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ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA
8:30 a.m.
Roosevelt Room

August 28, 1975

1. Report on Commodities Policy Parsky
2. Review for Meeting with the President



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

August 27, 1975

MEMORANDUM FOR MEMBERS OF THE JOINT EPB/NSC
TASK FORCE ON COMMODITIES

From: Gerald L. Parsky *GLP*
Subject: Current Commodity Policies

Attached is a memorandum dealing with U.S. commodity policy. In addition to summarizing U.S. initiatives, there is an extensive discussion of U.S. participation in the International Tin Agreement. Four options are presented for discussion.

Agency positions on participation in the International Tin Agreement will be sought Wednesday afternoon, August 27, and the EPB Executive Committee will discuss these positions at its Thursday morning meeting. There will be a subsequent joint EPB/NSC meeting to discuss these issues.

Attachment

REPORT OF THE EPB/NSC INTERAGENCY
TASK FORCE ON COMMODITY POLICY

Following the presentation of its report to the Economic Policy Board on August 8, the Joint Task Force was instructed by the EPB to finalize certain proposals presented in that report and analyse the merits of U.S. participation in the International Tin Agreement.

This report summarizes the merits of U.S. participation in the International Tin Agreement and the options for a decision whether and when to join the Agreement. It also presents in further detail Joint Task Force agreement about the conclusions of Phase I of the study, including summaries of findings on the five commodities studied (other than tin). Finally it reports on follow-up work on Task Force recommendations carried out by the National Advisory Council (NAC) on the World Bank minerals investment issue, and the International Monetary Group on the compensatory finance issue.

I. U.S. Participation in the Tin Agreement

Summary

A. Economic

1. The Task Force is agreed that U.S. participation in the Fifth Tin Agreement is unlikely to have a material economic impact, positive or negative, on supply or cost of tin.

2. Some agencies believe participation, however, would limit U.S. freedom to sell tin from our \$1.3 billion stockpile with unfavorable budgetary implications.

B. Political

1. The Task Force was unable to reach a consensus about the international political benefits of participation or the merits of announcing any participation at the Special Session. There would seem to be political benefits in improved relations with tin producers and lessened pressures from other LDCs for other commodity agreements. However, participation could lead to friction with tin producers and set a precedent for less desirable commodity agreements.

2. Domestic reaction to U.S. participation has not been determined. Congress has not yet been consulted. There are virtually no domestic producers but the consumers -- primarily the steel industry, the largest user -- have strongly opposed U.S. participation in the ITA in the past, in part because they fear it will establish a precedent. Their position this year has not yet been finally established.

A. Economic

1. Effect on Tin Price

-- The Task Force's analysis of the four previous International Tin Agreements (ITAs) concluded that they have been generally ineffectual in their efforts to stabilize tin prices. The ITA influences price exclusively through its buffer stockpile and export control provisions; the buffer stockpile has been too small to have a major impact on price.

-- Previous ITAs have been more effective in supporting the floor price than the ceiling price, largely due to export controls, the ITA's least desirable feature. They are, however, subject to consumer control and have been used primarily to avert severe temporary price declines. Controls may have retarded the shift in production toward relatively efficient producers.

-- The economic impact of the Fifth Agreement is unlikely to differ much from previous agreements. Most provisions are carryovers from previous agreements. While the buffer stockpile might reach 25,000 tons, twice the effective size under the current agreement, it would nevertheless be only a fraction of the size of the U.S. stockpile and fall well short of the level necessary to moderate major price increases such as those experienced in 1973 - 74. Under some circumstances, the larger buffer stock could delay or prevent the imposition of controls.

-- The ITA lacks many of the negative features frequently associated with recent proposals in international fora and has a balanced voting system. A majority of both the producers and consumers is required to approve either an increase in the buffer stock target price or the imposition of export controls. Under the weighted voting system, the U.S., Japan and the FRG would together control at least 49.9 percent of the consumer votes and probably a majority - depending on the number of consumers who sign.

-- The price set by the ITA is not insulated from market forces and there are many checks: tin substitutes, major producers (Brazil and China) outside the agreement, and the GSA stockpile.

-- On the other hand, it would be wrong to expect material economic benefits. Due to our stockpile, we have no major supply problems and already have the potential to exert considerable influence on the market price.

2. Effect on GSA Stockpile Sales

The U.S. owns a stockpile currently valued at \$1.3 billion. Most of this is in excess of strategic requirements and GSA has been making sales when it believes opportune. While there has been a degree of informal consultation between GSA and the ITC, GSA at times sells when the ITC is buying or otherwise uses its flexibility to pursue an independent national stockpile policy.

Examples of the use of such flexibility are the period 1968 - 73, when the U.S. refrained from sales, and the 1973 - 74 market shortage, when the GSA stockpile disposed of over 40,000 tons compared to sales of 12,000 tons by the ITC.

It is the U.S. interpretation of the ITA that we would not be under any legal requirement to harmonize U.S. stockpile disposal policy with ITC policy. Nevertheless, we might well be under political pressure to conform our domestic sales to ITC sales, or at least to refrain from selling when the ITC was buying. OMB has established the sum of \$100 million as anticipated revenue from GSA tin sales. Any shortfall in this item resulting from ITC pressures would have negative budgetary implications. Other factors, for example, market conditions, bilateral representations or lack of legislative authority, could have similar effects. (Reflecting some of these factors, GSA sold only about \$20 million of tin in FY 1975.)

3. Consultation With Industry and Congress

Members of the Task Force have met with some domestic tin consumers. Their position toward U.S. participation in the Agreement has not yet been finally established. In the past, they have generally opposed the Agreement, because they believe the ITA raises average tin prices and might set an unfavorable precedent for other agreements.

Congress has not been consulted about U.S. participation at this point. The Senate would be involved through the ratification process and Congress would become involved if a decision is made to make a contribution to the buffer stockpile. (Most agencies believe joining will create strong pressures for a contribution.) ;

B. Political

-- An announcement of U.S. participation in the Tin Agreement would be welcomed by the producer governments, (Malaysia, Indonesia, Thailand, Bolivia, Zaire, Nigeria, and Australia). The LDC producers in the ITA are moderates, whose political support we value, and dependent in varying degrees on tin for their export earnings. They see the ITA as significant and useful.

-- Participation in the ITA, the only existing mineral commodity agreement, would be evidence of the sincerity of our stated policy of considering commodity arrangements on a case-by-case basis and reduce pressure for unworkable agreements.

On the other hand, signing might create unrealistic expectations among other LDCs about the prospects for other commodity agreements. U.S. signature could thus set a precedent and lead to pressure from LDCs for U.S. participation in other agreements.

-- Once having signed, we might risk political friction with the producer countries if we strongly opposed them within the ITA or if GSA national stockpile policy proves inconsistent with ITA policy.

C. Options

The EPB/NSC could recommend one of the following:

(1) Do Not Sign the International Tin Agreement

The U.S. should not sign a mineral agreement for the first time in its history unless there are demonstrable economic benefits. The EPB/NSC study has concluded that there are no significant economic benefits and that

participation might interfere with operating GSA tin stockpiles in the national interest. Whatever political benefits may accrue do not appear adequate to justify U.S. participation in the Fifth Agreement. Nor do advocates of this option believe that the political advantages, if any, are more than short term.

(2) Sign the International Tin Agreement

The U.S. has publicly stated that it will consider commodity agreements on a case-by-case basis and this is as favorable a commodity agreement as we can reasonably expect today. An EPB/NSC study has concluded that participation will not significantly affect the price or supply of tin and it has not been demonstrated that participation would significantly interfere with GSA stockpile policy. Furthermore, on balance there are political benefits. These circumstances justify U.S. participation. Announcement of our intention to sign would not impede carrying out the usual consultations with Congress.

(3) Condition Signing Upon an Explicit Statement of the Reasons for Signing

It is a close case whether to sign. The economics of participating in the Agreement itself are neutral. The GSA stockpiles could be negatively affected, but the extent of the effect cannot be predicted. The political benefits in the short run are positive, but we are concerned that U.S. participation could be misconstrued as bowing to militant LDC pressure, pressing U.S. participation in numerous other commodity agreements, or otherwise unrealistically raise expectations. This possibility could be eliminated by accompanying the Executive statement of support for the Agreement with an explicit public statement that we are signing because it is an agreement which avoids direct pricing or indexation, works through a non-distortionary buffer stockpile, incorporates a balanced voting system, and does not require any change in stockpile policy of participating members. We would consult with Congress and might add other caveats as appropriate. Accompanied by such an explicit statement, we would support participation.

(4) Make No Decision at This Time

Countries are not required to sign until April 30, 1976; we need not make an announcement at this time. More important, Congress has not been consulted. We should use the time available for advance consultations with Congress and undertake further consultation with industry. We will then be in a better position to make a decision.

Tin Fact Sheet - 1974

Quantity (Q) is in long tons of metal
Value (V) is in thousands of U.S. dollars*

World Production - Primary

Q: 227,642
V: 1,813,885

Malaysia	30%	Indonesia	11%
USSR	13%	China, P.R.	9%
Bolivia	13%	Thailand	9%

Major Consumers - Primary

U.S.	Q: 51,611 V: 439,981	U.K.	Q: 14,317 V: 118,944
USSR	Q: 39,370 V: 327,000	Germany, FR	Q: 14,310 V: 118,944
Japan	Q: 33,284 V: 265,216	France	Q: 11,479 V: 95,760

U.S. Imports for Consumption - Primary

Q: 45,479
V: 387,744

Major Sources:

Malaysia	45%	Indonesia	9%
Bolivia	15%	China, P.R.	7%
Thailand	13%		

U.S. Consumption - Primary and Secondary

Q: 64,742
V: 551,936

Major Uses:

Tinplate	34%	Chemicals	8%
Solder	24%	Babbitt	5%
Bronze & Brass	14%	Tinning	4%

* Values derived from Metals Week annual prices (1974 cash price averages) for Penang, LME and New York.

II. Review of Phase I Report

A. General

There has been limited opportunity for further significant review of the work done in Phase I. The tentative conclusions in the Phase I report were based on an examination of six commodities (bauxite/aluminum, copper, iron ore, lead, zinc and tin). The principal agreed conclusions are the following:

- Price fixing commodity agreements are an inefficient means of transferring resources to LDCs.
- Of those commodities examined which are produced in the United States, agreements to maintain prices within an agreed range through the use of export or production controls would not appear to be economically useful or politically acceptable.
- There was no general conclusion about the efficacy of commodity agreements using other techniques for stabilizing prices. A theoretical simulation model covering the 1955 - 73 period, however, indicated that buffer stocks (without any direct export or production controls) could reduce price fluctuations with relatively small operating costs. However, the model indicated the capital costs would be very substantial, ranging from several hundred million to perhaps as much as several billion dollars, depending on the commodity and degree of price stability sought.
- There appear to be substantial difficulties, however, in implementing buffer stockpiles for bauxite and iron ore. Furthermore, on the basis of past experience, it is likely

most producer and consumer countries would favor supplementing a buffer stock with some provision for export controls as part of an arrangement to influence market price.*

- The U.S. should be willing to participate in pragmatic, case-by-case discussions with producers and consumers of specific commodities including those covered in the study. Bearing in mind the foregoing, these discussions may or may not lead to commodity agreements. Such discussions should stress information exchanges designed to improve product efficiency, market access, market promotion, product improvement, investment and diversification as useful means of dealing with particular commodity problems.
- The U.S. should pursue supply/access agreements through the MTN.
- While the U.S. should adopt the flexible approach toward individual commodity negotiations described above, we should continue to oppose indexation, generalized multi-commodity approaches, and commodity agreements that seek to maintain prices above long-term market levels.

B. Specific Commodities

Task Force findings respecting aluminum/bauxite, copper, iron ore, lead and zinc are attached as Appendix .

* Interior and CEA would stress that most probable arrangements would entail a degree of control over market price by an international organization.

III. Follow-up on Task Force Proposals

1. Increased World Bank Group (WBG) Investment in Minerals Development

In its August 8 report, the Task Force recommended that the World Bank place increased emphasis on promoting, financing and facilitating investment in mineral production in LDCs. It set out certain guidelines and agreed that the National Advisory Council (NAC) would set the specific limits.

World Bank Group investment in new sources of supply will help assure the future availability of minerals. A major IFC role in such investments will help assure private participation. The WBG should place increased emphasis on promoting, financing, and facilitating investments in mineral production in the LDCs. Within the Group the IFC should play a major role in such minerals activity. The World Bank itself should expand its financing for the associated infrastructure necessary to support such exploitation. A major expansion of IFC capital is needed to permit it to play this role. The President is being asked to approve U.S. participation in such a replenishment at \$100-115 million over 1977-79.

2. Compensatory Financing in the IMF

In its August 8th report, the Task Force concluded that compensatory finance schemes have the potential for mitigating violent fluctuations in export earnings, while minimally interfering with international commodity markets. It agreed that the International Monetary Group should develop a detailed U. S. position to implement these guidelines, for presentation to the IMF this September.

The IMG concluded that the U. S. should propose to the IMF Board of Governors a plan to assist countries suffering shortfalls in their export earnings. The plan would liberalize the present IMF Compensatory Finance Facility (CFF) by:

- increasing the limit on outstanding drawings from 50% to 75% of quota (100% if oil producing LDCs and all DCs are excluded),
- allowing a waiver on the present limit of 25% of quota to be drawn in a single year (with a new maximum of 50% if a waiver is granted),
- changing the present rule which limits the average of exports forecast in the two post shortfall years from 10% to 20%, thus making the calculation of the compensable shortfall more liberal.

Developing countries suffering shortfalls in export earnings would also be given access to the proposed IMF Trust Fund. The poorest countries would be eligible for grants for repayment of previous CFF drawings if unable to repay after five years, and all developing countries with export earnings shortfalls related to exports of specified commodities could receive additional compensatory financing on concessionary terms after using up their CFF drawing rights.

Aluminum/Bauxite

In 1973 the U.S. imported nearly all its requirements for bauxite (aluminum ore) amounting to \$143 million from the developing countries. Developing countries also supply half of our \$209 million imports of alumina, the intermediate stage between bauxite and aluminum.

Capacity would be a problem in the aluminum industry during the next three years. Profits have been low, relative to other metal industries while demand may grow at a higher than average rate. But the bottlenecks, if they develop, are likely to occur in the developed countries where aluminum metal production takes place rather than in the LDCs at the bauxite or alumina stage.

Compared to other metals the price volatility of aluminum is moderate. The price of bauxite, representing about 10 percent of the cost of aluminum, doubled during 1973-74 as a result of taxes imposed by our primarily Caribbean suppliers. It is very difficult to determine market price for bauxite because it is not openly traded and since most bauxite trades between two parts of an integrated company. The nominal price is thus in effect a transfer price rather than a market price.

For these reasons, it would appear to be extremely difficult from a technical standpoint to implement a commodity agreement aimed at fixing a price within a specified range. A further complication is frequent variations in bauxite composition. Thus, at this time, it would be very difficult to implement such a bauxite commodity agreement and in fact, for these reasons, the producers do not seek one. They prefer instead to operate through coordinated unilateral taxes and measures designed to increase secondary processing.

Copper

The U.S. is virtually self-sufficient in copper production and is the world's leading copper producer with 20 percent of world production. Including fabricated products, the industry contributed \$10 billion and 180,000 jobs to the U.S. economy in 1974. Nevertheless, the U.S. imports about 12 percent of its copper ore consumption and is both an exporter and importer of copper metal. Copper is vulnerable to substitution in many of its applications; thus, relative price relationships between copper and other metals and materials will be important to future growth. Current expansion plans by both U.S. and foreign companies appear sufficient to meet expected demand through 1978.

The U.S. relied on developing countries for 55 percent of its copper imports in 1974. Four developing countries Chile, Peru, Zaire, and Zambia, provided about 30 percent of world copper production in 1974. These countries are members of the Intergovernmental Council of Copper Exporting Countries (CIPEC) which functioned primarily as an information center until 1973 but which instituted export controls beginning late in 1974 in response to falling prices. CIPEC is now restricting copper output and is within a buffer stock scheme. The existence of CIPEC would be a key factor in any discussions with producers and consumers of copper.

The copper market has been extremely volatile, with large price swings caused primarily by short-run shifts in demand. A simulation showed that it would theoretically have been possible to stabilize copper prices during the 1955-73 period within a 10 percent range around the trend at a capital cost (recoverable) of \$4.4 million during peak periods. The model indicated the operative costs for the period would be relatively small. A buffer stock or export control proposal would probably meet with opposition from the domestic industry and could affect the normal activities of buyers and sellers.

Iron Ore

The United States ranks third in the world behind Russia and Australia as a leading producer of iron ore (92 million tons of ore were produced in the U.S. in 1974), while continuing to rank first in the production of raw steel. The U.S. iron ore industry is highly concentrated with the two largest companies producing about one-third of all domestic iron ore and raw steel.

The U.S. imports over one-third of annual iron ore consumption. U.S. exports are negligible. Leading exporters are Australia, Brazil, Russia, Venezuela, and Canada. Major importers are Japan, the Common Market and the U.S. Most U.S. imports come from Canada.

Iron ore expansion plans appear adequate to meet anticipated growth in demand at least through 1977. Substantial capacity expansion is being developed in Brazil, Canada and several African countries, including South Africa. Over the long term, the future world trade configuration is likely to shift in favor of iron and steel as opposed to iron ore since a number of producing countries want to get greater value from exports by processing.

Two-thirds of iron ore trade is under captive production or moves under long-term contracts between different parts of an integrated company, and so prices are not determined primarily by the free play of market forces. One-third moves under spot purchase or contracts with a duration of one year or less. For this and other reasons a commodity agreement designed to stabilize prices would be difficult to implement.

LEAD AND ZINC

At this time, there is no pressure for a commodity agreement in either lead or zinc, but there is an International Lead and Zinc Study Group (established in 1960) which collects and disseminates world production, consumption, trade and stock data. The United States, a leading producer and consumer, is a member of the Study Group, which meets annually to review the current and prospective market situations.

Lead metal prices have tended to rise since the early 1960's, peaking at 24.5¢ in 1973. Its present price is 20¢/lb. Zinc prices followed a roughly similar pattern, rising from 9.7¢ per pound in 1961 to 39-40¢ at present.

Developed countries, principally the U.S. and Canada, account for about 60% of world lead mine production and 85% of refined lead production. Moreover, developed countries account for over 75% of world exports in ores and 83% in refined metal.

Similarly, world production and export of zinc ore and metal are dominated by a few developed countries-- Canada, Japan, U.S., Benelux, Australia, France, USSR, and West Germany; LDCs presently account for about 13% of world zinc ore exports and 5% of metal exports.

The U.S. is reliant on imports for about one-half of its refined zinc consumption and one-fourth of its refined lead requirements; Canada, Australia and Peru are the main suppliers.

Future demand for lead and zinc is likely to be met by planned expansions in refinery capacity over the next three years; the LDC share of refining capacity is expected to increase from 25% to 27% in lead and from 14% to 20% in zinc.

Lead and zinc are unlikely candidates for an international commodity agreement. In recent years the issue has not been raised by any of the major producers even in periods of relative price weakness.

The commodities appeared on the original list of 19 commodities included in the UNCTAD Secretariat's proposals for an integrated program but were not included in the reduced list of 16 "core" commodities in the revised proposal presented at the July session of the Committee on Commodities. Most members of the Study Group, which represents virtually all lead and zinc consumers and producers, appear to be satisfied with the Study Group's activities.

Since most of the production and trade is carried on among developed countries, they would be the principal beneficiaries of a commodity agreement. Moreover, an agreement involving trade or production controls could cause serious problems for U.S. industry. These metals also present difficulties for such stabilization measures since they are co-produced - mainly with each other and to a lesser degree with copper, gold and silver - but have different end-uses.