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To see and return please. DRN 11/10.

CONFIDENTIAL

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Do the Policy Unit – Tony – wish to comment? DRN 11/10.

JU300

PRIME MINISTER

I am writing to say that there is a possibility that the International Tin Agreement (ITA) could be in difficulties in the near future.

2 The attached note sets out the main features of the ITA. The basic problem is that the Agreement is designed to maintain tin prices at levels well above what they would be in a free market. Some banks and brokers on the London Metal Exchange are becoming nervous about the ability of the Buffer Stock Manager to maintain the price of tin, and there have been some moves, as yet isolated, to reduce the extent of their dealings with him. At the last meeting of the Tin Council, the Executive Chairman asked member countries to give guarantees of the Buffer Stock Manager's £250m bank borrowings.

3 The consumer countries, which in the Agreement are principally the EEC and Japan, have agreed that no additional resources should be put into the Agreement without fundamental reforms, particularly in relation to the price level, and possibly not even then. The producer countries are considering an injection of additional funds, but this would not in the long run solve the underlying problems of the Agreement.

4 The consequences for the United Kingdom of a breakdown would in the short term be that the Buffer Stock Manager of the ITA would be unable to meet his commitments to some brokers on the London Metal Exchange. The amount of shortfall could be between £150-200m and some brokers might be forced out of business as a result, but the Bank of England believes that the LME as a whole would not be threatened. The Buffer Stock Manager would also be unable to repay his bank borrowings in full but no UK bank is exposed for more than £10m.

5 In the longer term the viability of the Cornish tin industry might be at risk if the tin price fell substantially. The industry employs directly some 1500 in Cornwall.

6 There could also be implications for our relations with the producing countries, chief of which in the ITA are Malaysia, Indonesia, Thailand and Australia. For this reason it is important that the UK should not be seen as in the lead in taking a hard line approach to the Agreement. The Foreign and Commonwealth Office will, I understand, be providing briefing for the Commonwealth Heads of Government Meeting next week. In addition there could be indirect repercussions on the prospects for other commodity agreements.

7 On the other hand, if the Tin Agreement broke down, and the price of tin fell substantially as would almost certainly be the case, UK consumers would gain from the lower tin price, possibly to the extent of £50m per year, depending on the magnitude of the fall in price.

8 A Working Party of the International Tin Council is currently trying to put together proposals for a package to put the Agreement on a more stable basis, but the prospects for early agreement do not look good.

9 The UK Government's share of any guarantees given by the International Tin Council of the £250m bank borrowings would be some 4-5%. Such guarantees would enable the Buffer Stock Manager to secure further loans to continue his operations. There could also be pressure from the producers for the consumers to match their proposed additional contributions to the Agreement in return for agreeing to a price fall and other reforms. If the consumers injected a further £60m, (the reported figure proposed by the producers) the UK share would be some £5m.

10 The UK, as a comparatively minor consumer in the Agreement, is not in a position to deal with this issue in isolation, and we need to keep in close touch with other consumers particularly the EEC and Japan. I would, however, need to see a convincing case before agreeing to inject more resources into this Agreement.

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There should certainly be no question of doing so without far reaching reforms. These would include a reduction in the price level and provisions for more rapid price adjustment to reflect market conditions; and arrangements for more control of the Buffer Stock Manager's operations, particularly in relation to his dealings on the London Metal Exchange.

11 I am copying this minute to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, the Secretary of State for Agriculture, Fisheries and Food, and to the Governor of the Bank of England.

L.B.

L B

11 October 1985

Department of Trade & Industry

999-49

THE INTERNATIONAL TIN AGREEMENT

Background

The Sixth International Tin Agreement which came into effect in July 1982 is a commodity agreement with economic provisions. It is due to expire in July 1987, but could be extended by up to two years. The purpose of the Agreement is to maintain the price within a given range, and for this purpose a buffer stock has been established and a Buffer Stock Manager operates a system of intervention buying and selling to keep the price within the given range.

2 Only about 50% of tin consumption is covered by countries in the Agreement, the major absentees being the USSR and the United States, and about 60% of production. The main producer member countries are Malaysia, Indonesia, Thailand and Australia, and the main producer countries which are not members are Bolivia and Brazil. The UK, although a consumer member, produces some 50% of its tin requirements.

3 The Agreement has been bedevilled from the start by the fact that the price range has always been considerably higher than that which would have been set by a free market. Production has been stimulated and consumption has fallen, and consequently there are large stocks of tin on the market despite export controls of 40% on producer member countries. The resources given to the Buffer Stock Manager and the amount of tin which he has been allowed to stockpile, have never been adequate to deal with a situation of chronic over supply. The Buffer Stock Manager has therefore had to resort to unorthodox methods, including entering into arrangements with brokers on the LME to keep tin off the market and entering into forward buying and selling arrangements. In addition he has incurred loan obligations of some £250m to the banks.

4 The difficulties which have always been liable to arise under the Sixth Agreement, have been exacerbated by the recent rise in sterling against the Malaysian ringgit which has made some banks uneasy about the value of the tin warrants given as collateral for their lending. In addition the rise in sterling has meant that the Buffer Stock Manager is now making a loss on his forward sales as sterling prices fall.

5 The United Kingdom put some £8m into the Sixth International Tin Agreement in 1982, and in addition pays some £50,000 per annum towards the administrative costs of the Agreement.