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The Crisis of the World Copper Market

By Dr. George Abrahamson, London

Copper plays a special role in the economy of the world although its annual output of only about 5,000,000 tons is far exceeded by many other international commodities. For economic reasons it is better to concentrate and smelt copper ores near their deposits, whereas it is usually easier and cheaper to do the refining and processing in industrialised countries. This has proved to be the most economical system and has led to some sorts of co-ordination of the economies of certain producer and user countries. These traditional links have little effect on the returns of individual mining and foundry establishments (or on refining and processing costs), as long as all sales—as was the case for many years—are effected on the basis of a uniform world market price, as quoted on the London Metal Exchange. In the last resort even domestic prices in the United States depended on these quotations, although they were fixed by the producers and were varied only after fairly lengthy intervals. There have of course always been occasional breaks in deliveries, and fresh business contacts had to be established when new production capacities came into operation or when traditional markets could not absorb normal output increases. But, in general, producers found it easy to adapt themselves to such market changes; and the London Exchange swung into action almost automatically.

Ever since the London Metal Exchange had to yield the fixing of prices of most of the internationally produced copper to the big overseas producers the absence of ties between processing countries and mining companies has turned out to be a weakness. Until the end of 1961 London was the undisputed arbiter in the world copper market. Naturally, producers as well as users were able to send their buying agents to the London Metal Exchange and could thus intervene against what they considered to be unjustified price movements. Such price support buying took place quite often without always being recognised for what it was. But at the beginning of 1962 support buying by copper producers' agents became so open and regular as to make the free functioning of the London market impossible. Until November 1963 the wirebars spot price, which was regarded as the standard price, remained with insignificant fluctuations at £ 234 per short ton. Even then this price had to be regarded as a firm producer price, as had been customary for a long time on the internal market in the USA though it was involuntarily sanctioned by the London Metal Exchange.

But support buying alone was not enough to stabilise prices. To prevent the world market price from falling, the big producers used agreed output or sales restrictions as a long-term remedy and resorted to direct intervention on the London market only as a short-term weapon. Production cuts amounted to as much as 15% of the planned output and reduced the free world's total supply theoretically by about

300,000 tons a year. The extent of support buying was never officially announced but at times it led to several million pounds worth of stock-piling and to a corresponding burden of interest payments. Nonetheless the producers' policy was entirely successful and when, therefore, at the beginning of 1964 copper producers were able to start using their capacities to the full and sell their surplus stock they stuck to the fixed producer price.

Shrinking Market Leads to Price Rises

After the return to full production it soon became clear to what extent users had come to rely on regular deliveries. While consumption of copper in the free world increased by 11% in 1964, the big producers had to meet a 15% increase in demand. But output of copper ore went up by only 3%, smelting by 4 1/2% and refining by 7 1/2%. At times breaks in production due to labour disputes compelled several producers to suspend contractual deliveries on the grounds of "force majeure". Their customers and firms which had no contractual claims to supplies or had under-estimated their requirements could do nothing but return ruefully to the London Metal Exchange where a barely increased supply from small producers and suppliers was now facing an incomparably greater demand from disappointed users who urgently needed copper.

The big producers had achieved the opposite to what they had wanted: prices were soaring on the free market which had shrunk and was therefore more unstable. Minor and occasional buyers who were to have been encouraged by stable prices to use copper found it extremely difficult to cover their requirements; and in the expanding markets customers with earlier orders were forced by rationing to look for substitute materials.

Nor did the big producers adhere to their agreed fixed price for long. Having supplied their regular customers with copper at £ 236 a short ton since January 1964, they felt induced in the middle of March of the same year to follow the free market price a little way and raise their common price to £ 244. In August, Chile then went on to £ 260, and the African producers reluctantly followed suit. A few months later, Chilean producers announced a further increase to £ 280, but this time the producers in Zambia and the Congo did not go along with them.

Meanwhile, unsatisfied demand concentrated on the London Metal Exchange which offered supplies from small producers, reclaimed scrap metal and occasional quantities sold by users who, under long-term contract, had bought more copper than they needed. In such an unbalanced market situation prices naturally continued to soar. Even minor wage disputes in the copper mining countries sent the London copper

price up because it was rightly suspected that many users would try to buy in the free market what they had failed to get through contractual purchases because of restrictions. In fact, a series of strikes made it impossible for the big producers to meet all their contractual obligations, and so even 1965 failed to restore the hoped-for balance between production and consumption in the free world. In May the major producers increased their fixed price to £ 288. In October it rose to £ 304, and the next increase to £ 336 came in January 1966. But in the meantime the London spot rate had climbed to £ 567.

Evidently this was not a case of a temporarily worsened imbalance due to excesses of speculation; on the contrary, the London Metal Exchange did its best to prevent speculation. But world production was simply not adequate to meet demand, and supplying regular customers at fixed prices had the effect of rationing by the big producers, without even the available supplies being shared out on a fair basis. The major producers also ran into difficulties with their respective governments. In Zambia, they had to pay copper mining duties based on excessive free market prices although the proceeds from their sales were much lower. In Chile, the government kept pressing for prices corresponding to the true market situation. Meanwhile processing industries reported a rapid advance of aluminium and plastics.

On the American market, where demand for copper had risen even faster in view of favourable market conditions and the need of the war in Vietnam, the authorities had stepped in to keep prices stable. Even before the end of 1964, 20,000 short tons had been released from State reserves; in May 1965 another 100,000 tons followed, and in November, when producers tried to raise their sales price of 36 cents per lb (£ 288), yet another 200,000 tons were released to be followed by 200,000 tons more in March 1966. Thus within 12 months normal supplies were augmented by about one quarter from reserve stock (while export restrictions were tightened); as a result the entire domestic demand was essentially met and the price level kept undisturbed. But at the same time the American authorities made it clear that they were unable to help other countries close their gap in demand.

This gap had arisen not through inadequate productive capacity, but through insufficient use of available plant owing to labour disputes, and to a certain extent also through unexpected and hitherto unexplained changes in stock piling. This is why big producers are, above all, trying to establish better labour relations; they can show some measure of success, at least as regards the attitude of responsible labour leaders. Co-operation with trade unions and authorities is likely to improve even further, depending on the degree to which indigenous workers are given responsible jobs. But it would be illusory to think that there will be no more strikes.

Need for New Production Capacity

It is therefore doubly necessary to create new production capacity. But to obtain the required capital there must be an atmosphere of confidence, and it is just that which, for political reason, is lacking in the production areas which are most important for the

European market (Zambia, Chile and the Congo). Nevertheless, all big producers have intensified their effort to open up new copper deposits and to start new or expand existing plant as far as practicable. They all hope to increase their output progressively either by launching new enterprises or by making better use of available refining plant. Present development projects suggest that we may expect the free world's output capacity to grow at a rate of at least 4% per annum. Taking a fairly long view, Canada and South America offer particularly good prospects for increased production, whereas Africa is looking towards better co-ordination of old and new plant. Thus within the next decade the production potential of the free world ought to be growing at about the same rate as consumption, provided there is no surprising slow-down in the replacement of copper by other materials. But a surplus is only likely if major production shortfalls can be avoided or if copper is no longer needed for the war in Vietnam. Until then the market is bound to remain unstable as no significant stocks are available.

Political factors further complicate price fixing by the big producers. In the producing countries of Africa and South America copper is by far the most important source of revenue and foreign exchange. In Chile the Government and the Senate have directly intervened in the price fixing process and the copper companies are finding it increasingly difficult to persuade government circles to adopt a policy of moderation. The unexpected price increase from £ 336 to £ 496 (with the London spot price at £ 765) which Chile announced in mid-April was much too large for other producers to follow as they had done in the case of previous price revisions. Even the Chilean authorities said it was an exceptional move, knowing that it meant the end of producer prices. The inevitable reaction of the other big producers was to abandon their fixed prices and to sell their current output at London forward rates.

This means that the experiment to fixed copper prices has failed. The attempt to stabilise prices was frustrated by unpredictable and incalculable fluctuations in supply and demand which a truly market could absorb through, at times, wide-ranging price fluctuations. The attempt came to nothing, although the producers had begun it with the advantage of large reserve capacities and stocks and despite the fact that—apart from an unexpected jump in 1964—consumption did not expand too rapidly. What ultimately brought about the collapse of fixed prices was not the elimination of a free market for regular copper sales by the big producers but rather their inability to meet additional and small-scale demand. In the absence of a free market mechanism, supplies to users had to be rationed one way or another. But the big producers did this in a most incomplete fashion by giving preference to their regular old customers on the basis of their previous purchases while ignoring other users. In the circumstances some black market tendencies were bound to appear on what was left of the free market.

It is questionable whether a return to the status quo ante is the right answer to the situation on the international copper market: for although the big producers are selling their copper at London forward rates and although producers' agents have again

offered and sold metal there, a few occasional sales do not make for a representative and balanced London market. In any case, within three days of fixed prices being abandoned, the London forward price fell by more than £ 140 and thus dropped below the Chilean sales price. Producers have recently re-affirmed their preference for fixed prices and it is feared that they may turn their backs on the Metal Exchange as soon as they can and hinder the free play of supply and demand by ad hoc transactions. Meanwhile copper users are trying to guess the level at which the world market price will ultimately settle. They know that the producers could accept a price of less than £ 300 although they might have to revise their calculations in the light of the latest taxation measures in Chile and Zambia; they also know that there is a threat of large-scale substitution of copper by aluminium and plastics unless the price drops below £ 400. These then would be the margins within which the world market price should settle.

The collapse of a fixed price for copper illustrates the difficulties of any cartellisation and producer control

of raw materials. As long as a real emergency—such as inadequate prices or insufficient markets—compels producers on the one hand to co-operate and on the other offers them a chance of adjusting the market by operating sales quotas or stock piling, such agreements work more or less satisfactorily, though often to the consumer's disadvantage. But where it is a question of directing consumption and of distributing a limited supply fairly among various categories of users, international agreements are, as a rule, too rigid and strict. In this respect there is no difference between private co-operation among copper producers and agreements which enjoy State approval and support like the international Tin Agreement. The Copper Agreement, too, had increasingly political undertones and finally led to an official British demarche in Zambia to give a warning against demanding excessive taxes from the producers. A free world market certainly has an advantage, which should not be under-rated, in that it prevents the international raw material economy from becoming the object of political considerations, which would be particularly dangerous in the case of strategic metals such as copper.

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World Business Trends

Vigorous Expansion of World Trade

Turnovers in world trade during the first months of the current year have been considerably higher than a year ago. From January to April 1966 exports of the five most important Western industrial countries (USA, Germany, UK, France, and Japan) representing 45% of world trade surpassed their previous year's corresponding value by a total of 13%. The rise of imports reached 15% even. Although these rates of increase do not justify the conclusion that an accelerated growth of world trade has taken place, since they are exaggerated due to the effects of the dockers' strike in the USA in the beginning of 1965, they are proving anyway that taking seasonal deviations into consideration—a continuation of the vivid expansion cannot be overlooked.

Naturally increases conditioned by the strike have been most vigorous in the foreign trade of the USA. The extraordinarily high growth of exports (January to April + 18%) and of imports (+ 23%) in a considerable degree reflects the previous year's losses. This above all applies to export values. Adjusted for seasonal

variation they have been slightly higher only in the first third of 1966 as compared with the last one of 1965. Import values, however, also under this aspect increased considerably at a rate corresponding to that of the previous year (1965: + 14%). This reflected clearly the vigorous expansion of demand together with an increasing utilisation of domestic resources. So the export surplus, calculated for a full calendar year, was already 20% smaller than in 1965. For the time being prospects for another reduction of the USA's balance of payments deficit thus darkened considerably again.

According to data available so far, in the first months of 1966 also in Western European countries imports from other parts of the world have been increasing more than exports to those areas. The trend towards reducing the West European balance of trade deficit, effective from mid-1964 until mid-1966, has thus proved to be a temporary feature only. And from this it results that after a temporary interruption contractive

influences on the development of incomes appeared again. Concurrently the internal European exchange of goods was influenced by the change in the regional differentiation of the business trend. Thus e.g. Italy's and France's export surpluses decreased slightly again, mainly due to a strong revival of imports—while vice versa a tendency towards greater surpluses prevailed in the Federal Republic of Germany.

In Japan too the beginning of a cyclical upward trend was reflected clearly by the development in foreign trade. After industrial production since the end of 1965 has been increasing again, imports have also increased considerably. From January to April 1966 they surpassed the results of the previous year's corresponding period by 13% (1965: + 3%). At the same time exports continued growing although at 14% they did not reach the previous year's level (1965: + 27%). Japan is profiting particularly from the buoyancy of imports in North America, for in 1965 almost one third of its exports went to the USA. Sales in this market in the first two months of 1966 have risen by 31% above their level a year ago. Also in Western Europe Japan achieved