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Central Intelligence Agency

Washington, D.C. 20505

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DIRECTORATE OF INTELLIGENCE

14 NOV 1985

MEMORANDUM FOR: See Distribution

FROM : [redacted] 25X1
Director, Office of Global Issues

SUBJECT : Impacts of Tin Market Collapse

Attached is a draft Intelligence Assessment that examines the tin market collapse and its potential ramifications for key players and institutions. Because the Tin Council meets again on Thursday, we felt you would find this advance copy useful. Should you have any questions, feel free to call [redacted] 25X1

[redacted] 25X1

Attachment:
<u>Crisis in the Tin Market: Current Situation and Long-Term Fallout</u> [redacted] GI M 85-10299, November 1985, [redacted] 25X1

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[redacted] 25X1

[redacted] 25X1

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[redacted]

SUBJECT: Impacts of Tin Market Collapse

OGI/ECD/CM/[redacted] (13 Nov 85) 25X1

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[redacted]

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Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

13 November 1985

Crisis in the Tin Market: Current Situation and Long-Term Fallout

Summary

The crisis in the tin market will not be resolved soon. Nearly all trading has been halted since the International Tin Council announced on 24 October that it could no longer support prices and reports of unofficial trading indicate prices are around 20 percent below the pre-crisis LME price. The member governments of the Tin Council, traders holding tin on the London Metals Exchange, and banks holding large tin stocks as collateral face grave obstacles to agreeing on a plan to resume tin trading at reasonable prices and, at this point, we do not believe the Council's debts will be repaid. [redacted] 25X1

The impact of the crisis will spread beyond the tin market. We believe tin trading will resume at prices 30 to 50 percent below the pre-crisis level. This implies sharply reduced tin earnings for Malaysia, Indonesia, and Thailand--and a devastating effect on Bolivia, where a 30 percent price decline would reduce total export earnings by a tenth. The tin crisis also may accelerate the decline of commodity agreements in general, and the London Metals Exchange could lose its dominant role in world metals trade as a result of recent events. Although several banks could suffer sizable losses as a result of the tin price collapse, none, in our judgment, is in danger of insolvency. [redacted] 25X1

The political fallout within the mining regions is likely to outweigh the direct economic impacts. With mine layoffs increasing, a strong political backlash is especially likely in Bolivia where layoffs could reach 40,000. Bolivian mineworkers are heavily unionized and influenced by the left. Such massive cutbacks will endanger the current La Paz government. In Malaysia, the fallout will affect primarily the ethnic Chinese who account for the bulk of mining activity. The big losers in Thailand will include powerful interest groups in the southern region where tin production and trade, including smuggling, is concentrated. [redacted] 25X1

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This memorandum was prepared by [redacted] 25X1
[redacted] Commodity Markets Branch, Office of Global Issues. The information contained herin is updated to 13 November 1985. Comments may be directed to [redacted] Chief, Commodity Markets Branch, [redacted] 25X1

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Crisis in the Tin Market: Current Situation and Long-term Fallout

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Background: The Role of the International Tin Council

The tin market collapsed because of actions taken by the International Tin Council--a 22-member organization of producer and consumer countries which has been in operation since 1956 to stabilize world tin prices. In recent years the the Council has supported prices by limiting tin exports from member countries and by purchasing tin on the open market. Because tin on the London Metals Exchange is priced in British pounds sterling, the weakness of the pound since 1980 helped buoy tin prices. As the pound began to rise earlier this year, however, tin prices began to fall. As a result of heavy buying and borrowing by the Council bufferstock manager, Council support funds were rapidly depleted. Finally, in late summer the Council's credit started to dry up and the Council turned to the Association of Tin Producing Countries for financial help. The ATPC promised to ante up an additional $60 million, but by late October failed to deliver. On 24 October, a secretive emergency meeting of the Council in London failed to solve the liquidity problem. Within minutes after the meeting, the price of tin on the LME plummeted. 25X1

The Current Market Situation

Tin trading has been suspended on the London Metals Exchange and the Kuala Lumpur market--the only two major tin exchanges--since the crisis began on 24 October. Although the LME hoped to stop trading until the Council and its creditors had reached some agreement to resolve the crisis, the exchange has announced it will reopen its tin market on Monday, 18 November as a result of pressure from some traders, and in an effort to put pressure on the negotiators. Press reports indicate some off-market, unofficial tin trading is occurring at prices of $8,400 to $9,900 per metric ton--roughly 15 to 30 percent below the pre-collapse LME price. The lack of organized markets to sell tin has caused many mines in Thailand and Malaysia to begin closing. 25X1

Uncertainty about the tin market has affected trading in other metals as well. Copper prices fell 10 percent in the first week of the tin crisis, while aluminum, lead, nickel, and zinc prices fell 5 to 10 percent. According to industry analysts, the price declines were triggered by large-scale dumping of these metals by LME traders trying to accumulate cash to cover their possible tin losses. Overall, however, international trading in metals has reportedly been light as traders remain cautious. For example, trade volume in silver has dropped by two-thirds, while copper trading has fallen by 60 percent. Since 1 November metals prices have recovered to near their pre-crisis levels but continue to react strongly to news on the tin situation.

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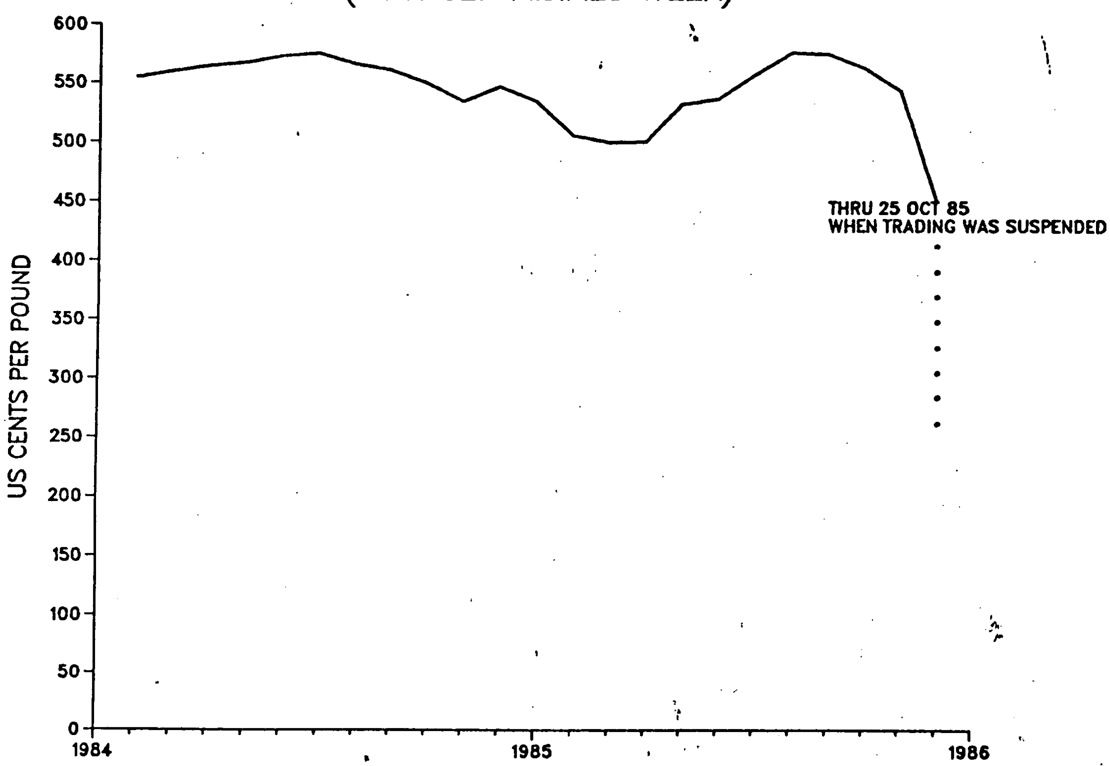
LME TIN PRICES
JANUARY 1984 – OCTOBER 1985
(SOURCE: METALS WEEK)



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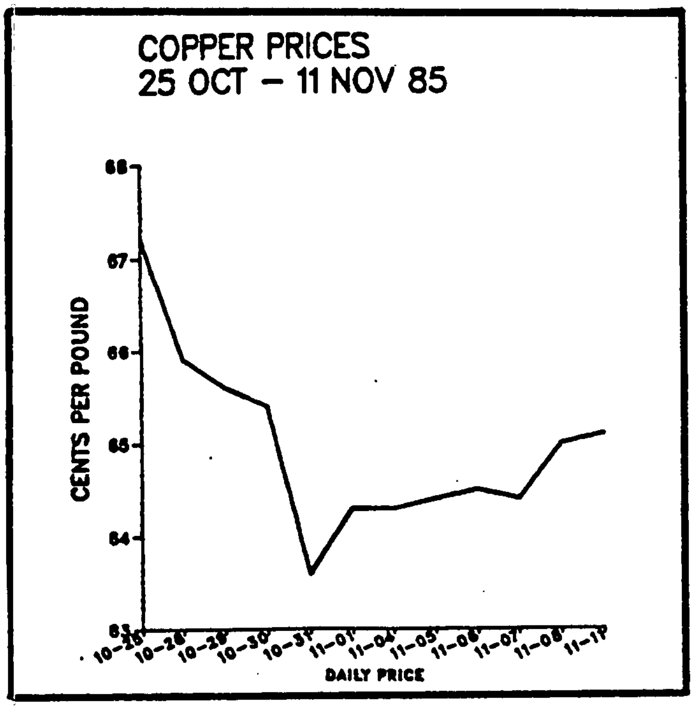
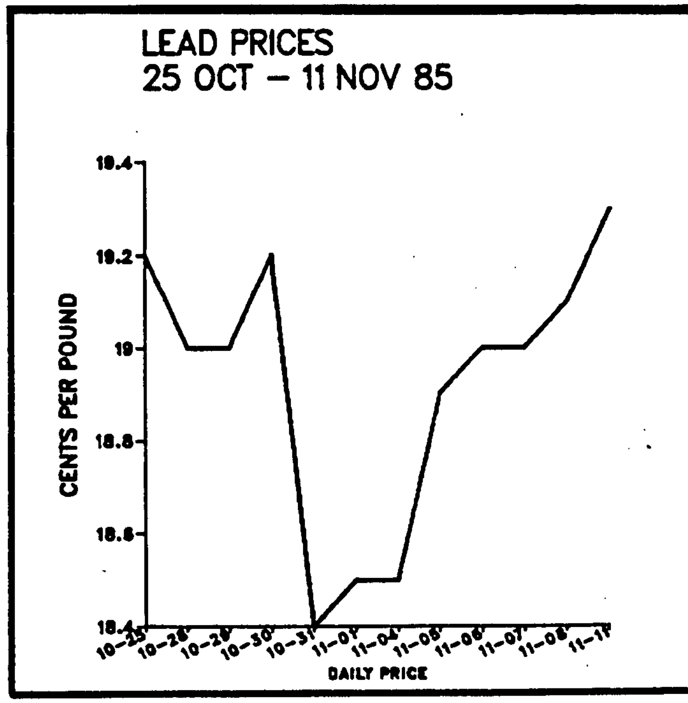
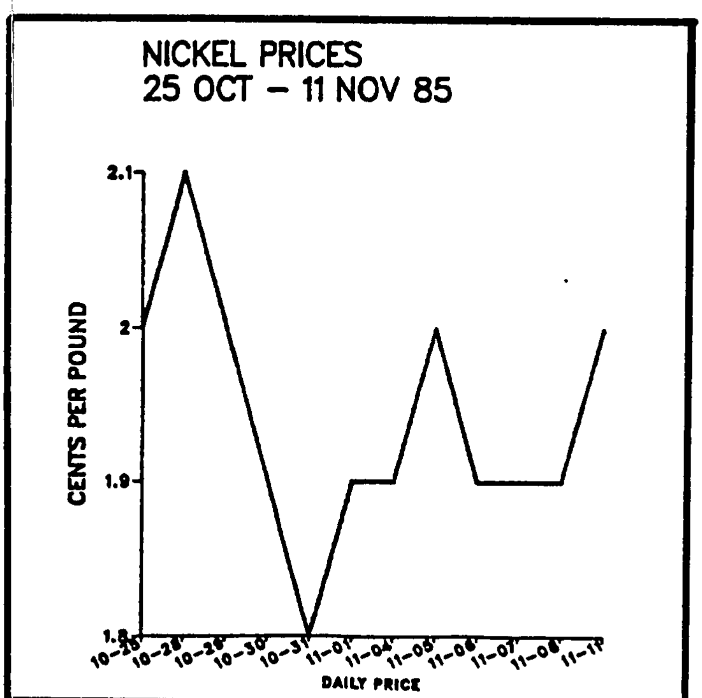
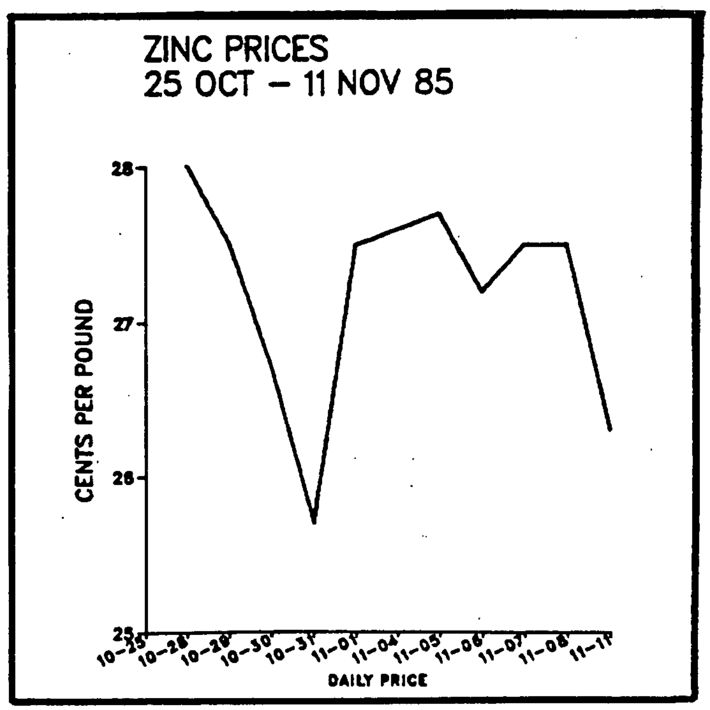
THE RESPONSE OF OTHER METALS AFTER THE HALT IN TIN TRADING









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A general loss of confidence in the LME--whose prices for the seven metals it trades are normally the international benchmark--has resulted from the tin crisis.

- o For example, Inco Limited of Canada, the world's largest nickel producer, asked the LME to halt nickel trading on 31 October due to the crisis' effect on nickel prices, stating that it would no longer consider the LME nickel price a meaningful indicator.

- o Following Inco's move, Cominco Limited of Canada reported that it had suspended sales of lead and copper based on LME prices.

- o To protect itself against large losses on the tin it holds, the Malaysian Mining Company withdrew from the LME after it was announced trading would resume.

One industry observer described this disregard for LME prices as part of a "ripple effect" that could worsen as the tin crisis continues. 25X1

Extent of the Financial Crisis

The extent of the financial crisis produced by the tin market collapse is serious and is aggravated by the complexities of the tin market's financial linkages.

- o The Council financed its bufferstock purchases with contributions from its members and by borrowing. The bufferstock owned 52,500 MTs of physical tin valued at $700 million just prior to the crisis, and owed $490 million to banks. The banks and traders are holding the Council's tin stocks as collateral. Creditors had required 125% margins on loans to the Council--meaning a one-dollar loan required $1.25 worth of tin. With a 20 percent price drop, the value of the tin collateral would barely exceed the value of the loans.

- o Moreover, the bufferstock manager had committed the Council to purchase 61,000 MTs of tin over the next three months at an average price of 8,900 pounds sterling per MT--a commitment of $772 million. Instead of making these purchases, however, the Council has the option to pay the sellers the difference between the contract price and the prevailing market price at the time the contract must be executed--the so-called "broker differential." 25X1

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THE MAJOR PLAYERS IN THE TIN CRISIS

The International Tin Organization governs the International Tin Council--a 22-member voting body of tin producing and consuming nations--and is a United Nations' affiliate. The number of votes held by each country is directly proportional to its net production or consumption of tin.

Producing Member	Percentage	Number of Votes
Australia	9.16	94
Indonesia	24.98	247
Malaysia	40.83	401
Nigeria	1.73	22
Thailand	21.74	216
Zaire	1.56	20
Total	100.00	1000

Consuming Member	Percentage	Number of Votes
Canada	4.75	49
EEC	51.06	515
Belgium/Luxembourg	2.32	26
Denmark	0.04	6
France	10.11	98
West Germany	18.27	173
Greece	0.43	9
Ireland	0.02	5
Italy	5.63	57
Netherlands	6.29	63
United Kingdom	7.95	78
Finland	0.15	6
India	2.83	31
Japan	39.67	370
Norway	0.50	9
Sweden	0.19	7
Switzerland	0.85	13
Total	100.00	1000

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<u>The Association of Tin Producing Countries</u> is an organization of producing countries and is separate from the International Tin Council. Members of the ATPC need not be members of the ITC and are not obligated to support the bufferstock operations. The membership is as follows:

Australia	Nigeria
Bolivia	Thailand
Indonesia	Zaire
Malaysia	

<u>The London Metals Exchange</u> is an international terminal market trading in seven metals. The LME has 28 members and is the only exchange where its members trade as principals directly with one another. The prices on the exchange serve as benchmarks for international metals trade. Metals traded on the LME are:

Aluminum	Silver
Copper	Tin
Lead	Zinc
Nickel	

<u>The LME members as of 24 October were</u>

Amalgameted Metal Trading	Ametalco Trading
Billiton-Enthoven Metal	Boustead Davis
Anglo Chemical Metals	Henry Bath and Son
Brandeis Instel	Cerro Metals
Entores	Gerald Metals
Gill and Duffus	Holco Trading
Johnson Matthey Commodities	Lazmet
Lonconex	Maclaine Watson
Metallgesellschaft	Metdist
Malaysian Metals	Mocatta Commercial
Phillip and Lion	J. H. Rayner
Sharps and Pixley	Shearson Lehman Metals
Sogemin Metals	Triland Metals
Wilson, Smithett, and Cope	Rudolf Woolf

With the exception of Metdist, these firms are owned by larger corporations of Britain, Canada, West Germany, Japan, Belgium, Malaysia, and the United States. Malaysian Metals withdrew on 12 November.

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[redacted] 25X1

As a result of this broker-differential arrangement, the lower the market price the more the Council will owe the traders if it is unwilling or unable to buy. For every one-thousand pound drop in the tin price from 9,000 pounds per ton, the Council will owe traders an additional $86 million. According to press reports, 14 LME trading firms have such contracts with the Council, but only some of these firms have large contracts. Moreover, because the value of the banks' tin collateral has fallen, the Council now has "residual debt" to its creditors--debt that the collateral no longer covers. Again, this causes the Council's liabilities to rise as the price of tin falls. According to Tin Council estimates, a 30 percent drop from the 24 October price would produce a residual debt of over $300 million. [redacted] 25X1

The legal obligations of the players in this situation are unclear. The agreement that allows the Council to operate in London subjects the Council to British court rule--meaning banks and traders could sue the Council. There is, however, dispute over whether the individual member states are responsible for the Council's debts: most Council governments do not consider themselves liable. [redacted] 25X1

<u>Short-term Outcomes: Three Scenarios</u>

We believe there are three possible outcomes to the current crisis. <u>First, the Council could default on all obligations and let the tin market collapse entirely</u>. Some observers believe prices could fall to 3,000 pounds per MT from this year's high of over 9,000 pounds as banks and traders liquidate all tin assets to cover their losses. Other metals prices and producer earnings also would be slashed in the fallout. Most of the LME trading firms are owned by multinationals that could provide funds to their subsidiaries if the Council defaults, according to trade press reports. [redacted] 25X1
[redacted] many of these parent corporations may be unwilling to bail-out their trading subsidiaries if the crisis drags on. 25X1 The banks would also suffer, but we believe that all have sufficient backing to weather a default. Hardest hit would be Malaysia's two largest banks, Bank Bumiputra Malaysia Berhad and Malayan Banking Berhad, which together hold about one-third of the Council debt. There are indications in the press that the British government might provide financial support to any creditors facing insolvency as a result of default. [redacted] 25X1

The LME might not survive a collapse. International confidence in the LME--which is critical for any commodity exchange--may be destroyed if even one of the LME's 28 traders goes under as a result of this crisis. The LME's unique trading method--brokers deal with each other rather than through a central clearinghouse--has long been questioned, and some metals traders view the tin crisis as an indictment of this

[redacted] 25X1

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RESIDUAL COUNCIL DEBT TO TRADERS AND BANKS
(millions of US dollars)

Price in pounds/MT	Brokers	Banks	Total
6,000	251	36	287
5,000	338	109	447
4,000	424	185	609
3,000	511	258	769

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ANNUAL COSTS TO COUNCIL OF RESUMING BUFFERSTOCK OPERATIONS
(millions of US dollars)

Price in pounds/MT	Broker differential	Interest	Working capital	Estimated total costs
8,000	78	85	113	275
7,000	164	81	100	345
6,000	251	77	85	413
5,000	337	72	71	480

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system. The death or reform of the LME would bring an important change, and, at least during the transition, introduce additional uncertainty in the way global prices of the seven LME metals are set each day. 25X1

Second, the bufferstock could be slowly reduced and most Council debts honored. Under this plan, the Council must assure its creditors that it will pay its debts--or the creditors will sell the tin held as collateral on the open market pushing prices sharply lower. How much capital the Council members would need to provide under this plan depends on the tin price that would prevail after trading resumes. While the ITC would survive on paper, tin prices would fall to market-clearing levels. Perhaps more importantly, the LME would stand a better chance of survival. 25X1

Finally, the Council could attempt to resume full bufferstock operations. For the Council, this option has the benefit of maintaining the value of the tin collateral held by banks and reducing the broker differential that would be owed traders for the Council purchase commitments. Because of this, the short-run costs of this option are lower for the higher support prices. Whether this option is viable in the long run, however, is open to question. Indeed, this path likely would be expensive because it would require continuing contributions from Council members. 25X1

Actions and Rumors of Actions

To end the crisis, the Council has been holding on-again, off-again meetings in London. The last session, which ended on Thursday, 7 November, produced only a lukewarm announcement that the Council was working on the problem. The Council has ordered a financial audit to determine the precise position of the bufferstock and its liabilities, and hopes to have it completed by the next meeting to be held Thursday, 14 November. 25X1

The banks involved have formed an emergency committee to discuss the problem and act with a united front. The 28 LME traders have deposited with the exchange $72 million to provide extra security against possible tin losses by members--and to boost the reputation of the exchange. LME president Jacques Lion has written an open letter to Prime Minister Thatcher urging her personal intervention in the crisis. As a group, however, the LME traders have taken no stand on the situation, and the Tin Council chairman, Peter Lai, has told US officials in London that he has had "difficulties" dealing with the traders. Related to this are press reports that some traders are considering filing suit against the Council. 25X1

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No comprehensive rescue package has been put forward by any party. Fragments of proposals--variations on scenario number two above--have been suggested, however:

- The banks have said they would postpone the Council's debt and interest payments for at least one year if, in return, the producing member governments provide 60 million pounds to meet their current tin purchase commitments and gradually reduce the stocks. Further, the banks want government guarantees that all of the Council's debts and future interest payments will be paid.

- The British government's rudimentary proposal also calls for an orderly sell-off and the payment of all Council obligations. Properly executed, this plan would lead to lower tin prices but, by saving the LME and its traders, allow the continuation of orderly metals markets. [redacted] 25X1

There are rumors of other actions to resolve the crisis:

[redacted] 25X1

- There are diplomatic and press rumors that the big three producers--Malaysia, Thailand, and Indonesia--are formulating a proposal to pay the Council's debts and resume bufferstock operations to defend a lower price level. [redacted] 25X1

These proposals, as well as any other rescue plans the parties might develop, would require substantial amounts of cash, commitments for future payments, and could not guarantee a smooth transition to a post-crisis market. Moreover, our analysis of the governments involved indicates little money will be forthcoming. [redacted] 25X1

<u>Positions of the Governments</u>

The incomplete nature of the above proposals suggests to us that there are no solid negotiating positions among the parties. To date, the only basis of agreement seems to be that tin prices will not return to the pre-crisis level. Moreover, we believe any plan that leads to an orderly market and repayment of Council loans must include the cooperation of the Council, its member countries, the bankers, and the traders. [redacted] 25X1

[redacted] 25X1

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Despite the rumors of an ambitious producer proposal, [redacted] the Council's member governments will not readily agree to any plan that requires substantial outlays by the members: 25X1

- Malaysia is the world's largest tin exporter and has a 20 percent payment share in the Council. [redacted] the Malaysian government will provide no more funds to help the Council. Malaysia has not informed other governments of any decision, but other Council members are looking to Malaysia to take the lead in any Council rescue effort. 25X1 25X1

- Thailand is also strapped for funds. The Thai government has announced it will contribute but only if other members pull their own weight. Thai miners were arguing for withdrawal from the Council even before the crisis.

- Nigeria has a small share in the Council's obligations, and is likely to endorse the least expensive rescue package because of the country's financial situation.

- Brazil, Bolivia, and China, not members of the Council, are not participating actively in the talks. Brazil has repeatedly stated its opposition to joining the Council, Bolivia has no money to support a rescue effort, and we have seen no Chinese response to the crisis. [redacted] 25X1

Most consumer countries have also balked at supporting a rescue package. With the exception of the United Kingdom, which put forth the proposal outlined above, the European Community countries have largely acted through EC channels. EC tin policy officials told the US mission in Brussels on 5 November that the other nine were against providing government guarantees to support the ITC. Prior to the announcement that trading would resume on 18 November, the EC could not consider any proposal until tin trading resumed. Moreover, the officials implied that the EC governments, except for Britain, did not consider the Council member governments liable for council debts. [redacted] 25X1

[redacted] 25X1

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A Likely Outcome

Given that the Council governments, with the exception of Britain, are either unwilling to contribute any funds, or will contribute only if all other members pay their shares, it seems likely that little money will be forthcoming. The decision by Malaysia not to contribute is particularly devastating to any chances for a cooperative resolution. Malaysia is considered a leader among the exporting Council members. Other producers, therefore, are likely to follow Malaysia's lead and not contribute. The tin-importing members are not likely to rescue the Council--which they have always believed to be a tool of the producers. 25X1

As a result, we believe the Council will ultimately default on its debts to traders and banks. These creditors will then be forced to liquidate their tin holdings--causing a 30 to 50 percent collapse in tin prices from their pre-crisis levels. The current efforts by the banks to seek cooperation from the Council members may shift, however, to an effort to collaborate with the LME traders--who also control large quantities of tin--to bring down the price of tin slowly, and perhaps sue the Council governments individually or collectively to recoup their losses. 25X1

Because the Council members' unwillingness to cooperate in a rescue effort is probably not fully recognized by the creditors, negotiations are likely to continue for a few more weeks. There is an outside chance that the creditors could persuade the Council to make some concessions in this period. Time is against them, however. The legal ambiguities, the size of the sums involved, the usual problems of negotiations, and the slowness of consultations with the respective home capitals will combine to bog down any resolution process. Meanwhile, pressures are building to resume tin trading by traders, speculators who sold tin short before the collapse, and private tin miners and users. It will be more difficult to negotiate a settlement while tin markets are open because of the changing value of the enourmous tin stocks being discussed. 25X1

The Long-Term Fallout

Regardless of how these events unfold in the near term, we believe prices will remain low for many years. In the meantime, falling tin prices will result in a shake out of many high-cost producers and substantial losses in earnings for several LDC exporters. Tin consumers, on the other hand, will benefit as prices drop. Lower prices will have little influence on overall tin consumption, however, because substitutes and improved technologies will continue to work against tin demand. The tin crisis could have widespread negative effects on other commodities as well. 25X1

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Country Impacts

Overall, the drop in tin prices is another blow to LDC commodity exporters already dealing with debt and earnings problems. [redacted] The drop in tin prices will not affect all producers equally, however:

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- Bolivia, which depends on tin sales for roughly a third of its export earnings, will be extremely hard hit. The combination of the low tin prices and declining production will probably lead to a foreign exchange earnings drop of $100 million in 1985, causing a 14 percent loss in overall export earnings. According to the US embassy, most private mines will close--creating 40,000 new unemployed. This will increase the political risk the coalition government now faces because of the leftist influence on the heavily-unionized mineworkers. The price drop may, however, provide a scapegoat for the president's already-formulated plans to slash employment in the public mining sector. Bolivia has approached the IMF for compensatory financing as a result of the crisis.

- Malaysia should be in a good position to weather the transition. Due to export quotas, many inefficient operations have already been trimmed. Nonetheless, the government estimates that only 22 of the existing 400 mines could survive a 50 percent drop in tin prices--throwing 17,000 out of work. Because tin accounts for only 3 percent of total export revenues, this will not pose a serious economic problem, but the political risks may be considerably steeper. Most of the small producers who are likely to fail are ethnic Chinese--politically important to the current government.

- Indonesia, which together with Malaysia ranks as the world's most efficient tin producer, also should fare reasonably well during this period of falling prices. Over the last few years, Indonesia has followed a policy of running down its smaller, older, and less efficient land-based operations in favor of new, large capacity, off-shore deposits. As a result, since 1980, the number of on-shore dredges has declined from 19 to 10 with the process being accelerated by tin export controls.

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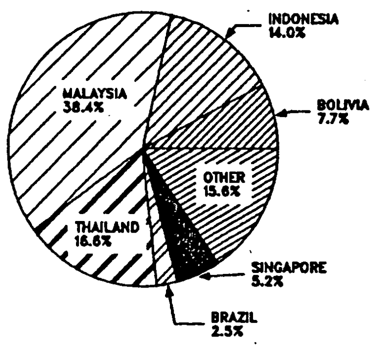
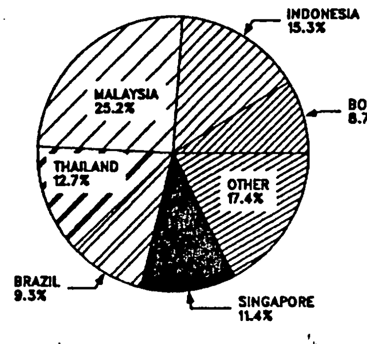
TIN METAL EXPORTS
IN 1000 METRIC TONS
1979



TIN METAL EXPORTS
IN 1000 METRIC TONS
1984



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- Thailand, which earned $223 million from tin sales in 1984, has begun shutting down many of its mines according to an embassy report of 9 November. As many as 20,000 jobs are threatened. Worker protest actions are being considered, according to local press reports. In the longer run, however, mine owners believe that Thailand can recover more quickly than its competitors because of low labor costs and high grade ore. The widespread smuggling of Thai tin is likely to cease, however, worsening the unemployment problems in the southern region.

- Brazil, which has tripled tin production to 21,000 tons since 1980, will also feel the effects of lower prices. Brazil, however, is still expanding its tin exports--mainly to the United States--and may be able to offset lower prices with increased export volume.

- China is the large unknown in the export equation. It has doubled first half 1984 exports in the first half of 1985. Most observers believe the Chinese will continue export increases even in the face of lower prices because of its hard currency needs.

Britain, which has expanded tin production in recent years, could find the going tough for its high cost production. This could further worsen the unemployment problems in the UK's mining regions. Canada, which recently placed in operation the East Kemptville open pit tin mine, will consume most if not all of the tin it will produce and thereby will be isolated to a large extent from price changes.

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Other Commodity Agreements: Spillover Effects

On a broader front, an ongoing tin market crisis will blacken the already tarnished reputations of international commodity agreements. For decades the Tin Agreement has been cited as a model for other commodity-support operations. The legal and financial problems raised by the possible default of the Tin Council have led some banks and diplomats to question the structures of other agreements. Last week banks informed the International Natural Rubber Organization that they would not accept rubber as collateral for their loans to the rubber bufferstock. The International Cocoa Organization also has bufferstocks, although cocoa purchases have been suspended since 1982. While neither of these commodities faces threat of collapse similar to the one of tin, memory of the Tin Council's difficulties will likely undermine government support for those agreements. The collapse of the tin agreement comes one year after the international sugar

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agreement dissolved and efforts to form a tea pact failed. These events reflect the recent weakening of intergovernmental programs that attempt to aid LDC commodity export earnings, and are evidence that market forces are expanding their role in world commodity trade. 25X1

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