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WLM-2

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Dear Peter,

Yesterday I finally met my two primary tutors at the Center of Latin American Studies here. Unfortunately we did not talk about my plans; both were too preoccupied by the arrival of Octavio Paz, the noted Mexican poet and author of Labrynth of Solitude. When I found out he was due to speak upon his arrival, my plans did not seem to matter much anyway. I put away all thoughts of metal markets, miners in Bolivia, and the International Tin Council and joined the crowd to listen as Maestro Paz reflected for an hour and a half on the nature of poetry in modern society. I will pass on but a brief excerpt. A Brazilian student asked Maestro Paz to justify his shift from the Left during his association with the Surrealists before the Spanish Civil War to his present day position, which the Brazilian characterized as Center-Right. Paz responded that realism had forced him to rethink his views as he witnessed the excesses of Stalin and the failure of one planned economy after another. He mused, "The great mistake of our generation was that we forgot democracy....The terms Left and Right, they are useful as journalistic jargon only....Perhaps the problem we Latins have is that we are too passionate...we have too much identity."

But I must finish one story before starting another. As I wrote in my last newsletter, the contradictions in the structure of the ITC that led to its collapse came into being during the negotiations for the VIth International Tin Agreement, 1980-82. Haggling over the buffer stock size and use of export quotas characterized the debate that grew into a row between the consumer states led by the U.S. and the producers, led by Malaysia--and to a lesser extent, Bolivia.

The U.S. negotiating stance was strongly influenced by the election of President Reagan and the ascendancy of free market ideologues in the Administration. Although the U.S. had not been a member of the ITC during the first four agreements, it took advantage of its status as the number one consumer in the Vth Agreement to press its views. US negotiators maintained that export controls only

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encouraged uneconomic and marginal producers to stay in the game. You can well imagine Bolivia's delight upon hearing this argument. The U.S. delegation proposed a buffer stock of 70,000 tons to take up the extra production left on the market by the abolition of export controls. Producer nations countered with a buffer stock proposal of 30,000 tons. Such was the stalemate produced by this dual debate that the talks, which began in Geneva in 1980, had to be extended another year with the result that the Vth Agreement was also extended past its original 1981 closing date.

In the end, the U.S. pushed so hard for the increased buffer stock that a compromise was reached at 50,000 tons. A normal stock of 30,000 tons was to be funded by the members (shared equally among the producer/consumer camps) in either tin metal or cash.* And then, to everyone's dismay, the U.S. refused to ratify the VIth Agreement. Bolivia was opposed to any agreement that would cost it money at a time of scare foreign exchange reserves and bowed out also. To the Americans, the VIth Agreement had become a producers' Agreement; to the Bolivians, it was a consumers' Agreement. As it turned out, it was just a bad Agreement.

Much of the immediate post-crash analyses focus on the limitation imposed on the size of the buffer stock. When one takes into account the special lends, special borrows, and unpriced sales that Buffer Stock Manager de Koning accumulated, total stocks attributable to the ITC after October 24, 1985, they amount to 79,385 tonnes. This quantity, which far exceeded the declared stockpile of 52,540 tons, was forced upon the BSM as he tried to maintain the Council's price range and defend the floor of 29.15 Malaysian ringgit. A larger stockpile, so the argument goes, would have allowed the BSM more flexibility and enabled him to trade without hiding the tin "off warrant" in special deals.

However, one ITC official privy to the negotiations, argues that the fundamental problem of the buffer stock was actually much more subtle than its mere size. Although he reminded me more than once that the downfall of historians is that they, with the benefit of hindsight, try to assign foresight, he declared, "What the U.S. did not understand then and does not understand now is that the size of the buffer stock mattered not at all. The buffer stock could have been 30,000 or 50,000 or 70,000." It was the ceiling set on the buffer stock that demands attention. This limit was, in his words, "a recipe for disaster."

Under the Vth Agreement, the buffer stock and export controls worked in tandem. Article 21 sets the member states' contribution to the buffer stock at 20,000 tons, but then allows for unlimited borrowing to increase the stock. Unlimited borrowing never got out of hand because when the buffer stock hit 5,000 or 10,000 tons, export controls were put into effect. Thus, at a relatively early point in the over/under-production cycle, the BSM and Council could intervene with two weapons to bring consumption and

* A further 20,000 tons were to be made up of borrowing; thus, the total of 50,000.

production back into equilibrium. As demand picked up and the price moved out of the upper range set by the Council, sales from the buffer stock commenced in tandem with a downward revision of export controls. Thus, a country like Bolivia rarely had the incentive to flood the buffer stock with tin. It was more profitable to follow the guidelines.

In the VIth Agreement, however, the U.S. also pushed--and won--for a clause that would not allow the imposition of export controls until 70% of the buffer stock was filled. In so doing, argues the ITC official, they insured that the buffer stock would always be near capacity. Ironically, the argument for a limited buffer stock that fit in nicely with free market ideology actually encouraged the opposite: a captive market. So long as producers knew they could put tin on the market and the BSM would have to buy it up until 70% of the buffer stock was full, of course they would.

I would like to come back to this at a later date and analyze production trends with this in mind. It is a compelling argument nonetheless, if only on its theoretical grounds.

Whether one accepts this theory or not, the VIth Agreement in practice was full of holes. On 30 June, 1982, the buffer stock stood at 49,385, largely as a result of the buying forced when Malaysia's infamous "Mystery Buyer" scheme failed and some 50,000 tons of tin suddenly came onto the market. Now, when the 50,000 ton buffer stock limit for the VIth Agreement was negotiated, this figure assumed that the U.S. and Bolivia would join. When they and others did not, the 30,000 tons of the total to be made up by members' contributions had to be scaled downward to reflect the sad fact that the Council now included only 52% of the membership that participated in the negotiations. So instead of 30,000 the total was set at 19,666 tons of tin, to be contributed in cash or metal. Combine this lower figure with the 20,000 ton allowed by borrowing money, and one discovers that the ITC possessed more tin in its buffer stock than was allowed before even one transaction with the London Metal Exchange took place. To alleviate the problem, delegates decided to transfer 24,000 tons to the Vth Agreement, leaving the balance in the VIth.

If all this sounds confusing, it just gets better. Contributing to de Koning's dilemna was the fact that most members chose to make their contribution to the buffer stock in tin metal, not cash. Only Thailand made its full contribution in cash. Australia later made a cash contribution of L3.2m and transferred its tin back to the Vth Agreement; Malaysia came up with L18.8m in July 1984. De Koning faced, nevertheless, a grave and serious situation. The buffer stock was almost full and he had very little cash to maintain its size.

How, then, did the Council manage to operate for three years? Simple. De Koning secured loans using tin warrants and the reputation of the ITC as collateral; more importantly, he played a risky and dangerous game of arbitrage between the metal market and currency markets.

The bleak world economy in 1982 might have made members reluctant to make their contributions to the Council in cash. But it

also made for an overvalued U.S. dollar. De Koning was in the position of defending tin based on a reference price from Penang set in Malaysian ringgit (and the ringgit closely follows the movement of the U.S. dollar). In London, tin traded on the Metal Exchange in L sterling. This meant that as the dollar rose against the pound--and by the fall of 1984 the two currencies almost reached parity--the value of de Koning's buffer stock rose accordingly. From 1982-84 de Koning was able to play and win. Almost without variation, the 90-day contract worked in his favor since the dollar could seemingly do no wrong.

For such cash as he needed, the reputation of the ITC and the growing value of his stocks made credit easily available. Bernard Engel, then deputy buffer stock manager and in charge of securing credit, told me that such was the faith of banks in the ITC that not once did he have to go out and bang on doors. The banks came to him. Indeed, two of the major creditors to the ITC are also two of Malaysia's largest banks: Bank Bumiputra Malaysia BHD and Malayan Banking Berhad. Sir Adam Ridley, director of Hambros Bank, PLC, and chairman of the group of bankers seeking to recover losses estimated at L340m, put it this way, "We were dealing with an organiation that claims the foster parentage of the UN. There was never any doubt that the member countries would honor commitments made on their behalf by the Council....France, West Germany--these are countries with AAA credit ratings." The credit terms reflect this trust: loans were given at 1/2% abover LIBOR; tin warrants valued at 125% of the loan value were accepted as collateral. When a price decline moved the value of tin below the value of loan obligations, tin was added on margin to bring the collateral back up to 125%. Immediately after the crash speculation grew up trying to explain why the banks took such risks; there was even talk of special loan provisions that made such a venture more attractive. Engel denies this, "I wish it were so; but no, our relationship with the banks was very straightforward."

With a built-in dependence on foreign currency movements, time and circumstance could not stay on the side of the ITC forever. At a Council session in March 1984, de Koning pressed the membership for the ability to operate below the floor price. This was not granted until a year later in March 1985. By that time he had been forced to push the price higher and higher. The lapse of a year to make the decision proved costly; after March 1985 the dollar and ringgit began to decline against sterling. Forward trading gains turned into forward trading losses. One dealer responsible for a hefty volume of tin futures told me that he warned de Koening that the dollar could not continue forever upward, that de Koening's misplaced faith in the dollar was his "Achilles Heel." When de Koening did see the error of his ways, it was too late.

This dealer's view does not square entirely with the facts. Documents I have seen indicate that the BSM repeatedly warned the Council membership, from 1982 onwards, that they were gambling in a dangerously volatile market. These warnings mentioned not only the foreign exchange exposure, but the need for cash infusions to lessen the need for more loans. Yet it was not until August 1985 that a group of member states met in Canberra, Australia and decided to offer the ITC L60m to continue trading. When de Koning called the Exchange

to confess he had no more money, the promised sum was yet to be seen.

According to one delegate to the Council meetings, the inertia on the part of member states developed out of the visible evidence that de Koning was playing the market successfully. The general feeling surfaced that de Koning was like the little boy who cried wolf once too often. At times, the situation bordered on a comedy of the absurd. When one such warning failed to materialize in the fall of 1985 (solely, I am told, because of a "brilliant accounting maneuver"), the Japanese delegate took the opportunity to chastise members of the Secretariat for unnecessary doomsaying.

Others point to the existence of unpriced forward sales as evidence that the members were not adequately informed of the risky nature of their business. When the crash came, the buffer stock held some 6,810 tons of tin that had been sold but not priced. As long as the market went in the Council's favor, unpriced sales worked to increase revenue. But if there was a sudden drop in price, the difference between the Council's purchase price and the sale price created a loss. There is also the matter of "special lends and borrows"; this refers to the rolling over of the cost and interest on the tin purchase, kept confidential between the broker and the BSM. This meant that the tin really never changed hands at any expense, but moved back and forth between the Council and the Exchange in a kind of merry-go-round.

These arrangements were not solely favorable to the ITC. If the BSM operated for two years on the strength of the dollar, it is a safe bet that the brokers did so as well. The existence of the short sellers' market, culminating in the June 1985 squeeze I discussed in my first newsletter, fed happily off of unpriced sales. Unpriced sales provided a secure source of supply in such a speculative venture.

I was not able to speak with Jaime Bueno about these issues; he did not return from South America in time for me to see him. My amazement that a trading operation could take place without the full understanding of its membership did lead me to another delegate, Malaysian Trade Commissioner Amha Bin Buang. I asked him if he would agree with the one of the theses put forth in John Crabtree's new book The Great Tin Crash: Bolivia and the World Tin Market. Crabtree seems obsessed with the idea that Bolivia's current misery can be traced to the fact that brokers on the London Metal Exchange can earn L40,000 a year while miners in Bolivia eke out a subsistence wage, thereby shedding light on the injustice of the international economic system and the dominance of the North over the South. I asked Mr. Amha because the Malaysian tin sector suffered equally with Bolivia. He rejected Crabtree's terms of debate. "We are the number one loser....and the litigation resulting from the crisis makes it more expensive for us. But no, we knew the risks and we decided to take the chance. Without the Exchange we could not have

supported the price as we did. The Exchange was essential to the producers...."

Rather, Mr. Amha and other analysts draw attention to the internal workings of the Council. Since so much has been made of the producer-consumer conflict, I asked Mr. Amha how the producers got on among themselves. Again, he was frank in his response, "Well, we're all in competition with one another aren't we. You know, the problem of the ITC is the problem of all international organizations. A meeting is scheduled to begin at 10 a.m.; this means it will not start until 11 a.m. Then, because of other items on the agenda and the fear that no consensus can be reached on difficult issues, these issues are saved until the last when we must rush in order that the delegates may go home."

This procedural mentality certainly shows up in the months immediately following the crash. The creditors grouped themselves together around Sir Adam Ridley of Hambros and Mr. Peter Graham of Standard Chartered Bank. They, in concert with Ralph Kestenbaum of Gerald Metals, Ltd., constructed a rescue package known as Newco. NewCo would have been a holding company owned by the bankers and brokers to buy up the ITC's tin stocks and release them over a three year period. Originally the risk capital to be raised was set at L270m, L200m of which was to be put up by ITC member states. The targeted disposal rate of the 85,000 tons of tin, which would have come into ITC's hands in January 1986, was calculated on the premise that tin would open at L7,500 per ton, and then as the market cleared out, settle around L6,000. However, since the tin contract was suspended all this time, no one could say for sure where the price of tin might go. Thus, plans to sell 8% of the stockpile per quarter, with a minimum release of 2% per month, seemed inflexible to producers and Japan.

The early stages of talks on NewCo were marred by the unwillingness of member states to admit liability for the ITC default. The UK government stood alone in advocating a guarantee of the debt. The reluctance came then, as it does now, on the basis of sovereign immunity. Member states argued that the ITC was a limited liability concern. If that is so, and the House of Lords will finally decide if the member states are liable, the members of the ITC rarely gave this impression before the crisis. Only after the enormity of the Council's debts became known did countries try to cover their bases by resorting to legal counsel. One delegate from a producing country assured me that his country only consulted lawyers on this question after October 24. Before that date, his country's responsibility to the Council was never questioned. He maintains that the producers "were pushed to the wall" in the months after October 24. Bankers and brokers neglected diplomatic overtures in favor of a take-it-or-leave-it approach; this took little account of the fact that delegates had to confirm every stage of the talks in their capitals. Indeed, when the question of financing NewCo arose, it would have had to go before several parliaments for approval.

The situation was actually a bit more complicated. Feeling still existed among the producer countries that the Metal Exchange had unfairly changed the rules in June 1985 when the Council got ahead of the game to the producers' advantage. And the producers, mainly LDC's, were naturally hesitant to commit more money to tin when they would no longer influence the price.

Trying to understand the stance of the EEC countries is even more difficult. The obligations of countries like France, West Germany, and Holland stand out as miniscule when compared to their respective GNP's. And, when one considers the pressure currently levied on Third World governments to maintain debt service, the legal integrity of their position hardly seems credible. To this day, Sir Adam feels that the recalcitrance of the EEC countries to stand behind the ITC originates in considerations quite apart from tin. As he wrote at the time and repeated to me, "Their concern about the precedent which admission of full liability would involve was easy to imagine. With the recurrent problems over financing the EC's budget, the last thing they would want is a greater risk of complicated legal wrangles such as might arise if an Intervention Board for Agricultural Produce ran out of money and was unable to fulfill its contracts to purchase, let's say, surplus wheat."

All the above notwithstanding, when the March 5, 1986, "do-or die" deadline for accepting NewCo came, it was not the EEC countries which shelved the idea, but Indonesia and Thailand. By the end of February, the EEC states had been largely prodded into accepting the principle of the plan due to the UK's offer to supply additional bridging finance through the Bank of England.

I must admit I do not find the footdragging of the consumer countries too surprising. For most of 1985 consumers were paying wildly artificial prices; if the ITC was dead in the water, so be it. I do not mean to imply that I agree with the position. But more perplexing to me--concerned as I am with Third World development--is the inability and unwillingness of the producers to come together in their collective best interest and try the NewCo plan. There is no assurance that the NewCo plan would have worked. Bernard Engels shared his theory of the markets with me, calling it the Everest Principle. "Anytime you set a target price in the market, no matter how reasonable it is, the market will attack the price simply because it is there." Perhaps this would have been the fate of NewCo. No one knows.

My conversations here have led me to form more realistic ideas about trade based on Indonesia's rejection of the plan. Sources in London make clear that Indonesia's decision to go it alone.* A group of "Young Turks" captured the ear of Suharto in Jakarta and effectively overturned decades of cooperation in the commodity agreement. Sir Adam told me, "Not once during the course of our negotiations did I hear any concern for the marginal producers, that is, your Bolivia."

*had very little to do with official statements released.

Instead, the Indonesian position was based purely on market considerations. These "Young Turks", whom my sources declined to name, were convinced beyond all doubt that the price of tin could not fall below L5,000 per ton. Although the opinion of Mines and Energy Minister Dr. Subroto is not clear, this group carried enough political weight in Jakarta to sway the Prime Minister.

Their view of the market was not based solely on price, but a desire to steal market share from Indonesia's Asian rival, Malaysia. Thus, they could afford to ignore de Koning's explicit warning that an unregulated market might result in tin falling below L3,500 per ton.

The Indonesian rationale stems from the nature of its tin industry vis-a-vis the Malaysians. Although tin was first mined by the Dutch on the island of Bangka in 1709, the industry is still emerging. The majority of Indonesian deposits presently worked are both alluvial and offshore. This gives the Indonesians a competitive advantage since sea dredging is a relatively inexpensive industry once the initial capital investment is in place. Sea dredging becomes even more economical when one considers that nearly as much alluvial tin ore goes back over the side of the dredge as is scooped up in the first place. Thus, the same area can be mined twice with nearly equal yield.

In Malaysia, the situation is nearly reversed. Gravel pump operations comprise the bulk of the industry (56%). These mines are owned, in the main, by ethnic Chinese who have traditionally favored export control because of high operational costs. And, reserves in Malaysia have been more fully exploited than in Indonesia.

Given the above, these "Young Turks" convinced Suharto that a temporary squeeze in the market could force the Malaysian industry to contract. Conversely, Indonesia could weather the storm by expanding production and lowering costs. Then, when the price crept upward, they would rule the market.

A phone call to the Indonesian Embassy here resulted only in the answer, "I am sorry, but government policy is made in Jakarta." So I sat down with the publicly available figures to check out the theory.

Within months of the collapse, the Indonesian rupiah was devalued by 45% to make Indonesian tin more attractive. The royalty on tin exported paid by miners to the government was reduced. On the European market, tin was priced at a discount above and beyond that conferred by the devaluation. As of November 1986, none of the estimated 27,000 strong work force had been laid off. Most telling are the production figures: tonnage increased from 22,000 in 1985 to 25,216 in 1986. In 1987, it is estimated that Indonesia exceeded by 3,000 tons the export quota of 24,216 tons set by the Association of

Tin Producing Countries. Finally, the tin smelter built in 1973 to reduce the country's dependence on the Malaysians turned around a 1985 loss of $12 million to a profit of 34,700m rupiah.

But even the "Young Turks" were not infallible. If anything, production has had to increase simply to make up for the decline in revenue brought on by the persistently low price. It would not be entirely correct to lay the blame solely on the Indonesians either. When the VIth Agreement came into force, the Tin Council could no longer claim the majority of tin production under its control. Artificially high prices encouraged smuggling in the Far East that never came under any umbrella, international or otherwise. China returned to the world market with force in 1983, producing approximately 8% of the 210,000 tons mined that year. Most significantly, Bolivia's neighbor to the north has exploited some of the richest tin fields in the world. In 1977 Brazil produced only 5,761 tons; in 1985 that figure had risen dramatically to 24,900 tons. The lion's share of this tin ore is mined in the alluvial deposits of the Paranapanema owned Pitinga site located 250 km from Manaus, the capital of Amazonas. Both Brazil and China refused to join the ITC and its successor, the ATPC.

I have no idea how I will explain all of this to a miner in Bolivia. Talks held earlier this year in Geneva raised the possibility of an International Tin Study Group; its function will be purely statistical in nature. Though it is impossible for me to have an irrefutable notion of how much tin still overhangs the market, I have heard estimates as low as 34,000 tons. Twenty-five thousand tons is considered normal, so analysts are also thinking ahead to the not too distant future when tin will again top L6,000 per ton. It is certain that the era of international tin control has passed; until the litigation is settled, the London Metal Exchange has been advised to keep the tin contract off the market. And as for commodity agreements in general, Mr. Amha of the Malaysian Trade Commission sums up best the sentiment here in London, "Yes, there is talk of solidarity in the South. I do not see it. Even when you have an international agreement, it always boils down to your tin against my tin."

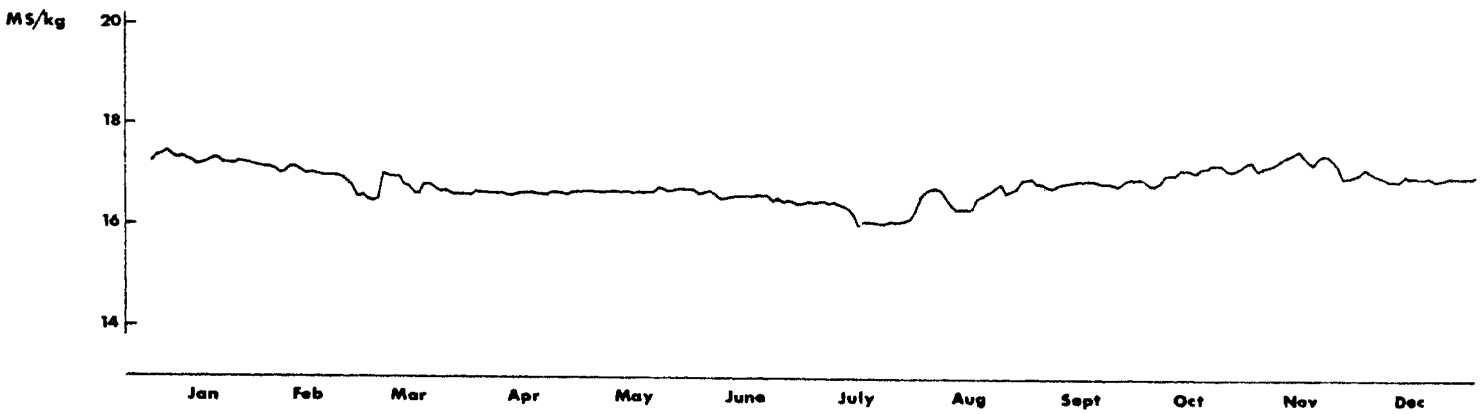
As ever,

WL Melvin

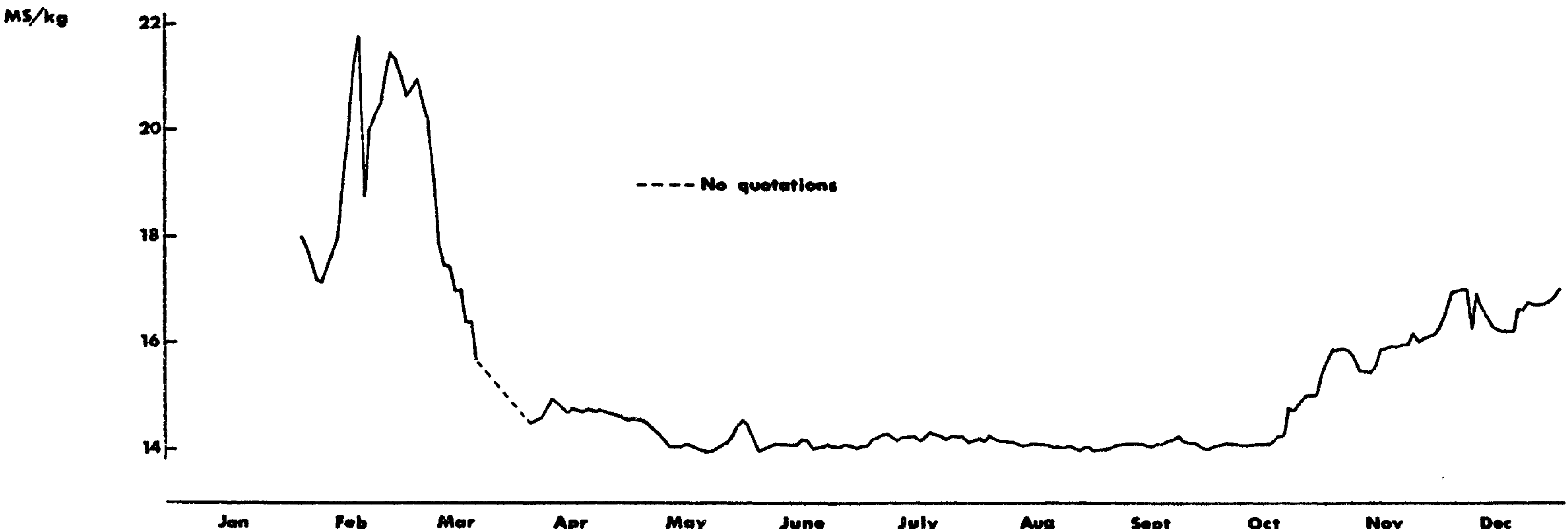
Received in Hanover 5/26/88

KUALA LUMPUR TIN MARKET

DAILY TIN PRICES 1987



KUALA LUMPUR TIN MARKET
DAILY TIN PRICES 1986



Trading on Kuala Lumpur Tin Market suspended from 25 October 1985 to 2 February 1986 inclusive.

ITA Price range	Unit	Floor Price	Sector Lower	Sector Middle	Sector Upper	Ceiling Price
	M$/kg	29.15	29.15-32.06	32.06-34.98	34.98-37.89	37.89

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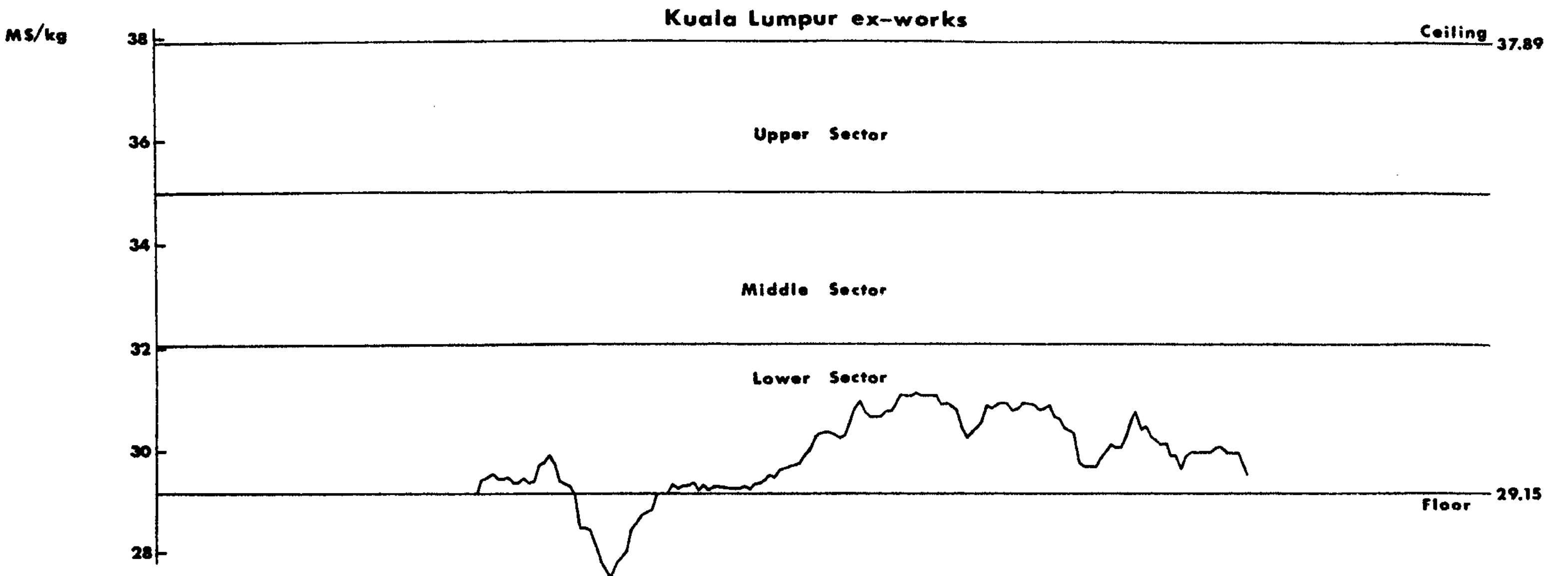
DAILY TIN PRICES AND WEEKLY LME STOCKS 1985



DAILY TIN PRICES AND WEEKLY LME STOCKS 1983

PENANG Straits ex-works

M$/kg.

38 36 34 32 30 28

Ceiling

Upper Sector

Middle Sector

Lower Sector

Floor

LME High Grade

£/tonne

9500 9000 8500 8000 7500

Cash

Forward

Jan Feb Mar Apr May June July Aug Sept Oct Nov Dec

7 14 21 28 4 11 18 25 4 11 18 25 1 8 15 22 29 6 13 20 27 3 10 17 24 1 8 15 22 29 5 12 19 26 2 9 16 23 30 7 14 21 28 4 11 18 25 2 9 16 23 30

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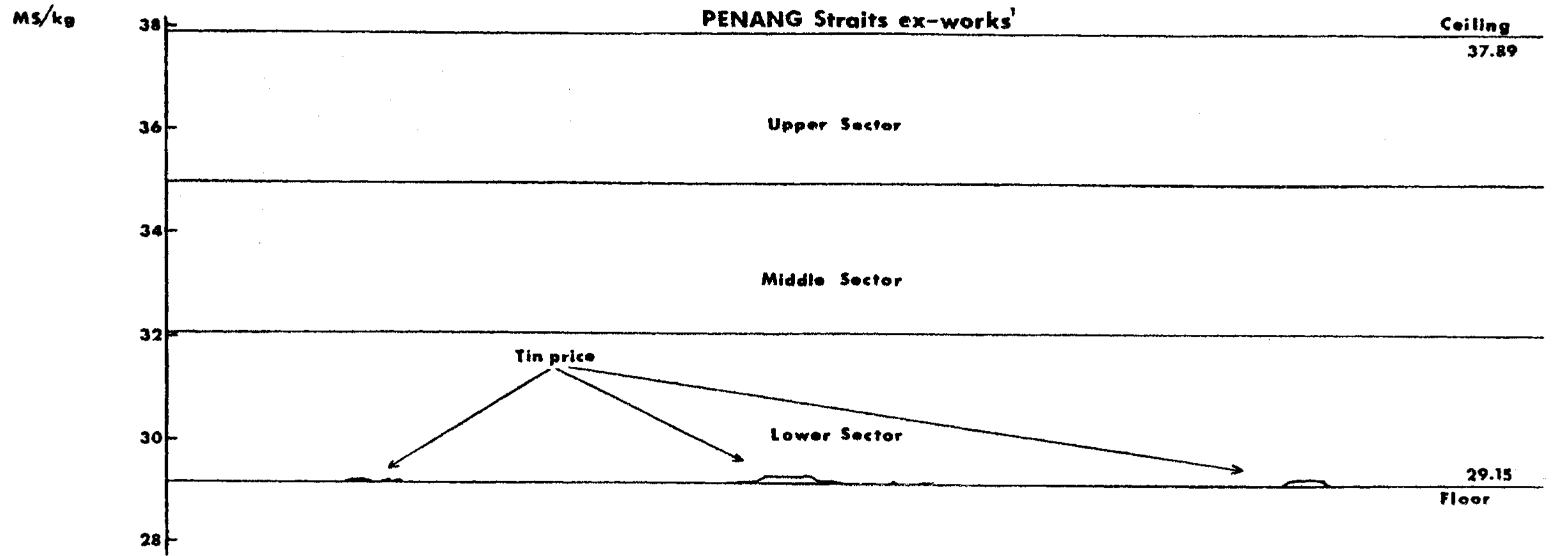
LME Standard and High Grade Stocks

DAILY TIN PRICES AND WEEKLY LME STOCKS 1984



DAILY TIN PRICES AND WEEKLY LME STOCKS
1982