

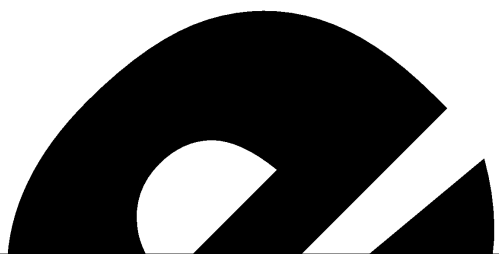


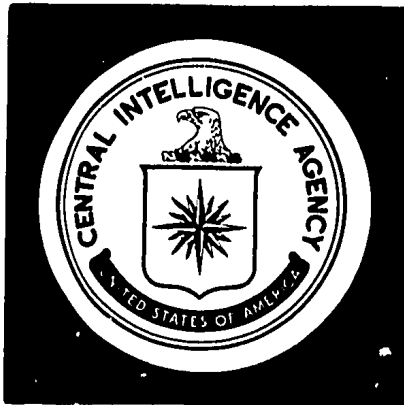
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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

Soviet Sugar Purchases and the World Market Situation

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
January 1972

INTELLIGENCE MEMORANDUM

SOVIET SUGAR PURCHASES AND THE WORLD MARKET SITUATION

Introduction

1. During the past few weeks, the USSR has purchased about 750,000 metric tons of sugar on the world market at a total cost that probably exceeds \$100 million. These purchases were made through brokers in London and New York, with most of the amount covered by Brazilian sugar plus smaller volumes from Australia and various other non-Communist sources. It had been anticipated that world sugar supplies might be tight during 1972, but large-scale Soviet buying on the world market was completely unexpected. These purchases have combined with other factors at work in the market for some time to drive world sugar prices to their highest levels since the boom of 1963. The world spot price nearly doubled between late November and early January, rising to more than 8 cents per pound. This memorandum examines the impact of Soviet purchases on the world sugar situation within the context of other forces already apparent in the market. It also assesses the 1972 outlook for the sugar market and the windfall gains accruing to major sugar exporting countries, including Cuba.

Background

2. The world sugar market is a complex structure consisting of a number of special markets more or less insulated from one another. The domestic markets of the sugar producing countries are generally regulated to protect local producers and facilitate participation in various international trading arrangements. The international markets consist of the free market and several preferential markets - the most important being the US market for Philippine, Latin American, and some other sugar; the UK market for

Note: This memorandum was prepared by the Office of Economic Research.

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Commonwealth sugar; and the Communist area market for Cuban sugar. These preferential markets maintain price-fixing arrangements, together with import quotas. The free market is the residual outlet for the world's sugar, and only that production not earmarked for domestic consumption or for one of the preferential markets is exported to it. Some 70% of total sugar output is consumed by the countries that produce it, and considerably more than half of the sugar entering international trade is exported to preferential markets.

3. The free market's status as an outlet of last resort forces it to assume nearly all the burden of adjusting to changes in world supply and demand. Because these changes are focused on a marginal segment of the total world market and because demand for sugar is relatively inelastic, free market prices (see Table 1) tend to be highly volatile, falling sharply during periods of abundant supply and rising excessively when supplies tighten. Free market prices generally run considerably below preferential rates, however, and various international agreements have been worked out since the early 1930s in an effort to stabilize them at levels reasonably profitable for the exporting countries. The new arrangement established in late 1968 under the International Sugar Agreement counts all but a few of the world's sugar exporters as participants and has been fairly successful in buoying up free market prices. Under this agreement, the International Sugar Organization controls the volume of sugar allowed entry into the market but suspends all export quotas when sugar prices rise above 5-1/4 cents per pound.

Recent World Market Trends

4. The current tight market has been in the making for several years. During 1968-70, production and consumption were in close balance, and world sugar stocks grew very slowly (see Table 2). In fact, the ratio of stocks to consumption declined during these years. In 1971, stocks declined in absolute terms as well, as a result of mediocre crops and the continuing growth of demand. Because production apparently is recovering only moderately, stocks are expected to decline further at least through the first half of 1972. A stock decline two years in succession would be unusual. The last time it occurred, the sugar market boom of 1963 was the result.

5. Because of this tightening supply trend, future prices began to increase as early as mid-1971. Spot prices, however, did not rise sharply until December, when a series of extraordinary developments exerted additional pressure on the market. Soviet purchases on the free market probably were the most important of these developments, but rising tensions in the Middle East, the war between India and Pakistan, and growing confusion in the world money market immediately preceding the dollar's

Table 1
Sugar Prices in the Principal World Markets

	Annual Averages in Cents per Pound, F.O.B. Caribbean											
	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>15 Jan 1972</u>
Free market	2.9	3.0	8.5	5.9	2.1	1.9	2.0	2.0	3.4	3.8	4.5	8.0
Preferential markets												
United States	5.4	5.6	7.3	6.0	5.8	6.1	6.4	6.5	6.8	7.0	7.8	8.2
United Kingdom <u>a/</u>	5.7	5.7	5.8	5.7	5.8	5.9	5.7	5.0	5.0	5.0	5.0 <u>b/</u>	6.4 <u>b/</u>
Communist countries <u>c/</u>	4.0	4.1	6.3	6.0	6.0	6.0	6.0	5.9	5.9	6.0	6.0	6.0

a. Negotiated prices under the Commonwealth Sugar Agreement. These prices include some freight and insurance. Following 1964, they also include special payments to the less developed Commonwealth members only. Lower prices in 1968 and 1969 primarily reflect devaluation in 1967.

b. Estimated.

c. Average prices paid for Cuban sugar only.

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devaluation all contributed to the sharp rise in sugar prices. During the first part of December, rumors of Soviet and East European interest in the free market began to appear. As additional information concerning the Soviet purchases became available, it added to the spate of speculation already under way. Rumors concerning additional Soviet import requirements in the face of shortfalls in Communist area sugar supplies continue to buoy up the market.

Sugar Production and Stocks in Communist Areas

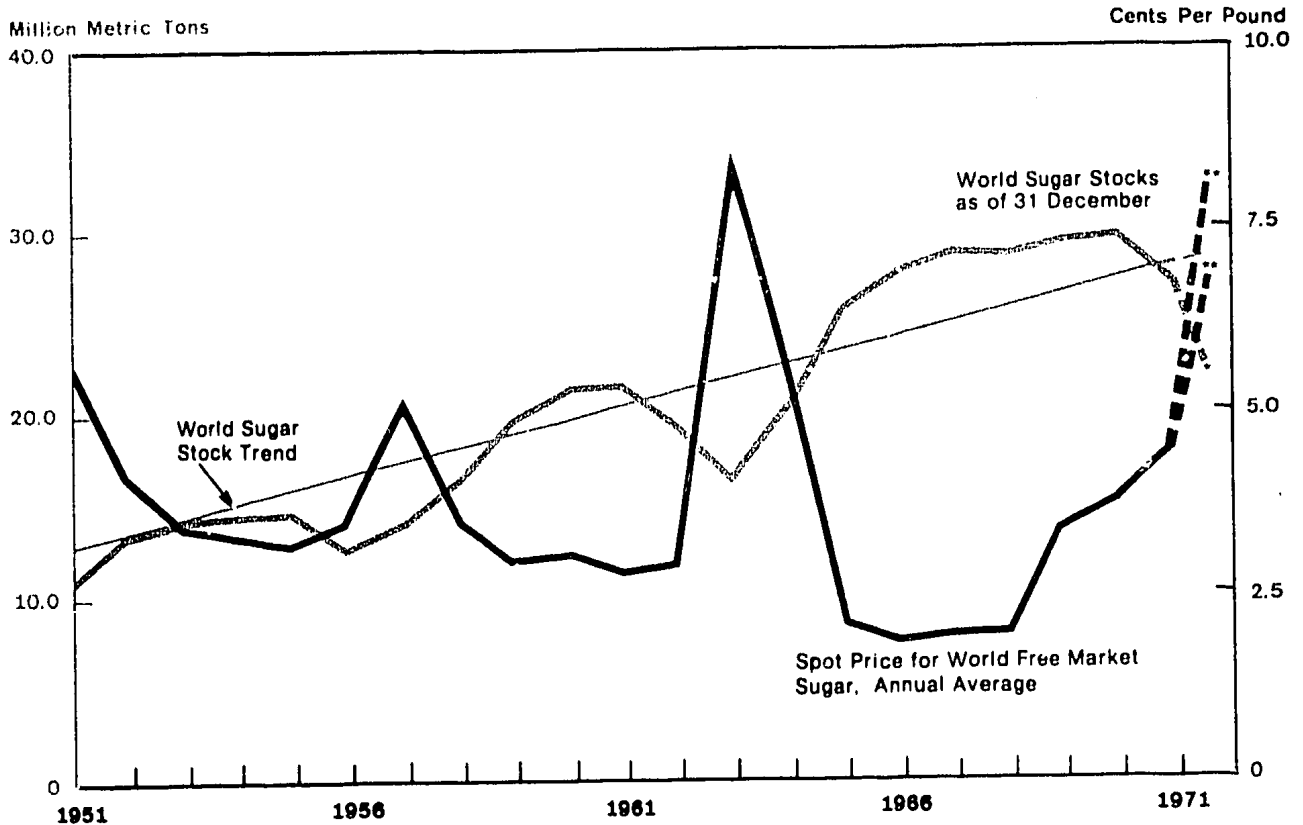
6. Total sugar output in the USSR, Eastern Europe, and Cuba stagnated during 1966-70 and dropped by about 6% in 1971, partly because of drought (see Table 3). This production record and a continued rise in consumption by more than 3% annually are important factors in the present tight market situation. The three areas combined account for more than one-fourth of total world production. After 1965 the USSR reduced the area planted to sugar beets because of the availability of Cuban sugar, but increased yields maintained production at high levels in some years. East European countries also reduced their plantings somewhat, probably because low world prices made sugar production for export unprofitable. Cuban production was plagued by labor shortages, the failure of mechanization programs, and a generally inefficient harvest organization.

7. The widening gap between total Communist production and consumption has been met by reducing both exports and stocks. Eastern Europe in 1965 was a net sugar exporter by more than 700,000 tons; by 1971 it had shifted to a net import position exceeding 300,000 tons. Since 1965, Cuban stocks have been reduced slightly; since 1969, Soviet stocks have been cut substantially. In 1971 alone, total Soviet requirements for consumption and fulfillment of export contracts may have exceeded the USSR's production plus imports from Cuba by upwards of 500,000 tons.

8. The marked decline in Soviet sugar stocks since 1969 is a partial explanation for its recent sugar purchases. Another factor, however, may be the dim outlook for imports from Cuba during 1972. Cuba normally provides about one-sixth of total Soviet sugar supplies, and good Cuban crops have tended to offset poor Soviet harvests (see Tables 3 and 4). In 1971, however, both countries suffered from relatively poor crops, and Cuba is faced with still another bad harvest in 1972. Its production is expected to fall from 5.9 million tons in 1971 to 5.0 million tons or less this year.

Market Prospects for 1972

9. Fluctuations in world sugar prices correlate closely with deviations of stocks from normal levels (see the chart, wherein normal is defined by

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*Estimated seasonally adjusted stock level as of 30 Jun 1972

**Estimated range of world sugar prices: Jan-Jun 1972

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the long-term trend line). Stocks at the end of 1971 were only slightly below normal but evidently were being drawn down very rapidly. World sugar production in the 1972 crop year* probably will fall at least 6% below requirements for consumption plus normal additions to stock. By next summer, stocks may be as far below normal as in 1963, when free market prices averaged 8.5 cents per pound.

10. This prospect probably will dominate the market during the first half of 1972. Beyond that point, production prospects for the 1973 crop year will gradually become the primary price determinant. There is a good

* The sugar crop year ends on 31 August of the stated year.

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Table 2
World Sugar Production, Consumption,
and Apparent Stock Changes a/

Thousand Metric Tons			
<u>Year</u>	<u>Production</u>	<u>Consumption</u>	<u>Apparent Stock Change</u>
1960	52,090	48,763	3,327
1961	54,726	52,756	1,970
1962	51,329	54,277	-2,948
1963	51,949	54,451	-2,502
1964	59,768	54,765	5,003
1965	64,863	59,580	5,283
1966	64,044	61,700	2,344
1967	66,380	63,675	2,705
1968	66,794	66,571	-177
1969	69,544	69,260	284
1970	72,951	72,262	689
1971	71,890 <u>b/</u>	75,000 <u>b/</u>	-3,110

a. Includes some East European countries not included in stock data shown the chart.

b. Preliminary.

Table 3
Sugar Production in the USSR,
Eastern Europe, and Cuba

Million Metric Tons, Raw Basis							
	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971 <u>a/</u></u>
USSR <u>b/</u>	9.7	9.0	9.1	9.8	10.1	8.8	9.3
Eastern Europe <u>b/</u>	3.8	4.5	4.7	4.1	3.9	3.7	3.7
Cuba	6.1	4.9	6.2	5.3	5.5	7.6	5.9
<i>Total</i>	<i>19.6</i>	<i>18.4</i>	<i>20.0</i>	<i>19.2</i>	<i>19.5</i>	<i>20.1</i>	<i>18.9</i>

a. Estimated.

b. Computed from data on refined beet sugar production on the basis of 92 parts refined to 100 parts raw.

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Table 4
Cuban Sugar Exports, by Destination

	Thousand Metric Tons, Raw Basis						
	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u> ^{a/}
Communist countries	<u>3,610</u>	<u>3,257</u>	<u>3,931</u>	<u>3,201</u>	<u>2,875</u>	<u>4,802</u>	<u>3,250</u>
USSR	2,110	1,815	2,473	1,832	1,352	3,105	1,500
Eastern Europe	669	788	768	808	863	961	1,050
Far East	831	654	690	561	660	736	700
Non-Communist countries	<u>1,706</u>	<u>1,178</u>	<u>1,752</u>	<u>1,412</u>	<u>1,924</u>	<u>2,104</u>	<u>2,000</u>
<i>Total exports</i>	<i>5,316</i>	<i>4,435</i>	<i>5,683</i>	<i>4,613</i>	<i>4,799</i>	<i>6,906</i>	<i>5,250</i>

a. *Estimated.*

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chance that sugar availability will increase sharply by mid-1973 because producers will respond to the current high prices and because better weather probably will return to the Communist countries. It is by no means sure, however, that the increase will be sufficient to cover the existing production deficit, the growth in consumption, and the additions to stocks needed to move them toward more normal levels. At present there is considerable pessimism in the market concerning possible improvement in the stock situation during the next year or so.

Benefits for Exporters

11. Cuba, the world's largest exporter, stands to benefit most from the sugar market boom, but its earnings still will not necessarily be much higher than in 1971. Cuban sugar export volume in 1972 could fall 1.0 million tons below the estimated 5.2 million tons sold last year, which would cause its total export earnings at 1971 prices to decline from \$825 million to about \$700 million. This prospect is now changed. Cuba could increase its total export income slightly this year if the sugar price obtained on its free market sales averages close to current market levels.

12. The USSR - a major exporter to the free market - will benefit relatively little from this year's high prices, because it has been forced into the market as a buyer to cover its export commitments. Net Soviet exports to the free market may amount to no more than 400,000 tons in 1972 compared with an average of more than 1 million tons in recent years. Eastern Europe also continues to be an important exporter to the free market and could derive considerable benefit from current high prices. These exports, however, are made possible only by large imports from Cuba. In 1970, Eastern Europe exported close to 1.1 million tons to the free market but imported nearly 1.0 million tons from Cuba. Prices paid to Cuba, which average close to 6.0 cents per pound, are fixed on a long-term basis and are not likely to be affected by the current market situation.

13. Many non-Communist producers, the Philippines and most Commonwealth countries in particular, will benefit little if at all from the market boom because all but a small part of their sugar is exported to the US and UK preferential markets, where prices have increased only moderately. The Commonwealth Sugar Agreement's negotiated price was increased recently from 5.0 cents per pound to 5.8 cents. In addition, the special payment made to the less developed Commonwealth members was raised from 0.175 cent per pound to 0.810 cent. Preferential prices paid by the United States have increased from 7.5 cents per pound (f.o.b. Caribbean) in mid-1971 to about 8.2 cents in mid-January 1972. This increase appears to reflect concern on the part of domestic sugar traders that foreign suppliers will shift exports to the free market if US prices

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fall below world market levels. This fear is not well founded, however. Little diversion of this sort occurred during the boom of 1963, and it is doubtful that exporters would risk long-term benefits from access to the US preferential market to exploit an advantage that probably will be relatively short-lived.

14. Finally, there is a broad group of countries that export both to the free market and to preferential markets. Among the Commonwealth countries, Australia is the most important exporter in this group, with more than 60% of its annual exports of more than 1.5 million tons of sugar going to the free market. If prices remain high, Australia would earn an additional \$85 million on its normal volume of free market sugar sales – a gain of minimal importance to its balance of payments. Windfall earnings will be of far greater significance to less developed countries such as Brazil, the Dominican Republic, Taiwan, and India, which also are major exporters to the free market. All of these countries will benefit substantially from high world sugar prices, but Brazil and the Dominican Republic probably will benefit most of all because they have large stocks available and can take maximum advantage of the current market.

15. Brazilian sugar will be used to fill about three-fourths of the recently contracted sales to the USSR – an amount approximately equal to Brazil's normal annual sales to the free market as a whole. Because of its large stocks, Brazil may be able to maintain sales to its regular free market customers as well. If its free market sales thus double in 1972, its sugar earnings at current price levels could rise by some \$125 million, or almost 5% of total exports in 1971. In such an event, earnings from free market sales would more than match those from expected sales to the US preferential market. The current boom will have a far greater impact on the Dominican Republic, which relies on sugar sales for about half its total export earnings. If International Sugar Agreement quotas remain suspended, the Dominican Republic would be able to about double its free market sales by drawing down on its large surplus stocks. These sales could exceed \$100 million, approximately matching Dominican earnings in the US preferential market and helping to drive total exports some 50% above their 1971 level.

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