CONFIDENTIAL

PRIME MINISTER

TIN

You have arranged a meeting on 3 January to discuss the tin crisis. It may be helpful if, in advance of that meeting, I set out my views on the issues we need to consider, to supplement my Private Secretary's letter to yours dated 24 December.

2 There are three questions to be considered:

(i) What should be HMG's response to the package of proposals for a negotiated settlement put forward by bank and broker representatives to the International Tin Council (ITC) member countries on 23 December?

(ii) What further steps should we take to persuade other countries to take a constructive attitude towards a negotiated settlement, following your personal message to Chancellor Kohl on 20 December?

(iii) What action, if any, should we take if no settlement is reached and the tin market collapses?

Reduce our possible role

Response to bank and broker package

3 A note summarising the essential features of this package is at Annex A. The proposal is for a new company to

JF4ARS

be formed which would take over the ITC's obligations to the banks and brokers, and manage the orderly sale of the tin stocks thus acquired over a three year period. The finance for the new company would be provided by £70m equity subscriptions by brokers and banks; a £200m contribution by ITC member countries, of which the UK share would be £8m; and bank borrowings, of which it is proposed that HMG should guarantee £50m.

4 The bank and broker package has not yet been agreed by all the banks and brokers concerned: indeed I understand that, of the 16 banks which have outstanding loans to the ITC, two have already indicated that they are not prepared to participate in the package.

5 Many ITC member Governments are likely to find the bank and broker package disappointing. They would prefer to see a higher contribution from the bank and brokers than £70 million, or just over 25 per oent of the total anticipated losses. There will also be pressure for a higher contribution from HMG. There may be further negotiations aimed at altering the package to the detriment of the position of the banks, brokers and of HMG.

6 We can readily accept that we will contribute our 4 per cent share of the proposed £200m ITC contribution to the package. I consider that, in the circumstances, we should also be prepared to accept that HMG should guarantee up to £50 million of bank loans to the new company. We would only lose money under this guarantee if the average price at which the new company sold tin fell below £6,000 a tonne. There is clearly a risk that this may happen, but informed market opinion indicates that about £6,000 a tonne is the likely level at which the tin price will settle in a free market,

and an increasing amount of tin has recently been traded off-market at about this price level.

7 In accepting the extra contribution by HMG of a guarantee of £50m borrowings, we will need to make it clear that we are doing so only in order to secure a settlement. We should make it a condition of our agreement to the guarantee that all other ITC member governments are prepared to contribute their share of the £200m contribution required.

Further international moves

8 The main stumbling block preventing a constructive approach to a settlement of the tin crisis is now the collective attitude of the European Community Governments. Three countries, FRG, France and the Netherlands, have been particularly strong in opposing negotiations, and indeed these three countries ensured that the EC group blocked, on 19 December, proposals by the producer members of the ITC to set up a formal group to negotiate on the ITC'a behalf. You have already written to Chancellor Kohl; I suggest you should now write to the French President and to the Dutch Prime Minister. A draft, which follows closely your letter to Kohl, is at Annex B.

9 Given the generally constructive attitude shown by other ITC member countries, it could be counter-productive at this stage to make a general high-level diplomatic approach. We should first see how other countries react to the bank and broker proposals: these will be discussed at an informal meeting of the ITC on Tuesday 7 January.

CONFIDENTIAL

13 No decisions are required on Friday on the details of any of these fallback options. But it will be essential, if we do not rule out the possibility of intervention, for work to go ahead to prepare the ground thoroughly, since if there is no negotiated settlement we would need to have a fallback mechanism in place and ready to operate by 24 January.

C Bradley

L B

January 1986

(Approved by the Secretary of State and signed in his absence)

DEPARTMENT OF TRADE AND INDUSTRY

JF4ARS

999-49

cc NO
BW
BG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

PS/Secretary of State for Trade and Industry

2 January 1986

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Dear Mr Norgrove

TIN

Thank you for your letter of 30 December.

I attach a minute from my Secretary of State to the Prime Minister which he has seen and approved.

The annexes have been drawn up by officials for the meeting and have not been seen by my Secretary of State in final form.

I am copying this letter to Philp Wynn Owen (HM Treasury), Richard Broadbent (HM Treasury), Colin Budd (Foreign and Commonwealth Office), Henry Steel (Law Officer's Department), John Bartlett (Bank of England) and Professor Griffiths (No 10 Policy Unit).

Yours sincerely

C Bradley

CATHERINE BRADLEY
Private Secretary

DW4AJL

999-1

CONFIDENTIAL

Action if no settlement

10 If no settlement can be reached to the crisis, it is clear that the LME will reopen the tin market by the end of January; there will be a collapse of the tin price with a number of brokers going into liquidation. The future of the LME as a whole may be in doubt. What is certain is that there will he litigation by banks and brokers against the ITC the Member Governments, and HMG.

11 We do have a straightforward option of doing nothing in such circumstances. The ITC is not a body which HMG controls, or in which we have a major direct interest. We made strenuous attempts in 1983 to improve the control and reporting systems within the ITC, but found no support. We would of course vigorously defend any action brought against HMG. But the Solicitor General advises that such an action against us has a good chance of success At the worst, the cost to us of such an action might he £500 million. The prospects of recovering the bulk of this sum against other countries by legal action are not good and by diplomatic action highly problematic.

12 Attached at Annex C is a note by officials outlining alternative ways in which HMG could intervene to stabilize the tin market and reduce or eliminate the likelihood of successful legal action. As indicated in the minute dated 24 December, I do not think we should be prepared to intervene in order to save the LME, but we should at least consider doing so in order to reduce the potential costs on the Exchequer.

JF4ARS

999-49

ANNEX A

PROPOSAL TO ITC MEMBER GOVERNMENTS BY BANK AND BROKER REPRESENTATIVES

The essential features of this proposal, circulated to ITC Member Governments on 23 December, are as follows:

2 A new company is to be formed to take up the ITC tin purchase contracts with LME brokers and to take over from the banks their existing loans to the ITC together with the tin held as security.

3 The new company to be financed as follows:

Equity capital, subscribed by banks and brokers	£70m
Contributions by ITC member countries	£200m
Bank loan guaranteed by HMG why?	£50m
Banks existing loans	£271m
New bank loan facility	up to £150m.

4 It is expected that the new company would hold 85,000 tonnes of tin at 31 January 1986, and would sell all this tin in a controlled manner over a three year period. It is expected that the average price at which tin will be sold will be £6,000 a tonne. At this price all the equity and ITC contributions would be lost, but the HMG guaranteed loan would be repaid in full. For the whole of the £50m HMG guaranteed loan to be lost, the average price realised for tin would need to fall to about £5,400 a tonne.

5 It is stipulated that ITC member countries which participate by contributing their share to the new company would not have legal action taken against them by the banks and brokers subscribing equity to the new company.

6 The proposal has been put forward to the ITC on a personal basis by Mr Graham of Standard Chartered Bank and Mr Kestenbaum of brokers Gerald Metals. The banks and brokers generally have not yet agreed to participate.

ANNEX B

DRAFT LETTER FOR THE PRIME MINISTER TO SEND TO THE FRENCH PRESIDENT AND THE DUTCH PRIME MINISTER

I am writing to you to express my very great concern about the failure of the International Tin Council to meet its financial obligations.

As you know, since the announcement on 24 October that the ITC could no longer honour its contracts, the member countries of the 6th International Tin Agreement have been unable to agree on any course of action to resolve the crisis in the tin market.

From the outset, the UK Government made it clear that we were prepared to meet our share of the ITC's commitments, and we called on other governments to do likewise. We also circulated to other Member Governments a note setting out our analysis of the legal position.

If a settlement is to be reached, the position of the European Community countries, as the largest consumer group within the ITC, will be crucial. Within the European Community, I understand that up to now your Government has rejected any legal responsibility for the debts of the ITC, and has opposed a proposal that representatives of the Commission of the European Communities should take the lead in seeking to negotiate a settlement.

I really must ask you to look again urgently at the position now being taken by your Government. Although you and we may disagree about the extent of the legal liability of Member States - an issue which could only be fully tested in the Courts - it cannot be right for governments to disclaim responsibility for the actions of a body set up to act on their behalf, and on whose governing Council they are directly represented. If no solution can be found, and the ITC fails, leaving massive debts, I believe the repercussions will be widespread, and highly damaging to the international financial and commercial community. We should be giving an appalling example for other negotiations, including in particular international debt negotiations.

You will know that the producer governments have agreed to work towards a negotiated settlement. This was the first encouraging development in weeks of discussions. As a result, on 23 December a package of proposals was put to the member countries of the ITC by bank and broker representatives, as a means of resolving the crisis. The stand taken by the consumer governments will decide whether it makes any headway. The UK Government has decided, despite the heavily disproportionate risk we are asked to bear under this proposal, to give it our support if and only if all other ITC Governments agree to participate . [It is at the limit of what we are willing to undertake.] I believe that if you were to join us in taking a constructive position in favour of the proposal, other Community and other consumer governments would be likely to follow.

FALLBACK OPTIONS

Three options are considered. A central point in each is a mechanism for the disposal of tin by a single agent so as to avoid a drastic fall in the price of tin, and thus minimise the total default.

2 The first option is for HMG to contribute the whole of the ITC contribution required by the bank and broker package (see Annex A). The cost of this would be £200 million maximum, plus the guarantee for a £50 million loan.

3 The cost of this option would be reduced if other ITC member countries were to join HMG in making contributions to the new company. It seems likely that the company would not be able to sue the ITC or member governments, and the banks and brokers would have incurred no loss themselves giving rise to a legal claim. We should therefore be limited to political and diplomatic pressure to secure contributions from other governments. However in this respect we should not be significantly worse off than were we to take no action and wait to be sued under joint and several liability since the Solicitor General's advice has been that in that event we should need to rely on political and diplomatic rather than legal action.

4 A second option would be for HMG either directly or through a new company to buy the tin at a fixed price say £6,000 per tonne with the sole object of minimising market disruption. The finance required would be about £270m including £30m interest costs, of which the greater part could be borrowed using the 40,000 tonnes of tin purchased from the brokers as security. HMG or the company would hold this tin off the market for a year, in order to allow the banks to sell the tin they hold (as security for loans to the ITC) in an orderly manner, but the new company would not otherwise be concerned with the banks. On the eventual sale of tin held by the company, losses would arise only if the price fell below £6,000 a tonne, apart from the costs of servicing the company's debt.

5 Under this option the costs to HMG might be only £30 million interest costs, with a further loss of £40 million if the average tin price fell to £5,000 a tonne. But all that would be achieved would be a stabilisation of the tin market: the banks and brokers would still be likely to take legal action against HMG; and a number of LME brokers could go into liquidation. There is a risk of additional costs to HMG, as a result of legal action, of up to £120 million to cover losses by the brokers and possibly a further £50m on losses by the banks, although in each case there might be some chance of recovery from other governments.

6 A third option would be similar to Option 2, but at a higher tin price in return for undertakings from brokers and banks that they would not take legal action against HMG. If a price as high

as £7,500 were necessary, and if the tin could be sold over a period at £6,000, a loss of £60m plus £40m financing costs would be incurred by HMG; if the price fell to £5,000 this loss would be £100m plus £40m financing costs.

COSTS OF POSSIBLE OPTIONS

	Selling Price £3500 per tonne £m	Selling Price £5000 per tonne £m	Selling Price £6000 per tonne £m
Uncontrolled collapse; UK sued for whole loss, no recovery from other countries.	500	-	-
<u>Option 1</u>			
New Co on basis proposed by banks and brokers but UK pays full ITC share.	-	250	200
<u>Option 2</u>			
UK buys brokers' tin at £6000 per tonne	-	70 (40 loss, 30 financing)	30 (financing)
+			
Risk of successful litigation against HMG, no recovery from others.	-	170	120
Total		240	150
<u>Option 3</u>			
HMG buys at £7500 from brokers in return for no litigation from banks and brokers.	-	140 (100 loss, 40 financing)	100 (60 loss, 40 financing)