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A New International Tin Agreement?

by Günter Behrendt, Bonn*

The International Tin Council (ITC) has, by setting up a "Preparatory Committee", once more given the starting signal for the preparation of a new International Tin Agreement (ITA). The intention is that the new agreement should take over from the current 6th ITA when it expires on 30th June, 1987. Presently the Agreement is facing a difficult situation. The apparent equilibrium between demand and supply since the beginning of 1985 remains unstable and some producer countries are urging their governments to leave the ITA. How could this situation come about? How can the problems be solved?

The Preparatory Committee for a new International Tin Agreement has now met for three working sessions. The little information which has so far become public on the positions adopted by producing and consuming countries can be summarised as follows:

- The producing countries are placing the main blame for the ITA's difficult current situation on the changes made when the 5th ITA was succeeded by the 6th. They therefore propose a return to the wording of the 5th Agreement – evidently assuming that such a step would itself suffice to master the present problems in the tin market.
- On the other side of the table, there is a widespread view among the consuming countries that there is little point in discussing traditional elements of ITAs unless producer and consumer countries can agree on some way of returning to normality from the market's extreme current situation. These countries believe the right conditions must first be created before any new international tin agreement can properly function.

The following centres upon the "extreme market situation" mentioned above, the factors which brought it about and, finally, the conclusions which need to be drawn as far as any new international tin agreement is concerned.

Production and Consumption since 1976

The 4th ITA expired in mid-1976. When the 5th ITA came into operation (1st July, 1976) the export restrictions which had applied for the preceding 14 months were lifted. Evidently, the ITC felt they could be lifted now that the ITA buffer stock had been almost completely run down. However, the export restrictions

had also had another effect: by mid-1976 production and consumption of primary tin metal were once more at roughly the same level, and this in turn offered almost ideal conditions for the start of a new tin agreement.

As Figure 1 shows,¹ this ideal situation lasted only a matter of months. From the third quarter of 1976 consumption of primary tin metal went into decline. With the benefit of hindsight we now know that this was the start of the longest period of falling consumption in the tin market's history. By the time the decline had come to rest 6¼ years later (at the end of 1982; total market decline 22.3 %) consumption of primary tin metal was back to the level of more than 50 years previously, of 1929 in fact.

By way of contrast, any observation of movements in primary tin metal production shows that for long periods there was quite obviously no link between production and consumption trends. Four phases can be distinguished on the production side between 1976 and 1985:

Phase 1: Although a sharp decline in consumption was already becoming apparent, production moved in the opposite direction to reach a level by the end of 1978 at which it was more than 30,000 tonnes in excess of consumption on an annual basis.

Phase 2: Whereas consumption continued to decline, production persisted at its new high level for three whole years. (Towards the end of this phase, the supply of primary tin metal was in fact raised as a result of increased sales from the US-government's strategic

¹ In this survey exclusive use is made of official ITC statistics. Differences may arise as the ITC figures contain estimates for some centrally planned economies whereas the rest of this country group is excluded. This article does not deal with the centrally planned economies.

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stockpile run by the General Services Administration – GSA.)

Phase 3: From the 4th quarter of 1981, production too went into decline, actually falling considerably faster than consumption.

Phase 4: Once consumption picked up again after the end of 1982, and as production appeared to settle at a much lower level from the end of 1983, there was a virtual equilibrium once more between consumption and production by the beginning of 1985.

Summary: Between the 3rd quarter of 1976 and the 4th of 1981, production trends bore no relation whatever to consumption trends. It took five years for production to begin to react to what in the meantime was a substantially lower level of consumption. A total of nine years elapsed – from the end of 1976 to the beginning of 1985 – before the production and consumption of primary tin metal were again at comparable levels.

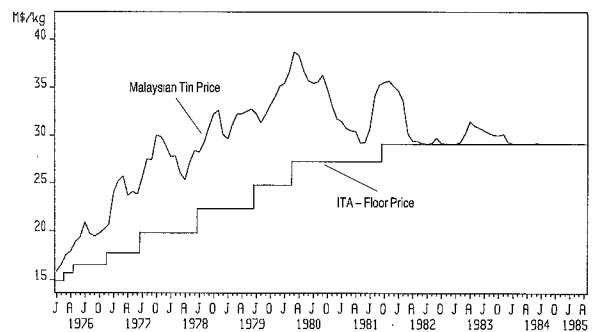
Price Movements and the Role of the ITC

The question as to the reason why consumption and production developed in opposite directions for more than five years is answered by Figure 2, which shows the movement of tin prices between 1976 and 1985. The steep rise in the price of tin in five large leaps starting in 1976 certainly makes an immediate impression. When it reached its peak in 1980, the price of tin was almost 2½ times its level at the commencement of the 5th ITA on 1st July, 1976. However, in the period which followed a downward trend established itself on the tin market. By May 1981 the price of tin had fallen by 25 %. Apart from the period from June 1981 to June 1982 when a mysterious buyer attempted – though it eventually proved to be in vain – to reverse the market trend by

making massive purchases, the price level reached in 1981 has hardly changed up to the present day.

In addition to price movements on the ITA reference market (Penang/Kuala Lumpur), Figure 2 also shows the floor price set by the ITC. In 1976 alone, the council raised this minimum three times, and four more increases followed in the period to 1980. Given that consumption of primary tin was in marked decline between 1976 and 1980, the answer to the question as to whether the market price or the ITC floor price was the cause, and which was the effect, is clear: during a period when consumption trends called for just the opposite, the ITC drove up the market price with the aid of seven increases in its floor price. Once the peak had been

Figure 2
The Malaysian Tin Price and the ITA-Floor Price 1976-1985



Source: Monthly Statistical Bulletin, International Tin Council.

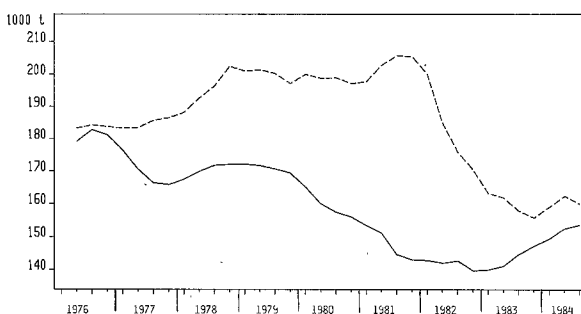
passed in April 1980, there were two further increases in the ITC floor price. They undoubtedly had the same effect on production as preceding increases had done. There was, however, a difference in that the floor price increases carried out up to 1980 were intended to drive up the market price, whereas the last two, now that the market trend was downwards, had the purpose of setting the floor price level the ITA had to defend as high as possible.

Summary: There is scant reason for ITC members to complain about the currently unsaleable tin metal stocks amounting to 100,000-200,000 tonnes worldwide and the difficult situation this has created for the ITA. The pricing policy for which they were responsible during the 5th ITA is the chief cause of the dire state of affairs on the world tin market today.

The "Outsider" Problem

Figure 3 shows world production of primary tin metal during the period 1976-84, subdivided as follows:

Figure 1
Production¹ and Consumption¹ of Primary Tin Metal 1976-1984²



--- World Production — World Consumption

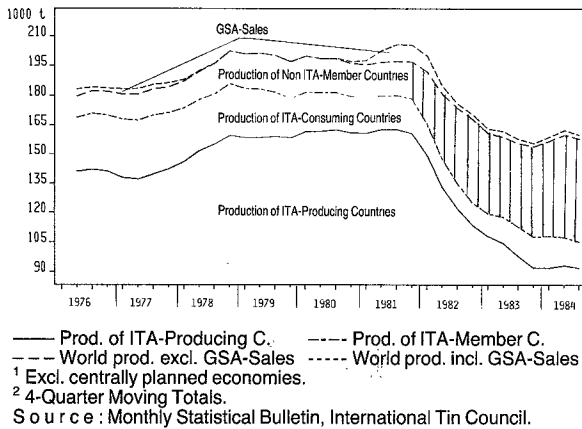
¹ Excl. centrally planned economies.

² 4-Quarter Moving Totals.

Source: Monthly Statistical Bulletin, International Tin Council.

- ☐ production of producing member countries of the ITA,
- ☐ production of all member countries of the ITA,
- ☐ world production (excluding GSA sales),
- ☐ world production (including GSA sales).

Figure 3
Production¹ of Primary Tin Metal 1976-1984²



As Figure 3 shows, the downturn in all the production curves named above came simultaneously (at the end of 1981). However, the speed with which ITA member and non-member countries' production volumes were adapted to the lower level of demand differed greatly. In retrospect it is clear that, after the end of 1981, ITA producing countries needed to cut their primary production by 1,500 tonnes for every fall of 1,000 tonnes in world production. Thus, non-members of the ITA steadily increased their share of the world market from that time on. During the full period of this enquiry, the outsiders' share of world production was multiplied almost five times, reaching 32 % in 1984. The share of ITA producing countries, on the other hand, fell from 83 % in 1981 to 59 % in 1984.

Finally, two other circumstances are illustrated by Figure 3:

- ☐ There is little cause to criticise the consuming countries in the ITA for the amount of primary tin metal they themselves produced during the export restrictions which were reintroduced in April 1982. Their production curve follows that of the ITA producing countries relatively closely. Moreover, their production has been halved during the period under examination.
- ☐ The significance of GSA sales for overall market movements is limited. 1981 is the only year during the

period under review in which they became a more marked feature. This occurred at the same time as the mysterious buyer already mentioned made the attempt to corner the market – the GSA sales policy which was put forward by the US-government at that time, from the consumers' point of view at least, does not warrant criticism.

Summary: Not only did the ITC's pricing policy during the 5th ITA prevent production being adjusted to reduced levels of consumption for many years; it also allowed a problem to arise which had not existed until then: the outsider problem.

The Influence of Exchange Rate Movements

The reference market for the ITA until 1972 was the London Metal Exchange (LME). Given the heavily fluctuating sterling exchange rate at that time, the ITC determined that in future this function would be taken over by the tin market in Penang. If any of the ITC members taking that decision in 1972 actually believed that it would at least reduce – even if it did not eliminate – the influence of exchange rate fluctuations on the course of the ITA, they should have learned otherwise from the experiences of the last few years, if they had not already done so.

Undoubtedly, the Malaysian tin market is extraordinarily significant in determining the world market tin price. Even so, it has been shown in practice since 1972 that the Buffer Stock Manager of the ITA (BSM) cannot confine his intervention to the Malaysian market if he wishes to influence the world market price level. The BSM is thus still compelled to intervene far more on the LME than in the Malaysian tin market, even though he has no duty to do so under the terms of the ITA.

Figure 4
The LME-Tin Price and the Impact of Exchange Rate Fluctuations 1976-1985

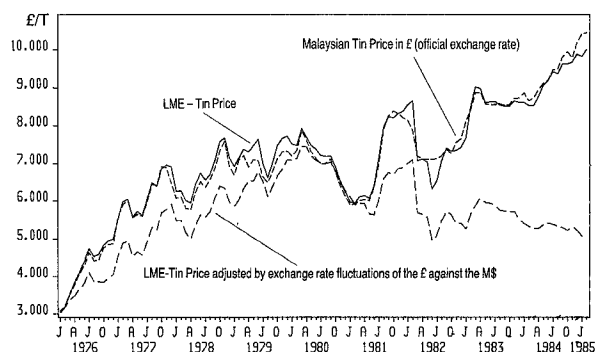


Figure 4 illustrates price levels on the Malaysian tin market and on the LME, or in other words shows the extent to which the BSM succeeded in establishing a reasonable parity in world market prices. When comparing the two it would be logical to assume that the tin price on the LME would be higher than the Malaysian price by the margin represented by transport and insurance costs. Figure 4 does indeed show this to be the case until 1982. From mid-1982, however, the circumstances are reversed, with the LME price lying below the Malaysian price. Looking back to 1972, then, one can see that the ITC decision taken then was unable to hold back the influence of exchange rate fluctuations on the course of the ITA. The result it has had instead has been that the benefits and burdens flowing from the ITA have been unequally distributed among the participating producing countries: while the two producers with access to the Malaysian tin market can profit from the relatively high price obtained there, all other producing countries must content themselves with the lower price on the LME.

There has traditionally been a close relationship between the Malaysian and US dollars. This was especially apparent over the last two years as the US dollar – and hence the Malaysian one too – “skyrocketed” on an unprecedented scale. Figure 4 shows both the actual development of the LME tin price and the same curve adjusted to eliminate exchange rate fluctuations. Comparing the two curves, the influence of such fluctuations can be seen to be relatively constant from mid-1976 to mid-1979, then to have lessened before disappearing altogether in the second half of 1980. From early 1981 onwards the influence of exchange rate fluctuations increased once more until, by April 1983, it had actually become the overriding factor in the determination of prices on the London tin

market. Once the influence of exchange rate fluctuations is eliminated from the LME tin price time series, it becomes evident that the price trend has not been a rising one since April 1983, but quite clearly a falling one.

One conclusion which flows from this, however, is that without the influence of exchange rate movements the BSM's need to intervene on the London tin market would have been greater still, by a large margin.

From the point of view of Malaysian tin producers, the price they obtain has remained almost constant since 1982. In every other currency but the US dollar and Japanese yen, on the other hand, the price of tin has risen strongly. This explains why several countries found the production of tin metal a lucrative business in recent years so that they set about expanding what had previously been insignificant production volumes or began to exploit fresh reserves.

Summary: As a result of the Malaysian dollar's strength against almost all other currencies, and against the pound sterling in particular, currency influences on the working of the ITA have been substantially increased since 1983.

The price differential between the Malaysian tin market and the LME – together with the fact that all but two of the ITA producer countries are denied access to the Malaysian market – has meant that the benefits and burdens of participating in the ITA have been unequally distributed among the producing member countries.

The strength of the ITA reference currency (M\$) against almost all other currencies is one of the main reasons for the emergence of the outsider problem (see above).

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Conclusions

Given the narrow tightrope the 6th ITA has been walking since it came into force and the fact that it still has two years to run, it may seem rather rash to many observers to be considering the question of what shape the next ITA should take at the present juncture. Certainly, right at the moment it is more important to come up with measures which can ensure the current ITA's survival for its remaining two years. It does not seem to make sense to consider any new ITA until it is certain that the 6th agreement can last out its life under orderly conditions.

The fact that production and consumption of primary tin metal have again been at roughly the same level since the beginning of 1985 could be interpreted as signifying that the conditions are right for the ITA gradually to return to good health. To take this view, however, would be to overlook the instability of this "equilibrium" and how great a price has had to be paid to attain it. The greatest danger currently facing the ITA comes from the outsiders' influence, which has grown steadily in recent years. Given the major losses of market shares they have suffered, it can hardly come as a surprise that more and more utterances have come from tin industries in traditional ITA producing countries lately demanding that their governments should withdraw from the Agreement. This is all the more understandable if the enterprises involved could also operate profitably at a considerably lower price but are compelled by the ITA to offer their tin at a higher price, thus leaving the field open to the outsiders. None of the appeals made to these countries to hold back their production have so far had any success. Quite the reverse – it is clear from production plans that an increase in supply from outsiders is also likely to occur in the years to come, a development which will further undermine the ITA in two different ways:

- ☐ As more market share is lost the pressure on ITA producing countries will increase.
- ☐ Every single tonne of tin produced by outsider countries and not taken up by the market must be taken into the ITA buffer stock if the BSM wishes to maintain the existing price level. This means that the factors determining the scope of the funds still available to the BSM in the last two financial years will be the level of outsider production and the level of illegal tin trading (smuggling).

There is only one answer as to how the ITA can rid itself of these troublesome "free riders", and that is to cut substantially the price of tin from its current level. Painful though such a step may be for the ITA producer

countries' tin industries, there is no other way of rolling back the influence of the outsiders and of getting their own market shares back to the level their countries traditionally held.

The "textbook theoreticians" advise that there is only one solution to the extreme situation the tin market now finds itself in: in order to give the market the chance of setting a price which will restore equilibrium between supply and demand, there should be a transitional period with no ITA. Experts familiar with the tin market also have grave doubts as to whether a "controlled" price reduction to a much lower level can be successfully achieved within the framework of an international commodity agreement. Even so, given the harm one fears would be done to the tin industry around the world if an "uncontrolled" price reduction occurred, the above doubts should not hold anyone back – least of all the ITC's members – from giving due consideration to possible solutions. The concrete measures needed fall into two problem areas:

- ☐ how a price reduction of this kind can technically be carried out in the tin market, and
- ☐ how the financial consequences for the ITA of such a price reduction can be cushioned.

With regard to the second problem, the price reduction would presumably have the consequence that a proportion of the loans taken out would no longer be considered by the creditors involved to be fully guaranteed by the tin held in the ITA buffer stock. There is hardly any conceivable solution to this problem other than the repayment of the outstanding loans no longer deemed to be covered. It ought not to come as a surprise if the consuming countries participating in the ITA showed little inclination to contribute towards these repayments. They could always point out that the funds involved were merely a fraction of the extra profits earned by ITA producing countries by raising prices in the years since 1976.

It is up to the producing countries in the ITA to indicate their willingness to talk on this central issue of a substantial reduction in the price of tin. They ought to do this sooner rather than later, as time is running short. If on the other hand the producing countries feel the time has come to abandon the cooperation with consuming countries which has now lasted 25 years, in the belief that they may thus be able to avoid making the necessary price adjustment, no one will be in any position to stop them. In this case though, there would be little point in continuing the discussion on a new international tin agreement in the "Preparatory Committee".