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Dear Peter,

For those readers of the Institute newsletters who have not shared in our conversations and correspondence over the last year, I suppose a brief explanation is in order.

I first heard of the Institute's search for an Andean Fellow in October 1986, only days after returning from 14 months of volunteer service with the Catholic Church in northern Peru. The thought that I could build on my prior experience and go back to the Andes excited me enough to fashion a loose design to study how Andean youth are coping with poverty. The apparent lack of social mobility for the poor moved me to think that the possibility of regional conflict--as exemplified by M19 in Colombia or Sendero Luminoso in Peru--merited serious investigation. Then too, I was concerned with the impact of Liberation Theology upon the poor. Not since the Protestant Reformation in the 16th Century has a theological movement stirred constant controversy so far beyond the altar. Throw in the violence and distorted economies brought on by the drug trade and one might be well advised to wait for the flames. A different course of action came to mind instead. Why not take advantage of the public forum afforded in the newsletters to set on the table for discussion the difficult problems that beg solution in the Andes? The Right and the Left in Latin America have so politicized every picayune detail of existence that one wonders whether there is any room left for compromise. Yet, it seems to me that if policy-makers with responsibility in the Andes are to avoid a pot boiled over, it is high time to stop equating the middle path with cowardice.

Well then, one may ask, why does a Fellow appointed to learn about indigenous societies in the Andes postmark his first newsletter from Cambridge, England? Simply put, my view of the world broadened considerably. In the months between our first chat and my appointment I worked for the international trade law firm of Stewart and Stewart. The firm represented traditional American industries in order to bring antidumping and countervailing duty suits against foreign competitors engaged in unfair

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trade practices.

As a consequence I developed a more practical and pragmatic understanding of international business and the not so level playing field upon which it is played. I was surprised to find that Third World nations competed with one another for market share in diverse industries just as fiercely as their First World counterparts. I especially found this to be the case in the exploitation of natural resources. I was forced to admit that although I had written about the nationalization of Bolivia's mines in 1952 as part of my rationale, in reality I knew nothing of mining or the marketing of minerals in the international market. This is despite the fact that mining has been the hope and tragedy of the Andes since the 16th Century. After all, Pizarro conquered the Incas in search of El Dorado.

In particular I became intrigued by the spectacular collapse of the International Tin Council on October 24, 1985. Founded in 1956 during an era of great faith in international institutions, the ITC had been hailed as an example, par excellence, of effective arbitration between producers and consumers in the often volatile commodity markets. Mr. Pieter de Koning called the London Metal Exchange in his capacity as buffer stock manager (BSM) for the Council and informed the Exchange that the Council was broke and could not meet its forward trading commitments. Trade on the 90-day tin contract opened down on the 24th, falling quickly to L8140, well below the floor price of L8500 which de Koning was obliged to defend under the terms of the VIth International Tin Agreement. Trading in the tin contract was immediately suspended. Rumors had circulated for months that the Council, although ostensibly funded by its 22 member governments, was in dire straits. Now everyone's fears were realized, and when a Peat Marwick audit calculated the Council's debts ran to L900 million, a controlled hysteria set in. Since the Exchange operated in a principal's market instead of through a clearinghouse, no one brokerage house could be sure that its position was secure. The 14 houses caught with unfulfilled tin warrants were also obligated to the balance of the Exchange membership vis-a-vis contracts in the other metals traded: copper, zinc, aluminum, lead, nickel, and silver. A default caused by the tin crisis might have a knock-on effect around the Exchange. For the next three months bankers, brokers, and bureaucrats, tried to rescue the Council. Finally, on the evening of March 5, 1986, Indonesia and Thailand--both important tin producers--refused to agree to a plan designed to wind up the debts of the ITC in an orderly manner and release tin on the market slowly so as to avoid a free fall in the price. The Exchange decided to reopen the tin contract long enough to settle on a ring-out price of L6250 per ton. The price was a far cry from the L10,000 per ton which tin had topped earlier in the year; it was an even more distant price than the L3672.5 quoted on the European spot market in Amsterdam last week. The tin contract disappeared from the Exchange, to be replaced by waves of litigation designed to recover the losses suffered by brokers and bankers after the collapse.

This was the havoc wreaked in London. Thousands of miles away in the Bolivian sierra, the collapse of the Council proved even more immediate and disastrous. Victor Paz Estenssoro had assumed office only months before, inheriting an economy ravaged by inflation and mismanaged by state-run bureaucracy. Victor Paz was committed to rationalizing the bloated public sector. His most obvious target was the organization he helped create as the hero of the 1952 Revolution, the Corporacion Minera de Bolivia (COMIBOL). Even when the price of ton soared above L10,000, Bolivian tin moved gingerly in world markets. The location of the mines invariably top 10,000 feet above sea level. Whereas in Southeast Asia, tin is found in largely alluvial deposits mined by dredge or gravel pump, Bolivian tin miners must engage in deep-lode, hard rock extraction. These difficulties give to Bolivia the dubious honor of producing the world's most expensive tin at more than L6500 per ton.

From 1975 to 1985, tin brought in anywhere from 25% to 50% of export earnings. It was 1982 before natural gas surpassed tin as the country's number one generator of foreign exchange. In 1984 tin brought in revenues amounting to $247.8 million; in 1985 this fell to $186.7 million. The decline spurred by the ITC's collapse was not temporary. On exports of 12,000 tons in 1986 and assuming a liberal average price of L4,400 per ton, revenues did not exceed $101 million. Estimated production for 1987 dipped even lower and was matched by lower prices. For estimated production at 9,000 tons and an average price estimated at L4,000, Bolivia earned $72 million. Emphasis is placed on the estimated nature of 1986-87 figures, since I have not calculated the $ dollar/ Malaysian ringgit; tin prices are now quoted on the Kuala Lumpur tin market. Nevertheless, no one can dispute that the trend in export earnings from tin has moved dramatically downward at a time when Bolivia needs all the foreign exchange it can find to meet external debt payments.

Perhaps more important was the role played by COMIBOL in the Bolivian economy. Before the ITC collapse the parastatal firm employed 27,622 with dependents numbering 124,000. The tin crisis forced the Paz government to accelerate its plan to rationalize the mining industry; by March of this year, the State Department assured me that more than 20,000 miners had been let go with no prospect of return. Miners were paid one-time severance buyouts, but with little or no knowledge of how to invest the money, a great many miners are now clustered around La Paz and Cochabamba. Those who do not live in the makeshift tent cities have either headed for the Chapare and Beni to cash in on the coca trade or have stayed behind in the mining centers for lack of a better alternative.

With these facts in mind, I came to London last month. Had Bolivia been a victim of rapacious market speculation on the London Metal Exchange? In this sense, my concern is with the recent past; however, as any futures trader will aver, the past is indeed prologue. Futures trading sets the benchm ark for producer pricing. In turn, predictability in pricing trends allows countries like Bolivia to make decisions about investment and exploration in the commodities sector--or alternatively--shutdowns and layoffs. I will not pretend that the account which I set forth below is perfect. The amount of money involved in the litigation and the prestige or embarrassment at stake for parties to that litigation serves to keep many facts cloaked in secrecy and warps , even more. I have no doubt that each person whom I spoke to possessed his own reasons for telling me his side of the story.

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On June 26, 1985, the International Tin Council succeeded in squeezing the tin market. For short sellers on the Exchange the day of reckoning seemed at hand. Banking on the imminent collapse of the ITC fueled by rumors of its insolvency, brokers were obligated to provide tin to buyers that they did not possess. Three months earlier Pieter de Koning took advantage of the ability to sell below the M$29.15 per kg. floor price and in the process, absorbed all the available tin on the market. He was now the only ready seller to the short market.

According to sources at the ITC and LME, the market had been oversold to the extent that 380 tons of tin simply did not exist. They were nowhere to be had except on paper. It was a perfect corner. One insider bluntly remarked, "The Council had the Exchange by the short and curlies. They (the Council) could have charged any price for that tin--even L100,000 per ton. Of course, the Buffer Stock Manager would not have done so, but he would have made the brokers pay dearly for playing against the Council."

LME rules at that time imposed no limit on backwardation, that is, the situation that arises when the cash or spot price of a metal is greater than its forward price. The LME suspended trading after the second ring when the "back" climbed to L850. The Exchange rejected de Koning's offer to sell 1,000 tons to the illiquid market at L10,000-10,100. Instead the LME Committee intervened in its capacity as the governing body of the Exchange and imposed a L90 limit on the back. The move angered the ITC and brokers on the Exchange who had either covered their shorts or been forced to pay single day prompt lending before the rule change. To many, the squeeze evoked memories of Malaysia's failed attempt to corner the market through Marc Rich in 1982.

Though similarities between the two events exist, important differences remain. In 1982, Malaysia was attempting to solidify its position in the market by driving up the price. In June 1985, the corner reflected just how distorted and artificial the market had become in the three years of the VIth International Tin Agreement. Only four months later the Council fell apart, raising serious doubts about the future of international commodity agreements of any kind.

To fully understand the ITC's collapse and Bolivia's beleaguered economic position vis-a-vis the tin crisis, one must step back in time even further. Efforts to stabilize the price of tin began most significantly with the formation of the Bandoeng

Pool. Depressed commodity prices after World War I left the Federal Malay States and Netherlands East Indies with considerable overproduction. This convinced the two governments in 1921 to set aside 17,000 long tons until world stocks were drawn down sufficiently to raise the price. Whether this buffer stock actually succeeded in sending the price upward is debatable. Worthy of note, however, was that by 1925 when the Pool ended, producers realized that a measure of control over stocks also gave them partial control of the price.

The other significant attempt to influence pricing before World War II was the International Tin Control Scheme of 1931. This evolved from the unsuccessful Tin Producers Association formed after the stock market crash in 1929. The earlier group included the three major Bolivian producers: Patino, Arramayo, and Hochschild. When consumption in the United States did not recover and the Great Depression set in, the Scheme was put forth--in large part by Patino--as a more active measure to stabilize production and pricing. Bolivia, Siam, Nigeria, the Netherlands East Indies, and the Federal Malay States were represented. Agreement was reached to create a centrally managed buffer stock of 21,000 long tons to be bought and sold to defend a target price of L160. Regardless of the agreed upon production quotas, national interest prevailed. By 1934-37, the attempt by these countries to support a price was beginning to unravel and the problems of the agreement are instructive.

Simon Patino had the most obvious interest in maintaining price control. Production costs in the Orient ran about L70 per ton cheaper, allowing the Asians more flexibility. Patino even took to purchasing shares in Malayan mining companies; this overt maneuver to force Asian producers to comply with quotas designed to keep high cost producers in the game created considerable ill will. An excerpt from The Times of Malaya, May 24, 1933, reflects contemporary sentiment:

> The protagonists of tin control are to say the least, excellent propagandists; they never miss an opportunity to impress on everybody and it appears to us, especially on the Malayan miners, what a 'marvelous thing' tin control is. On the other hand, it appears to us that those who oppose tin control are people who do not interest themselves much in propaganda; obviously they do not know its value....
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> Mr. Patino's figures are correct, but what was and is Bolivia's situation as tin producer as compared with Malaya....Without the international tin control project Bolivia's mining industry would have collapsed and therefore Malaya's chief rival would have suspended production....We would add that whilst the mines belonging to the Chinese in Malaya could have continued to produce tin at this very low price (L109), we very much doubt if Bolivia could have done the same....Well do Malayan miners want the price of tin to be permanently controlled? We say that such a permanent control is contrary to Malaya's interests and we have done everything possible to oppose such a tendency....

The governments of the United Kingdom and the United States joined the Scheme from 1937-1941 as nonvoting advisors to the Committee. During this period U.S. delegates predicted that unrealistic pricing could push consumers to conduct research for substitutes. Although the outbreak of World War II insured demand for Bolivian tin (the Japanese overran Southeast Asia), this argument is used today as well to explain the shift from tin to aluminum for beverage can production.

The International Tin Council now in place traces its origins to the Havana Charter of 1947. The Charter laid down the guidelines for international commodity agreements in Chapter VI:

1. The existence of a primary commodity surplus causing serious hardship to producers;
2. The development or threat of widespread unemployment or underemployment in connection with a primary commodity;
3. These difficulties will not correct themselves in a free market in time to alleviate dislocation in industry;
4. Any commodity agreement should assure an adequate supply to meet world demand at fair and stable prices
5. Any commodity agreement should allow votes for consumers as well as producers;
6. The commodity agreement should allow for satisfaction of demand from the most economic sources.

The first International Tin Agreement was drafted under the auspices of the United Nations Conference on Trade and Development in 1956. The U.S. chose to remain outside the International Tin Council even though it allowed for consumers. The U.S. was then engaged in compiling a huge strategic stockpile of tin; thirty years later the stockpile remains a politically sensitive point with Bolivia. The total stockpile inventory stood at 312,325 tons in 1960; today that total is nearly halved at 177,053 tons (September 1987). To put these figures in perspective, one must consider that the 1960 stockpile represented almost twice the level of world consumption. The present stockpile, with 1986 world production measured at 181,000 tons, stands out as a potent force in the marketplace.

ITA I empowered the ITC to purchase tin on a cash basis only; the object was to defend a price range with an express high and low agreed upon by the members. By 1958 the Council went broke trying to defend tin at L730 a ton. The Soviet Union flooded the market with unrestricted sales; with its own strategic stockpile, and having remained outside the ITC, the U.S.S.R. had no stake in tin control. The Council went broke trying to absorb the surplus. Evidence of division between producing countries existed in the 1930's and the 1958 incident should have served warning on the present Council: when confronted by a significant producer who wishes to remain outside any market control scheme, price stabilization becomes risky business.

Once the ITC was refinanced, it rolled fairly smoothly through the next two decades. Tin consumption grew at a positive if unspectacular rate, exchange rates remained relatively stable, and the ITC claimed more than 80% of tin production under its umbrella. Important elements of the present Agreement developed along the way. ITA II required members to contribute cash to finance the buffer stock. ITA III imposed export quotas that took effect after the Buffer Stock Manager purchased 5,000 tons of tin. In 1971, ITA IV allowed the Council to enter into futures trading and removed the cash only proviso for deals with the London Metal Exchange. It was also in ITA IV that the price range which the Council was obligated to defend shifted to the Malaysian market; prices were quoted in $M (or ringgit) per picul, and later, per kilogram.

Together with the ability to trade in futures as allowed by ITA IV, the 3rd Agreement altered the original nature of the ITC. According to ITA III, the Council was no longer in the market to prevent volatility. The 3rd Agreement clearly stated the Council's new purpose: to assist economic growth in the producing countries and uphold "the importance to tin producing countries of manufacturing and expanding their 'import purchasing power...." With hindsight, these two additions to the original ITA gave to the Council its status in 1985 as a speculator. This also allowed the Buffer Stock Manager unprecedented power. One sure way to assist economic growth in the producing countries was to increase the price of tin. Of course, this takes no account of whether an increase in revenue meant an increased investment program in the producing country or whether the money left straightaway in another form. Nonetheless, it would seem that a feeling settled into the Council--and in particular, the Buffer Stock Manager's office--that the only way to beat the Exchange was to become a better speculator and trader than anyone on the Ring. In all of my conversations here, there has been universal acclaim for Pieter de Koning in this regard. He was a first-rate trader indeed.

But the International Tin Agreement was meant for consumers also. By the time negotiations for ITA V rolled around in 1975, the U.S. had reconsidered its former position on commodity agreements and became a member under the Agreement in 1976. Once a member, it was up to the U.S. and Bolivian delegates to take opposite views on almost every issue. The U.S. opposed every proposed increase in the price range, renewing the argument that artificially high prices only encouraged substitution. Even though I am an advocate of commodity agreements, there is merit to the U.S. position. Plant production of aluminum grew an average of 8.0% from 1965-70; 4.5% from 1970-75; and 4.9% from 1975-78. In the same periods, mine production of tin grew by 2.9%, declined by 0.6%, and grew by 1.5%. During World War II the tin can and C-Rations went hand in hand; now 60% of canned goods are made with aluminum. Even though aluminum has enjoyed a steady 25% rise in value this year to $U.S. 2655, this is still well below the European spot price for tin. While consumption of tin for use in solder is assured a market niche in the microelectronics industry, solder use as a whole is down. The one area in which tin consumption has grown is tin chemicals such as stannous flouride.

Continued releases from the strategic stockpile during U.S. membership in the ITC also aggravated relations with the Bolivians. The Malaysians agreed with their producer-competitors and in 1982 negotiated a "Memorandum of Understanding" to limit the disposal of tin from the stockpile to 3,000 tons per year. This tin does not enter the free market directly from the General Services Administration, which administers the stockpile; rather, the GSA provides two metal processing firms, MacAlloy and Elkem, with tin in payment as part of the Ferro-Alloy Swap and Upgrading Program. Since the collapse of the ITC, the GSA has probably released more than 3,000 tons per year; estimates for 1986 and 1987 run at 5,500 tons. This estimate is based on the fact that the Ferro-Alloy Program establishes payment credits instead of tonnage totals. Even though the details of tin contracts and prices are classified, the precipitous decline in the price of tin since 1985 certainly suggests more tin on the market from the GSA stockpile to make up the difference.

Thus, in roundabout fashion, I have brought us up to the early 1980's in tin control. Rather than elaborate more now, I will save the story of ITA VI for my next newsletter. The transition from the 5th Agreement to the 6th is crucial to comprehending the ITC's collapse and I think it is better treated separately. I am also waiting to speak with Jaime Bueno, COMIBOL's longtime representative in London. Senor Bueno is travelling in Brazil and Bolivia until he returns on May 18. I then have a few ideas about Indonesia's rejection of the plan put forth by brokers and bankers in early 1986 to moderate the effect of the ITC's default. I am reluctant to express these yet, though my reservations should be cleared up this week.

As ever,

WL Melvin

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