the only metal for which there is an international agreement guaranteeing minimum prices for producers. Most tin producers and consumers, except the United States, belong to the International Tin Agreement, and are represented on its governing body, the International Tin Council (ITC). The tin agreement was the first commodity to attract International Monetary Fund support under the IMF's buffer stock financing facility established in June 1969.

One of the primary functions of the ITC is to maintain tin prices between a floor and ceiling price set by the Council. The price range is maintained by manipulation of a buffer stock financed by a fund provided by the tin producing countries. The Council in a weak market may also apply export controls, limiting exports of producing countries until equilibrium is restored.

The buffer stock has an upper limit of 20,000 metric tons. In recent months the stock has been almost exhausted in efforts to stem rising prices, resulting from supply shortfalls. Sales from the buffer stock and from the US stockpile covered a 55,000 ton deficit in the world tin supply over the past two years.

The ITC is able to support its floor price effectively, providing the tin mining industry with a safeguard against a collapse in prices. The Council has been less successful in

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preventing the price from going above the established ceiling price, but it has restrained run away price movements.

Recently, the Council adjusted its floor and ceiling prices upward to cover rises in production costs. The new floor price of $2.95 a pound is still well below the prevailing LME market price of $3.37, however, and tin producers, led by Malaysia, which mines 45% of the world's tin output, are seeking an increase in the floor price to $3.27 a pound to offset soaring production costs. The prime complaint of tin producers is that the inadequacies of minimum guarantees provided by the current buffer floor price is seriously hurting many small tin miners who use the floor price as collateral for loans. As a result, there have been mine closures among small-scale marginal operators, aggravating the shortfall in mine production. Malaysian mine output dropped by about 4,000 tons in 1974.

Consumer nations of the ITC want no further upward price revisions, insisting the ITC should not reinforce the existing inflationary trends throughout the world. Although not opposed to a small increase in buffer floor price to cover increased producer costs, consumers fear an increase of the magnitude proposed by Malaysia will force them to subsidize inefficient and marginal production.

FUTURE

To ensure sufficient flexibility in its efforts to moderate

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price fluctuations the ITC is exploring ways to finance the doubling of its buffer stock limit to 40,000 tons. The current buffer stock is down to insignificant tonnage and the US stockpile is nearing the end of its permissable sales quota.

Increased consumer participation and greater financial support from the International Monetary Fund are proposed to finance the larger buffer stock. At the present time the only consuming nations who have provided funds are the Netherlands and France. IMF financings is limited to assisting those countries with an adverse balance of payments. Tin producing countries that are also exporters such as Indonesia and Bolivia are probably ineligible. Based on the present buffer stock floor price of $2.95 a pound, a 40,000 ton tin buffer stock would cost at least $260 million.

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CIPEC Countries Seek Buffer Stock Agreement

Chile, Peru, Zaire, and Zambia, members of the International Council of Copper Exporting Countries (CIPEC), are seeking cooperation of producers and consumers to stabilize world copper prices.

CIPEC producers, who do not control a sufficiently large share of world copper exports to establish an OPEC-like cartel, want an organization patterned after the International Tin Council, which attempts to maintain agreed floor and ceiling prices through manipulation of buffer stocks. The CIPEC nations are studying a plan which would include all major copper exporters and importers willing to join, possibly including the participation of private copper producing companies. The participating exporting and importing countries would each control 50% of a vote weighted by the size of each country's copper exports or imports. The CIPEC countries would control two thirds of the producer votes and one third would be allocated to producers in Canada, the Philippines, Papua New Guinea, and Australia. The importing countries considered for the plan are Japan, Germany, the UK, Belgium, France and Italy.

Members of the organization would establish a buffer stock and purchase copper on the London Metal Exchange when the price falls below the floor price and sell copper on the

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LME when the price rises above the ceiling level. Suggested floor and ceiling prices are 68 cents and 89 cents a pound. Purchases of about 500,000 tons of copper are estimated necessary during 1975 at a total cost of about $750 million. The IMF would be asked to share in financing the buffer stocks.

The CIPEC nations are particularly concerned about the extreme volatility of copper prices because of their reliance on copper revenues for a large share of export earnings that have been hard hit by the sharp decline in copper prices. Some consuming nations also are concerned about prices and supply over the longer term unless relatively stable prices are achieved at a level sufficiently high to foster investment. They point to shortages during the economic upturn in late 1973 and early 1974, when copper prices doubled.

Prospects for the formation of a copper stock, however, appear poor. Reasons for joining are less compelling for consuming nations currently benefitting from low prices and for non-CIPEC producers hopeful of expanding their share of the world market. Moreover, few countries would be willing to build up buffer stocks given the large overhang of world copper stocks -- now totalling 800,000 tons. Many countries favor production cutbacks to the complex involvement of financing international buffer stocks. (See Attachment - [redacted]
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MAJOR RUBBER PRODUCERS AGREE TO ESTABLISH BUFFER STOCKS

Malaysia, Indonesia, and Thailand, which account for 80 percent of world rubber production moved closer last week toward an agreement to set up buffer stocks as a means of stabilizing natural rubber prices. The buffer stocks will probably be built up to some 350,000 tons at a cost of $200 million.

Details of the scheme, which is intended ultimately to include all rubber-producing nations, was worked out by technical experts and is subject to governmental approval. It may be fashioned along the lines of the International Tin Council, which includes both producers and consumers.

The move toward a price-stabilization plan was led by Malaysia, which alone turns out 45 percent of world rubber output. In response to widespread discontent among small producers at falling rubber prices, Kuala Lumpur late last year launched a program to curb production by reducing tapping, accelerating replanting, and prohibiting chemical stimulants. Malaysia also called on other major producers to join in a coordinated marketing system that would include both buffer stocks and production controls.

The pricing policy of the rubber group will not be disclosed until the participating governments approve it.

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Pressure for sharp increases is unlikely, however, because the major producers are acutely aware of the ease with which synthetics can be substituted. Although not finalized, discussions indicate floor and ceiling prices of 29 and 37 cents a pound.

Several means of financing buffer stocks are being explored, including financing by the International Monetary Fund and by the major oil-producing countries. The chances for success on buffer stocks will depend largely on the participating governments' ability to work out effective domestic production control programs. In Malaysia, about 50 percent of all rubber is produced on large estates where production controls can be readily implemented. In Indonesia and Thailand, small producers account for 75 percent and 95 percent, respectively, of rubber output; attempts to reduce production would be considerably more difficult and disruptive to the rural economies.

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EC Export Stabilization Program (STABEX)

The export stabilization plan grew out of a desire on the part of the developing countries for a stable income from their exports of raw materials. The first such arrangement between developed and developing states, it stipulates that the EC will provide grants or loans, mainly of a concessionary nature, to signatories whose earnings from exports to the Community of 11 agricultural commodities and of iron ore fall below a minimum reference level.

The final list of products consists of peanuts, cocoa, coffee, cotton, copra, palm oil, hides and skins, wood products, bananas, tea, raw risal, and one mineral, iron ore. Iron ore was a last minute concession by the EC, which specified that its inclusion should not constitute a precedent for other minerals. Some EC countries had originally sought to tie the export stabilization scheme to a provision guaranteeing EC access to certain raw materials. This proposal was eventually dropped, however, and no supply commitments other than a special arrangement for sugar were included in the final agreement.

Operating Rules

The following operating rules for STABEX have largely been gleaned from fragmentary State Department reporting.

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We expect to have an official copy of the Lome Agreement (200 pages) early next week. Hopefully, this will help to clarify some of the ambiguities in the present reporting on how the scheme will actually work. Key rules are:

1) To trigger a payment, the product must account for at least 7.5% of the country's exports to the world and the decline in export earnings from the EC for that product must be at least 7.5%. (In both cases, the percentages are 2.5% for the 24 least developed countries of the 46).

2) Payments will come from an EC fund set at 375 million units of account (about $450 million) over the 5 years of the convention.

3) Payments are not automatic; an ACP must make a request to the EC commision. However, once a payment is made, these funds are reimbursable to the EC if LDC export earnings increase above 7.5%. (No repayment is required of the 24 least developed.)

4) The recipient ACP decides how the financial payment will be used.

5) To prevent ACP export diversions or market manipulation a formula measuring the EC's share of total exports against the historical trend would be routinely applied to trade patterns. Significant diversions of shipments away from the traditional EC markets could result in denial of financial payments.

6) The ACP's are obligated, in the event of a fall in their total exports, not to reduce exports to the EC by a proportion greater than the fall in total exports.

7) The list of products can be reviewed after one year.

Iron Ore

In 1972 the EC (nine) imported -- by value -- 22.9% of their iron ore from ACP countries. Of the 46 ACP countries

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only Liberia, Mauritania, Sierra Leone, Ghana, Nigeria, Zaire, and the Congo exported iron ore to the EC. See Table.

EC Iron Ore Imports - 1972 1000's of US Dollars

				percent of total
Total EC Imports			1,269,631	
Imports from OECD (includes intra EC trade)		617,527		48.6
Imports from ACP countries		290,441		22.9
Liberia	184,623			
Mauritania	91,163			
Sierra Leone	13,453			
Ghana	629			
Nigeria	394			
Zaire	117			
Congo	62			
Imports from others				
LDC's-Latin America		295,026		23.3
LDC's-Africa (less ACP's)		36,120		2.8
Sino-Soviet		25,437		2.0
Other Developed		2,067		.2
LDC's-Far East		1,825		.1
LDC's-Middle East		1,186		.1

Using per capita GNP for 1972 as the criteria, Nigeria, Sierra Leone, and Zaire would be classified with the 24 least developed countries and thus eligible for payments under the 2.5% criteria. Ghana, the Congo, Liberia, and Mauritania are eligible for payments using the 7.5% criteria.

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Using 1972 trade data, Mauritania, Liberia, Sierra Leone, and Ghana are the only countries that might qualify for payments under the STABEX formula. This is based on the fact that iron ore exports represent more than 7.5% (2.5% in the case of Sierra Leone) of total exports.

We estimate that iron ore prices will increase from 5-10% this year and will continue to increase through 1980. Past price trends of Liberian ore are shown in the following table.

US Import Cost of Iron Ore (fob) Liberia
(Annual Average Price)

1974	$10.66 per ton
1973	$ 8.66 per ton
1972	$ 8.24 per ton

If iron ore prices increase as anticipated, no ACP country can request financial payment under the STABEX formula

The EC-ACP agreement will not influence the world iron ore market. Liberia, Sierra Leone, and Mauritania -- the only major producers of iron ore in the ACP -- produce less than 5% of total world production as noted in the table.

World Production of Iron Ore - 1973
(Thousands of Long Tons)

			%of total
Total World		794,321	
Liberia	21,161		2.7
Mauritania	9,252		1.2
Sierra Leone	2,362		.3
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ASSOCIATION OF IRON ORE EXPORTING COUNTRIES

A preparatory meeting of iron ore producing nations was held in New Delhi on 13-15 January 1975 to discuss the formation of an iron ore exporters association. Taking part in the conference were Algeria, Australia, Brazil, Canada, Chile, India, Mauritania, Peru, Sweden, the Philippines, and Venezuela. A draft agreement setting forth the terms of the proposed association was unanimously adopted at the conference, and will be submitted at the 2 April ministerial meeting of iron ore exporting countries in Geneva. The association would consist of a permanent board, a secretariat, and a conference of ministers, which would normally meet once every two years.

The original Indian version of the draft agreement called for progressive harmonization of the policies of member countries on problems relating to prices, production and export of iron ore, and coordination of national policies. The Australian delegation, who were firmly backed by the Canadians and received muted support from the Swedes, prevented any sort of a cartel arrangement from being adopted. The Brazilians gave tacit support to the Australian position.

Membership in the association will be open to any nation which exports iron ore or holds substantial reserves. Australia

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and Sweden agreed to join as full members of the iron ore association, while the Canadians have not yet made up their mind to accept. There will be no room for observer nations at future iron ore conferences. An earlier suggestion to allow consumer nations to join the association was rejected.

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TUNGSTEN

Representatives of tungsten producing and exporting countries will meet in La Paz April 7 with the objective of forming an association of tungsten producers. They will consider ways to limit past wide variations of tungsten prices and to analyze means of reducing European and US import tariffs on tungsten sales. Delegates from China, Thailand, Australia, Portugal, France, Brazil, Peru, Korea, Canada, and Zaire are expected to attend. The US and USSR will not be invited although both countries produce but do not export tungsten.

This group will present their proposals to the next session of the UNCTAD Tungsten Committee.

MERCURY

Some mercury producers met at Izmir, Turkey, on 23-25 January 1975. One proposal to emerge from the meeting was the establishment of an international association of world mercury producers. This was first mentioned at last May's International Mercury Congress in Barcelona, Spain.

Since May, these producers have studied the constitutions and regulations of other established metal industry associations and formulated statutes for a quicksilver association. These were provisionally approved at Izmir and are expected to be ratified at the next producers meeting, scheduled for April.

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The proposed association may be centered in Geneva. The precise objectives of the association are not known.

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The International Coffee Agreement, Its Current Status and Prospects

Background

1. The International Coffee Agreement of 1962 (ICA), signed by 41 producing and 24 consuming countries, created the International Coffee Organization (ICO) in order to strengthen the chronically depressed world coffee market. Led by the United States, the consumers were willing to support the ICO and to pay somewhat higher prices for their coffee imports in order to:

- reduce the need for direct economic aid to the coffee producing countries,
- contain the threat of Communism in the producing countries (thought to be serious in the early 1960s),
- improve their export markets in the producing countries.

The ICO also was intended to stabilize coffee prices as well as improve them, thus offering the consumers protection against sharp price increases during periods of scarcity. In fact, the ICO was very one sided in its operation. It helped the producers by strengthening the market somewhat but was unable to check steep price increases following the frosts that severely damaged Brazil's 1970 and 1972 crops.

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2. The ICA was renewed with some changes in 1968 but efforts to renew it again in 1973 broke down because of:

- the producing countries attempt to form a cartel outside the ICO,
- producer demands that the ICO support the high prices which prevailed in the wake of Brazil's 1972 frost.

Another fruitless effort to renegotiate was made in 1974 and the members have only succeeded in extending the life of the ICO without its regulatory powers. It continues to exist merely as a collector and publisher of coffee statistics and as a forum for further negotiations.

The Current Situation

3. A third effort to renew the agreement is now underway in a series of negotiations taking place in London and scheduled for completion in April. Prospects that a new agreement will be reached this time are fairly good. The producers' cartel has not been able to support prices on its own and the market has been weakening fairly steadily since early 1974. A recent producers' meeting in El Salvador failed to produce new initiatives and many exporting countries probably have concluded that a revived ICO is their best hope for a stable and profitable market.

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At the same time, the falling market has brought coffee prices back toward levels the consumers are willing to support. The outcome is still far from certain, however, as the negotiations have yet to face the central questions of the minimum support price and the allocation of export quotas among the producing countries.

4. If a new agreement can be reached, it probably will contain the following main features:

- A target price range which the ICO will seek to maintain by means of an export quota system.
- Market forces will be allowed to determine prices within the target range with quotas reduced or expanded only when prices threaten to move outside the range.
- A reserve coffee stock under ICO control that can be released to the market when prices rise excessively.
- Some mechanism for periodic review of the price targets to determine whether adjustments are required to compensate for rising world price levels or for dollar devaluations.

The first two points were the old ICO's essential features. The coffee stock idea is new and is being discussed as a way to give consumer interests greater protection under a revived ICO. The producers apparently have conceded this

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point but in turn are demanding that prices should be indexed to protect the real value of coffee exports as world price levels rise and in the event of further dollar devaluation. The consumers have unanimously rejected indexing but probably will agree to a periodic review and possible adjustment of price objectives.

The Outlook

5. If a reserve stockpile is created under a new ICO, consumers will be fairly well protected against the recurrent periods of high prices that have followed a major crop failure. The cost will be somewhat higher coffee prices during normal crop years as the ICO restricts the volume of coffee allowed to come into the market. For the next five years or so, however, and from a purely economic point of view, the cost probably is not worth it because the consumers would tend to be protected from recurring price booms in any case.

6. The producing countries still hold excessive carry-over stocks of coffee and it is difficult for them to hold these supplies off the market during periods of high prices. This probably accounts for the fact that the coffee market broke nearly a year before general commodity prices began to decline. Carry-over stocks in the producing countries estimated by the ICO were approximately 36 million

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bags as of 30 September 1974. Most of these were official stocks and there were additional holdings of significant size in private hands in many producing areas. While many of these stocks are not of exportable quality, they nevertheless are considerably larger than the working inventories required to support world exports, now about 60 million bags annually.

7. Current indicators suggest that world production during the next five years will rise faster than consumption. Prices during the next few months probably will recover moderately as consumers replenish their inventories, which have been drawn down to abnormally low levels. For the longer period through 1980, however, prices should remain stable or trend downward as world stocks again tend to increase.

8. In an unregulated market, however, the cost of low coffee prices through 1980 could be a period of very high prices thereafter. This would repeat the historic coffee cycle that has been observed during much of this century. Over the past few years, coffee prices have fallen sharply relative to prices for many competing crops. If this situation continues, aging coffee plantations, in some areas at least, will be replaced by other crops. In Brazil, which still produces one-third of the world's coffee, vigorous economic development is creating a special problem

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as labor costs rise sharply and domestic demand for alternate crops grows rapidly. Since coffee production involves heavy fixed investment in land preparation and trees, it tends to adjust very slowly to low unprofitable prices. Conversely, as capacity falls below consumption and excess stocks are finally worked off, it may require a considerable period of high prices to restore capacity to adequate levels.

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The International Sugar Agreement

Background

1. The existing International Sugar Agreement (ISA), signed in 1973 after failure to extend the 1968 agreement, provides only for the exchange of technical and statistical information. It does not control the sugar market and presently has no influence on prices. While the incentive for a stronger agreement has been impeded by recent high world sugar prices, some sentiment apparently exists for more effective regulation of the market. New renegotiations are not expected to get underway for at least another year, however.

2. During 1968-73, the ISA was designed to achieve a stable sugar market, largely through a system of export and import quotas. Its stated objectives were a remunerative return for exporters while providing adequate supplies to importing countries. With the major exception of the US and the EC (including the UK), which previously had their own preferential marketing arrangements, membership included most of the world's exporting and importing countries, including the USSR and Cuba. Voting power was equalized between exporters and importers, but was weighted within each group by the individual members' relative market roles. The Agreement helped raise free market sugar prices from the dismally low levels which prevailed throughout the

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mid-to-late 1960s. As world supplies tightened, however, producers, sensing that the fundamental balance had begun to shift in their favor, could not agree with consumers on prices and the economic provisions of the agreement were allowed to lapse in 1973.

The Current Situation

3. Since 1971 the world sugar situation has progressively deteriorated. Annual consumption has consistently exceeded production, leading to a steady decline in world stock levels. Stocks are now only 19% of annual consumption, well below the 25% level considered normal by the market. The world's sugar production capacity continues to grow very slowly, suggesting relatively tight supplies and high prices for the remainder of the decade.

4. Despite recent high prices for sugar, producers generally have been reluctant to undertake large scale expansion programs. Sugar prices tend to be highly unstable and producers apparently remember the collapse of earlier boom conditions that resulted in heavy losses. They apparently fear that the bottom could again fall out of the market, resulting in even greater losses than before. Risks have increased because the costs of land, equipment, and capital have risen considerably. Many producing countries are now trying to minimize their risks by signing long-term supply agreements with some of the major importers.

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Long Term Consideration

5. If a new agreement is signed within the next few years, its impact on the market probably would be small during its first few years. The current tight supply situation precludes the creation of the buffer stocks necessary to prevent large price fluctuations. Such an agreement probably would help to temper purely speculative swings in the market, however. It probably also would help forestall a possible move to form a producers' cartel similar to OPEC.

6. More significant, however, a new agreement could provide the promise of stability needed to encourage new investment in sugar capacity. This would require a long-term support price considerably above the levels prevailing in earlier agreements. Unless such incentives are provided, however, there is danger that stocks will continue to decline relative to consumption resulting in even higher sugar prices. This is likely to be an unstable situation because excessive sugar prices will stimulate the production of sugar substitutes, a trend that is already developing. Thus, an agreement to set a long-term support price at levels below current prices but adequate to assure profitable production probably would benefit both producers and consumers.