COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNITY POSITION CONCERNING A POSSIBLE INTERNATIONAL AGREEMENT ON COPPER

(Commission Communication to the Council)

EXPLANATORY NOTE

Subject : Communication of the Commission to the Council regarding the position of the Community as to an eventual international agreement on COPPER.

In view of the third UNCTAD preparatory meeting on copper in January 1978 (S/1955/77), the Commission presented a Communication to the Council regarding "guidelines for a Community position with regard to the preparatory work of UNCTAD for an international Conference on Copper".

Since that date and on the occasion of each one of the series of UNCTAD meetings on copper, the Commission regularly informed the Group "Commodities" of the Council of its views on the - very marked by now - evolution of the situation in the copper market and sector. Accordingly it does not consider useful again to set out factual data. Be it sufficient to recall that relatively tight supplies now have followed a very long period of surplus.

On the other side it is recalled that after numerous and relatively improductive meetings, the preparatory work on copper notably,set aside the prospect to limit oneself to the creation of a consultative body on copper in a first stage. Finally, a second Intergovernmental Group of Experts on Copper (2nd IGEC) will meet in Geneva from the 25th of June and the 6th of July ; its mandate will be to propose a reasoned selection of measures which could possibly form the basis of an international agreement on copper. A seventh preparatory meeting will meet in September 1979 at the latest "to appraise the findings and conclusions of the 2nd IGEC and make appropriate recommendations for the implementation of Conference Resolution 93 (IV) within the calendar of the Integrated Programme for Commodities".

As is well known, the revised timetable of the Integrated Programme envisages the conclusion of the preparatory work on copper and the holding of eventual negotiating conferences of international commodity agreements before the end of 1979. It is known as well that the fifth UNCTAD presently being held in Manila will notably look into the results achieved by the Integrated Programme and into its continuation.

Under these circumstances this project of a new Communication on copper proposes the outline of an agreement which, in our mind, should be capable of being accepted by the developing producer countries without being in contradiction with the principles of market economy or involving an excessive burden for the economy of the Community.

Introduction

The Sixth Preparatory Meeting on Copper set out the objectives of intergovernmental cooperation and also established a list of the elements which might appear in an international arrangement as well as a non-restrictive list of relevant aspects and implications.

In the light of the above indications, the Sixth Preparatory Meeting instructed a Second Intergovernmental Group of Experts on Copper (2nd IGEC) to carry out a technical examination of a possible agreement from the point of view of effectiveness, cost and advantages; if the 2nd IGEC is able to reach a conclusion on the most appropriate measures for stabilization, it is also invited to give an opinion on the arrangements for implementing and adapting those measures. The 2nd IGEC will meet from 26 June to 6 July and a Seventh Preparatory Meeting will be held "no later than September". This latter meeting will have the task of evaluating the results and conclusions of the 2nd IGEC and of formulating appropriate recommendations with a view to the implementation of Resolution 93(IV) within the timetable for the Integrated Programme for Commodities.

In the Commission's opinion, the climate and tenor of the discussions of the Sixth Preparatory Meeting lead to the conclusion that the Community position in favour of simple consultations between copper producers and consumers, or even further, in favour of evolutive international action is certain to meet with insurmountable incomprehension or even hostility whatever the merit of its arguments. It should be recalled, moreover, that at the Sixth Preparatory Meeting the Community stated its readiness to participate in a constructive spirit in a negotiating conference if there was a mutually acceptable basis for an agreement on copper. Lastly, the argument that UNCTAD V might eventually make the rapid convocation of a conference on copper more plausible or even politically inevitable, cannot, it seems, be ruled out.

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Given the timetable constraints, the Commission therefore feels that the Community should prepare itself now for any eventuality and should look beyond the work of the 2nd IGEC in July. It should therefore reach agreement on what it could regard as a plausible formula for an initial agreement on copper, that is a formula that could win the support of the developing country producers while at the same time pursuing as well as possible the interests of the Community.

To obtain the support of the developing country producers, it appears to the Commission to be unavoidably necessary to work from the outset along the lines of a stabilization agreement with buffer stocking, supported as a last resort, by export control. In counterpart to these economic elements, the agreement, which would have appropriate resources at its disposal, would oblige the parties to hold consultations on the closest possible basis and to ensure the necessary transparency of the copper sector at world level.

It is in this light that the Commission outlines here its reflexions on the headings in the mandate given to the 2nd IGEC.

For the sake of clarity, the headings of the mandate will be dealt with as follows:

1. Market stabilization and price range;
2. Buffer stocking and private or strategic stocks;
3. Practical arrangements and volume of the buffer stock;
4. Regulation of exports (and/or production);
5. Particular problems of the developing country producers;
6. Objective of, and arrangements for, international consultations, institutional aspects;
7. Financial requirements;
8. Financing arrangements.

It will be assumed that the data concerning the characteristics of the copper sector and its present situation are known. The Commission feels it is not necessary to return to these aspects since it recently reported on them in detail and there have been no notable subsequent changes.

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1. Market stability and price range

The indicators furnished by prices prevailing on the futures markets, and notably the LME, are not contested in practice. In any event, the Community would refuse to interfere with their functioning. For this reason, for the Community, market stabilization would consist of the maintenance of the price within a certain range around the long-term trend by defending a minimum price and a maximum price. It is true that the developing country producers would prefer the defence of a minimum price fixed on the basis of copper production costs, but this idea is complicated by the diversity of the level and structure of those costs and would therefore be difficult to apply. Stabilization, in the manner in which it can be envisaged, makes it necessary in principle:

- to have a satisfactory evaluation of the price corresponding at a given moment to the long-term trend;
- to determine the quantitative relationship that exists between the width of the stabilization range and the volume of intervention resources, i.e. stocking resources, that are necessary.

It must be recognized that the, hitherto inadequate, quality of the analysis of the phenomena observed on the market makes any such evaluations very approximate. Quantitatively satisfactory evaluations therefore seem to be a prior condition for stabilization.

It is nevertheless possible to avoid this prior condition - which would otherwise prevent market stabilization action in the present circumstances - if:

- there is no attempt to narrow the price range excessively;
- a certain margin of empiricism and flexibility as regards the management of the stabilisation resources is left for the managing body of the agreement.

It is certainly desirable that a possible agreement should meet these two conditions. In particular it can be maintained that to reduce the range below ± 10% for example would deprive the market of its

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rôle and accordingly its significance. In these circumstances, one cannot overemphasise the need for precision in the determination of the average stabilization price and the projected volume of stock.

If nevertheless the fixing of a price range as a realistic stabilization objective were on examination to appear an excessively delicate matter, this would not necessarily mean abandoning the idea of action to achieve stabilization. In order to avoid the well-known drawbacks of a badly chosen or excessively wide price range, an examination could initially be made of the possibility of buffer stock operation consisting in buying when the market is in contango (supply availability situation) and selling when the market is in backwardation (scarcity situation). This simple rule might or might not be combined with the fixing of a very wide safety range (eg $\pm$ 25%). The objective would in any case be to narrow the range subsequently in the light of the experience acquired.

2. Buffer stocking and private or strategic stocks

The Community should take note of the fact that, with price stabilization as the objective, the preparatory work has constantly indicated buffer stocking as an essential instrument of that stabilization.

It is clear that copper is particularly suitable for stocking and that between production and consumption the known or estimated stocks, of whatever nature, have always played an important rôle in the relationship between supply and demand, i.e. in the fixing of the market price.

The Community should therefore recognize at the outset that any agreement on copper should utilize buffer stocking. This being said, buffer stocking practised on a world scale does not ipso facto remove the problems linked with existing private and national stocks but can in fact result in a number of additional problems. The Community should pay particular attention to the problems that could arise from the fact that international stocking, by creating an illusion of security,

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might induce private operators or the members of the agreement to reduce appreciably the level of technical or strategic stocks, and, more generally, to play irresponsibly with their stocks for speculative purposes or simply to cope with liquidity problems.

The buffer stocking arrangements will therefore need to incorporate necessary safety features to avoid the possibility of buffer stocking giving rise to secondary effects which are worse than those it is designed to counteract.

3. Practical arrangements and volume of the buffer stock

In the course of the preparatory work carried out to date, the practical arrangements for buffer stocking have never been discussed in detail.

It should be observed first of all that the possibilities are either international financing and centralised stock management (international buffer stock) or a coordinated management of national stocks. This second formula would appear at first sight to have certain advantages, notably:

- that of not, in theory, requiring international financing;
- that of leaving to those who run the national economies - who are in the best position to see how the difficulties arising from the interaction of the various types of stocking (referred to above) can be avoided in the local context - the responsibility for fulfilling the buffer stock obligations incumbent upon their country.

However, it also has disadvantages, notably:

- recourse to international financing bodies would in any case be inevitable to enable certain participants in the agreement, particularly the developing countries who were experiencing financial difficulties, to honour their stocking obligations;
- the coordinated management of national stocks is necessarily cumbersome and success is uncertain given a market as volatile as the copper market.

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Since the disadvantages seem to outweigh the advantages, the Community should, in the Commission's opinion, declare itself in favour of international financing and centralized management of the buffer stock.

The hypersensitivity of the copper markets militates, at least if one excludes the hypothesis of a structural depression of metal prices, in favour of non-excessive stocking; it being understood that the agreement should contain a provision whereby an increase in these resources could be considered in the light of the circumstances prevailing. Moreover, in view of the danger of the effect of illusory security, the buffer stocking mechanism should not be given excessively large resources even to justify abandoning recourse to any other type of measure for reasons of simplicity or other reasons.

In any event and in view of the annual volume of the international trade, resources corresponding to 500,000 tonnes of copper, or approximately 10% of that annual volume or 5 weeks trading seem to be appropriate if one bears in mind:

- that buffer stocking is intended to be in addition to the stocking already practised by private and public operators and not to replace it;
- that 500,000 tonnes in supplementary stocks would at certain times (eg the end of 1973/beginning of 1974) have been equivalent to total recorded world stocks;
- that it is not intended that buffer stocking should be the means of absorbing the surplus in a continuing situation of overproduction;
- that it is necessary to remain within acceptable financial commitment limits.

The use of the resources calls for a number of comments. Firstly, during the running-in period of an initial agreement on copper, it will be necessary to examine to what rules and what special flexibility (see 1. above) it would be desirable, or even necessary, to subject the buffer stocking operations with a view to avoiding unexpected and undesirable effects.

Secondly, it will be seen that, depending on the circumstances, it might be desirable to be able to take action to immobilize or mobilize stocks by means of warrantage operations on private or public stocks, particularly in favour of developing country producers, rather than by purchases proper. In the Commission's opinion, if the possibility were provided for operations of this type, they should be treated as buffer stock operations.

With this one exception, the Community should remain firm regarding the principle that purchases and sales carried out by the buffer stock manager would have to be carried out on a cash basis and on the official markets.

Lastly, it should be added that the copper acquired by the stock should as far as possible be divided among warehouses situated close to the various areas of major consumption.

4. Regulation of exports

From the preparatory work on copper, it can be concluded that the regulation of copper production would not be directly possible in the case of certain major producers. Moreover, the Commission is well aware that recourse to export regulation, the only means of achieving analogous results, also would invite objections from the viewpoint of the market economy. The experience of the period 1975-78, when persistent production surpluses, coinciding with a generalized economic depression, kept prices at abnormally low levels, shows, however, that the inertia of the production infrastructure is such that the law of the market cannot rapidly ensure the downward adjustment of supply to demand. The Commission therefore considers that the possibility of having temporary recourse to export regulation must be envisaged in the agreement to cope as a last resort with circumstances of this kind. The use of such measures should in any case be conditional on

a) the exhaustion of the buffer stocking resources;

b) a negative result in consultations within the bodies of the agreement on a self-imposed and individual discipline at the production stage to bring prices to an acceptable level;

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c) a consensus within the managing body of the agreement not only on the arrangements for export regulation but also on the objective of market recovery, i.e. on the desired price rise.

Furthermore, the Community could indicate now that in its view, and since copper is traded in four forms - concentrates and mattes, blister, refined and scrap - the quota for any participant should be applied to the overall copper content of its exports, irrespective of the products exported. Naturally, it would also be necessary to envisage provisions to prevent participants from misapplying the quotas by exporting semi-finished products or via their trade with non-participating countries.

Under such conditions, the regulation of exports could be expected to have an effective and necessary influence on production and could avoid in particular the formation of large-scale and uncommitted stocks by the producers, the very existence of which would in the long run weigh heavily on prices.

Lastly, and in view of the fact that the mandate of the 2nd IGEC mentions them explicitly, a word could be said here on the implications of the stabilization measures concerning the co-products of copper and copper scrap. As far as the latter is concerned, the Commission does not consider that copper scrap poses any special problem with regard to market stabilization, except that it will be necessary to take it into account in the event of export regulation, as stated above. In practice, scrap and, more particularly, reclaimed metal already play a stabilizing rôle, since high prices stimulate recovery and the marketing of scrap and low prices have the opposite effect.

As regards the numerous co- and by-products of copper metallurgy (cobalt, nickel, molybdenum, zinc, gold, silver, etc.), it is particularly when the market is depressed for copper, possibly making the regulation of copper production inevitable, that problems are likely to arise because of the interactions between the markets in question. The question also arises of making allowances for these products in the losses in earnings from copper exports sustained by certain developing countries if such losses were to constitute a criterion for the application of possible measures specifically concerning them (see 5 above).

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The problems in question are, however, too varied in importance and nature, depending on the co-product, the country and even the ore deposits, for it to be possible at this stage to say whether and how an arrangement on copper could provide a solution.

5. Particular problems of the developing country producers

Mineral and metal production exposes operators to uncertainties that are normally the result of the market economy. The Commission would stress that in the case of developing countries that are economically vulnerable and in addition very dependent on copper (notably Zaire, Zambia, Chile, Peru and Papua New Guinea) these uncertainties can result in an economic disaster of unacceptable proportions for the countries concerned and also, because of the investment shortfalls cumulatively induced, can result in the unexpected and excessive loss of production capacity that by its nature should in no way be considered as economically marginal.

The copper-consuming industrialized countries cannot remain indifferent to such problems and corrective measures must be adopted. A first question on this subject involves discriminating between those corrective measures to be introduced in the copper agreement itself and those that should be included among development aid measures.

It is logical of course to include in the agreement on copper corrective measures to deal with the effects of the measures provided for in the arrangement itself. This applies in particular to the measures referred to in 4 above: measures which refer to the circumstances where the developing country producers would be obliged to simultaneously put a ceiling on their exports and receive less remunerative prices. The Commission therefore feels that with copper stabilization in view, an examination should be made in such cases of the ways of alleviating the difficulties faced by certain producer developing countries in honouring their commitments under the agreement, where such difficulties are due in particular to losses in earnings from copper exports.

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It is clear morevover that the problem of providing compensation as such for the developing countries' losses in earnings from commodity exports will continue to be studied both as a general development problem and in connection with the balance of payments problem.

The problem facing the Community is special and delicate because certain of its members consider that the compensation of the developing countries' losses in commodity export earnings should be considered as a solution instead of commodity agreements and particularly, in the specific case of copper, as a solution that is preferable to market stabilization measures.

For the Commission, it is therefore of the utmost importance to remove an obstacle which in its view is really rather artificial. The Commission would recall in fact:

a) that it is not "on" politically to propose the basing of a copper agreement on export earnings compensation for certain developing countries;

b) full compensation could prove much more costly than a stabilization agreement and the community, the largest world consumer importing copper mainly from the developing countries that are most directly concerned, might find it difficult to avoid making a very costly contribution;

c) it is clear that the Community will already be making a considerable effort in favour of certain of the developing countries most directly concerned in the context of the new ACP-EEC Convention;

d) the Community is in any event already involved in the discussions concerning "horizontal" solutions to this problem in the IMF, UNCTAD, etc.;

e) as far as the concept of the system is concerned, compensation for losses in export earnings cannot remain within acceptable limits unless:

   - it applies to a group of products;
   - the markets of the main commodities, including copper, are suitably stabilized.

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The Commission therefore hopes that the Community will be able to agree to its proposal and declare itself in favour of the principle of adjustments to the stabilization measures - to be written into any agreement - in favour of the most vulnerable developing countries. It should be prepared to study such adjustments without prejuduce and leave aside, as regards a copper agreement, the question of compensation proper for losses of export earnings from copper.

6. Objective of and arrangements for international consultations, institutional aspects

In the Commission's view, the success of an agreement on copper will be dependent to a very great extent on a special effort to:

- administer the measures while paying close attention to the development of the situation in the copper sector;
- take into account the practical experience and problems of industrial and commercial operators;
- ensure transparency, particularly as regards: the technological, economic and financial aspects of production and consumption; the futures markets; the international trade and the prices actually applied; the foreseeable trend of such data;
- clarify and encourage the consistency of the policies of the participants in the agreement with the objectives of that agreement;
- make it possible to define, with a view to the development of subsequent international action, the most suitable measures for market stabilization and more generally for an improvement in the functioning of the copper sector in the medium and long-term.

Given the interaction in all these fields the Community will therefore need to insist very firmly that the institutional structure of the agreement make it possible for close and effective consultations to be held between the participants. The Community will therefore pay particular attention to the powers of the governing body in the various areas covered by the agreement, to the decision-making process, and to the linkage and importance of the technical resources given to the agreement.

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Among these resources the agreement must establish a monitoring service to ensure the collection, elaboration, and, under the responsibility of the managing body of the agreement, the circulation of the information to ensure the desired transparency. The obligations of the participants relating to the communication of the necessary data must be set out explicitly in any agreement.

The previous examination of the measures to be envisaged shows that it would be necessary as a matter of priority to direct the studies and consultations towards certain subjects. In the Commission's view these would include in particular:

- an analysis of market phenomena, particularly the contango-backwardation movement and its significance in relation to the evaluation of the long-term price trend;
- the relationship between the price trend and the trend of factors determining production costs, particularly in the light of technological developments;
- the relationship between the width of a price range and the necessary buffer stock resources;
- possible interactions between commercial stocks, technical stocks, strategic stocks and buffer stocking;
- the foreseeable trend of production and consumption capacity.

The number and importance of these topics, more detailed knowledge of which constitutes a pre-condition for the effective management of the agreement and indeed for any improvement of the measures in subsequent agreements, also shows that the Community will need to pay particular attention to the determination of the duration of the agreement and to the conditions governing its renegotiation or adaptation. If an agreement of five years (or more) were proposed, either there would need to be provisions enabling its managing body to adjust the measures in accordance with circumstances or else there would need to be provision for the possibility of mid-term renegotiation.

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On this latter point it must be stressed, in the Commission's view, that unless an effort is made to achieve a better regulation of investment and of production capacity in the light of known and foreseeable requirements, the stabilization measures provided for in any agreement are in danger of frequently and perhaps permanently being insufficient to meet the needs of the moment. One of the main merits of the consultations pursued in the context of an agreement on copper would therefore be to promote a self-imposed and individual discipline as regards investment and capacity.

In conclusion, it should be recalled that experience has shown that it will be in the Community's interest to ensure the best means of being able to exercise effective control over the action carried out in the context of the agreement, particularly regarding the basis of the voting rights to be allocated to the Community and its intrinsic participation in the agreement. From this viewpoint, the Commission would recall its position on the form of the Community's participation in commodity agreements, a position on which the Court of Justice was asked for an opinion regarding the negotiation of the agreement on natural rubber.

8. Financial requirements

The requirements can be considered under three headings:

(i) Management of the agreement

The scale of the annual expenses might reasonably be as follows:

	mio ECU
Secretariat of the agreement	0.25
Copper monitoring service	0.5
Management of the buffer stock and of possible export regulation measures	0.25
Meetings of the organs of the agreement	1.00
	2.0

A five-year agreement would therefore cost 10 million ECU.

(ii) Buffer stock (First Window of the Common Fund)

The buffer stock is not, it should be remembered, lost expenditure, but rather investment to be made in stages, even if such stages and

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the corresponding volume are not foresseable in detail at the outset. At this stage it is only possible to say that 500 000 tonnes of copper at a price of probably less than 2 000 ECU per tonne would involve at the very maximum an investment figure of 1 000 million ECU.

All operations effecting stocks and the availability of the product and therefore the supply (warrantage, possible financial aids to the copper sector in certain developing countries and under certain conditions - see 5) should be brought under buffer stocking and be capable of being financed under this head.

(iii) <u>Other measures</u>: (Second Window of the Common Fund)

Without excluding the possibility of copper benefiting from activities in technological research, trade promotion, etc., it is unlikely that stress will be laid on this type of action. It would nevertheless be reasonable to make provision, under this category of measures, for the resources needed to carry out special studies on the copper industry and trade amounting for example to an annual figure of around 0.5 million ECU.

9. <u>Financing</u>

There are two theoretically opposed methods of financing: that of levies on international trade and that of national contributions. The advantage of the first method is its relatively simple nature and the fact that it makes it possible to avoid the budgetary problems relating to national contributions. However, this method gives rise to two criticisms:

a) It ignores the USA whose influence on the copper market at world level greatly exceeds the extent of its involvement in international trade.

b) This method is open to question as regards its allocation - difficult to evaluate in objective terms - of the financial burden between consumers and producers. Producers insist with some truth that in a depressed market the levies would amount to an equivalent reduction in their earnings.

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In any event, the prospect of the forthcoming establishment of the Common Fund will doubtless tend to exert an influence in favour of national contributions. On this assumption, any agreement on copper would accede almost inevitably to the Common Fund. This would mean, in so far as can be foreseen at present, the initial payment to the Fund of one-third of the maximum amount envisaged for the financing of the buffer stock, or 333 million ECU as a rough estimate.

The initial contribution of the Community, assuming equal participation of producers and consumers, would therefore amount to some 45-55 million ECU. The obligations of the Community, under the agreement, would involve complementary financing amounting to some 90-110 million ECU.

The Community participation in the current expenditure of the agreement - some 0.45-0.55 million ECU annually - whatever the method of financing should not of course pose any particular problems.