PRIME MINISTER

INTERNATIONAL COCOA AGREEMENT

You said that you would like to go further into the pros and cons of membership of the International Cocoa Agreement before deciding whether we should join.

The objectives which we set earlier this year - and frankly believed that the producers would never accept - were:

- a reference price below 105 US cents/lb; - why this figure?
- automatic adjustments in the price range of up to 13 cents/lb, related to changes in the level of the buffer stock and exchange rate fluctuations;
- membership must include at least 80 per cent of exporters (by volume) and 70 per cent of consumers;
- there should be no provision for borrowing.

The attached note by MAFF shows that these objectives have been very largely achieved viz:

- a reference price of 103 cents/lb;
- denomination in a currency basket, the SDR;
- veto-proof price adjustment;
- an explicit prohibition on borrowing;
- inclusion of a UK text on liabilities and financial responsibilities;
- 80 per cent producer participation;
- procedures for orderly liquidation if necessary.

Where the agreement falls short - but not much of our objectives - is:

- there will be somewhat less than 70 per cent consumer participation. But this does not affect the economic provisions since the levy to finance the Agreement is charged on exports to consumers whether they are members of the Agreement or not;
- the automatic price adjustment is in a range up to 12 cents/lb (rather than 13 cents). But the reference price is lower than we would have settled for;
- the Agreement refers to the possibility of taking advantage of financing from the Common Fund. But since there isn't a Common Fund and won't be, this is theoretical.

What happens if those who do not produce enough revenue?

The Foreign Secretary, the Trade and Industry Secretary and the Chief Secretary have all now commented. All three acknowledge that, while we would prefer to have no Agreement, we have little choice but to join this one since the conditions laid down have been met in all important respects; and can do so without any significant risk to our interests. It is proposed that we should make a formal statement of our objectives in principle to agreements involving intervention in markets.

What risk?

Agree that we should join on this basis, and subject to going through our Parliamentary procedures?

CDP.

CHARLES POWELL

24 September 1986

LO6ABH

Seen by CDP.

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the
Parliamentary
Secretary

PERSONAL

C D Powell
Private Secretary to the Prime Minister
10 Downing Street
LONDON SW1

23 September 1986

Dear Charles,

As you requested I am enclosing a background note on the Cocoa agreement and earlier correspondence which sets out in greater detail how the Agreement operates.

Yours sincerely,

Gill Tishler.

G Tishler
Private Secretary

CONFIDENTIAL

RENEGOTIATION OF THE INTERNATIONAL COCOA AGREEMENT

1. The final text of the new International Cocoa Agreement incorporates the great bulk of the UK objectives identified in the Ministerial correspondence resting with the Minister's letter of 4 July to the Secretary of State for Trade and Industry. These include:

(a) a reference price (now called the median price) below the equivalent of 105 US cents/lb (actually 103 cents/lb);

(b) no obligatory buying above 85 cents/lb;

(c) denomination in a currency basket, the SDR;

(d) a veto-proof buffer stock related price adjustment that could reduce prices by 12 cents/lb within a year in the event of heavy purchasing;

(e) an explicit prohibition on borrowing and on the buffer stock manager operating on the terminal market;

(f) inclusion of a UK text on liabilities and financial responsibility; May I see it?

(g) a requirement for 80% producer participation (which in practical terms must include the Ivory Coast) before the economic provisions can be implemented;

(h) procedures for the orderly liquidation of the agreement in the event that this becomes necessary, including identification of importers' share of any assets.

2. Aspects of the final text which were, or could be held to be, outside the delegation's instructions, were:-

(a) the required level of importer membership for provisional entry into force has been reduced from 70% in the 1980 Agreement, which we would have preferred to retain, to 60%.

(b) there is a reference to the (theoretical) possibility of taking advantage of financing from the Common Fund;

(c) some exhortatory language is included on limiting imports from non-members when supplementary price defence measures are in force. However, this would have no legislative implications;

(d) the buffer stock related price adjustment of up to 12 cents/lb in the course of a year falls short by 1 US cent/lb of our preferred maximum;

(e) the agreement may be extended for one extra year (to 6 years) longer than the present Agreement.

3. The UK has formally reserved its position on all these points, of which (a) and (d) are the most significant. The level of importer membership is an essentially political matter: a high level would enhance the Agreement and its decision-making, but it does not directly impinge on the economic provisions. The buffer stock levy is charged on all exports, to members and non-members alike. A 70% requirement would have gone beyond the actual level of importer participation in the 1980 Agreement, which excludes the USA. It was generally seen as excessive, taking into account the new and more important requirement for 80% producer participation. The width of the band for adjusting the price range in response to rapid buffer stock purchases was also a matter of negotiation against the background, first, of the major concessions which the principle of such adjustment represented for producers and, secondly, of the achievement of a median price very close to the long term trend level and some 30 cents/lb below the producers' opening bid.

4. Entry into force of the new Agreement depends on when the respective threshholds for producer and importer participation are reached. It now seems probable that 80% of producers will notify provisional application by the specified date of 1 October, but unlikely that 60% of importers willhave done so. In anticipation of this the Council of the outgoing 1980 Agreement recently used its powers to institute a four-month interim period, to

31 January 1987. This period will provide an extended opportunity for meeting the requirements for entry into force of the new Agreement and for transferring to it the (frozen) buffer stock arrangements.

5. The interim period has therefore removed the need to notify provisional application of the new Agreement before expiry of the old one. We have accordingly resisted pressure within the Community to take this course. Together with Italy and Ireland we have indicated that our provisional application can be notified only after completion of Parliamentary procedures. Successive discussions in Council Working Group and COREPER have now focused attention on the more urgent issue of signature, at least, by the Community and its member states before 30 September. The great majority of member states is in favour. A Ministerial decision is being sought.

Tropical Foods Division

23 September 1986

Mr Packers minute of 27.1. to Miss Tishler refers:

Mrs Adams
Mr Mason
Mr Thomas.

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
1 Victoria Street
London SW1

29 January 1986

RENEGOTIATION OF THE INTERNATIONAL COCOA AGREEMENT

The Fourth, and probably final Conference to renegotiate the Cocoa Agreement will start in Geneva on 10 February. The UK is the world's fifth largest importer, with imports valued at £279 in 1984. There is also considerable employment in cocoa and chocolate processing in the UK. A Cocoa Agreement could have a significant impact on the market. The negotiation is therefore one of importance to us.

This renegotiation has been going on for 2½ years and the general UK line is well established and understood by EC and consumer group partners. However, in view of the importance of the subject and concerns raised about commodity issues by the recent collapse of the Tin Agreement, I thought it worthwhile to write to you about the line I propose we should take at the Conference.

Only an Agreement which is economically soundly based will work and be worth having. In essence that means we must continue to insist on a realistic price range which reflects the long term trend of market prices. and which is automatically adjustable to take account of both rapid buffer stock buying and significant movements in exchange rate relativities. We will also need to stand firm on our insistence that there needs to be a high level of membership if we are to agree to participate in any new Agreement. The current Agreement requires 80% of exports and 70% of imports to be covered before it enters into force. We must ensure that those targets also feature in any new Agreement. Following international pressure the current Agreement was in practice brought into effect with significantly lower participation. We will have to make it clear that we would strongly resist participating on that basis again.

We will undoubtedly come under pressure at the Conference to make concessions for the sake of reaching agreement. I believe we will have to be very firm in resisting such pressure. Maintenance of our line, on which we expect the support of a number of like-minded consumer countries will, of course, not make the achievement of a new Agreement easy. Indeed it seems quite possible that the attempt to negotiate an Agreement with economic provisions will be unsuccessful. We could then find ourselves, as with sugar, with a purely administrative Agreement or, less likely, with none at all. I believe we could be quite content with either outcome.

.... I enclose a copy of the submission which has been put to me, which contains a detailed proposal for the UK negotiating position which I have accepted. I understand that your officials have been closely involved in the preparation of the submission and generally support the recommended approach. Perhaps you would let me know fairly quickly if you have any comments. The negotiators will, of course, report back to us if a package develops which goes beyond what I propose.

Copies of this letter go to Geoffrey Howe and John MacGregor.

MICHAEL JOPLING

RESTRICTED

RENEGOTIATION OF THE INTERNATIONAL COCOA AGREEMENT

Purpose of the Submission

1. To seek the Minister's approval for the United Kingdom's line to take at the next UN Conference for the renegotiation of the International Cocoa Agreement, starting on 10 February 1986.

Background

Earlier Cocoa Agreements

2. Following extensive negotiations the first Cocoa Agreement entered into force in 1972, and the second in 1975. Throughout the life of both Agreements market prices were above the price ranges set.

The 1980 Agreement

3. The 1980 Agreement came into force after further protracted negotiations. As negotiated the Agreement requires that membership comprise countries representating 80% of exports and 70% of imports. Eventually it became clear that neither the Ivory Coast, the principal importer, nor the United States, the principal exporter, were (for opposite reasons) going to join, leaving the membership requirements of the Agreement unmet. However, the Secretary-General of the UN pressed those prepared to join to allow the Agreement to enter into force and despite some resistance this was eventually accepted. The Agreement entered into force with 72% of exports and 61% of imports represented.

4. The 1980 Agreement was designed to defend a price range of 110 - 150 US cents/lb, using the mechanism of a buffer stock. If the market price fell below 110 cents/lb (the Lower Intervention Price) the buffer stock would buy in cocoa beans to force the market price to rise into the range. If the market price rose above 150 cents/lb (the Upper Intervention Price) the buffer stock would release cocoa beans to force the market price to drop back into the range. The mid-point of the price range (the main focus of the current

renegotiation) is called the reference price. Buffer stock purchases were funded by a levy of 1 and later 2 cents/lb on each transaction involving a member of the Agreement. (The levy is generally paid on export but on imports from non-member producers it is paid by the importer). Money from any buffer stock sales would augment the funds of the Agreement.

5. The 1980 Agreement contained provisions for adjusting the defined price range. There is a provision to lower (or raise) the price range if rapid buffer stock buying (or selling) suggested that the range was out of line with market reality. This proved to be the case shortly after the entry into force of the Agreement in 1981, and 100,000 tonnes of beans were rapidly bought into the buffer stock and the price range lowered by 4¢. This purchase exhausted the funds then available but did not prevent a further slide in market prices. Fortunately, unlike the situation in the Tin Agreement, the buffer stock manager was precluded from taking any further action to support the market either by borrowing money or by purchasing forward. An unsuccessful attempt was made to arrange commercial borrowing for further purchases, but this was not accepted.

6. Although the Agreement provides for the price range to be adjusted to take account of exchange rate movements and despite ample objective justification for action under this head, it proved impossible to find the necessary majority for a decision in the Council.

7. Neither the Council collectively, nor members individually had or have any contingent liabilities under any of the Cocoa Agreements. At present the 1980 Agreement has assets in the form of 100,000 tonnes of beans plus more than 200m US dollars in cash.

8. In EC terms the present Agreement is one of "mixed competence", - both the individual member states and the EC are members. Member states and the Commission are constrained by negotiating directives adopted by the Council. Further, if a new Agreement is acceptable to majority opinion within the EC the Commission would be likely to

bring forward a proposal that the Community join and that member states should do likewise. This proposal could only be blocked if the necessary votes could be found in the Council (unless we tried to use the Luxembourg Compromise). Non-adoption of such a proposal would prevent all member states from joining even if some were very keen to do so. In practice, it is therefore essential for the UK to play an active role in the negotiations, including those in Brussels concerning the EC attitude, if we are to protect our interests.

The Issues

Tactics To-Date

9. Government policy on commodities is to support agreements which are feasible, economically soundly based, and work to the mutual benefit of producers and consumers. Consistent with these principles we have so far worked constructively for a new Cocoa Agreement while insisting that an Agreement must include an economically defensible and adjustable price range, and that before it can enter into force a high level of membership must be achieved.

10. So far in the renegotiation, the EC has fallen into two main groups. One with the UK, FRG and Netherlands as a core, has urged a vigorous approach to the economic provisions of the Agreement. The other, smaller group, led by France, attaches more importance to getting an Agreement than to achieving any particular economic objective. It is not yet clear whether it will be possible to achieve a common position on all outstanding issues before the start of the next Conference, but discussions in Brussels are continuing, and may recur during the Conference.

The Present State of the Renegotiation and Lines to Take on Key Issues

11. On some basic issues a general consensus between producers and consumers has already been established in the negotiations. The main mechanism of a new Agreement is envisaged as a buffer stock which would have a capacity of 250,000 tonnes (including the 100,000 tonnes still in store from the 1980 Agreement). It would be funded, as before, by a 2¢/lb levy. Additionally, if the buffer stock

failed to defend the Lower Intervention Price, producers would be authorised to withhold from the market, in approved warehouses and under the control of the buffer stock manager, up to 120,000 tonnes of cocoa beans. The financing of this is still under discussion, but the EC has been prepared to accept that standard costs of storage and rotation could be paid from the Agreement's funds and costs of transport and insurance could be loaned. The beans would not, however, be paid for, and would remain the producers' property. This represents the present limit of consensus.

12. On the price level, consuming countries offered a reference price of 100¢/lb in October 1984. At the third conference in March 1984, the EC offered a package of measures based on a "final offer" reference price of 105¢/lb but this did not enable agreement to be reached, and the offer is no longer on the table. Producers are not united on the price level. However, they (and consumers) rejected a compromise package proposed at the last Conference including a reference price of 115¢/lb.

13. On price we have two separate, linked, objectives. We want (i) a satisfactory reference price which can be (ii) satisfactorily adapted to take account of developments over the life of the Agreement.

14. It is relevant that the dollar has weakened in the past year or so and the calculation that gave a reference price of 100¢/lb in 1983 would now give 112¢/lb. Market prices for cocoa have recently been in the range of 100 - 110¢/lb. Some in the consumer camp are arguing, therefore, that there is scope for an increase in the consumers' opening bid to a level above 100 - 105¢/lb. However, consumers' offers already made took into account estimates of future production prepared by the Secretariat of the International Cocoa Organisation. In practice, production is far outstripping these estimates, implying lower market prices in future. Work carried out by the Ministry's economists on the basis of the latest data suggests that a 100¢/lb reference price applied without adequate adjustment for the 5-year lifetime of the Agreement would probably become increasingly generous, and be likely to result in both buffer stock

purchases and withdrawals being used to their maximum limits with no possibility of sales from the buffer stock. Even though a reference price of 100¢/lb could look low at the beginning of a new Agreement, it could therefore be too high at its end.

15. On balance we should stick to 100¢/lb as a reasonable offer provided the price range intially set is capable of satisfactory adjustment. Since it has proved impossible in the present Agreement to get sufficient votes to secure optional adjustments, they should be automatic. Two types of adjustment are essential.

16. First, it is very much in our interests that the provisions whereby prices are adjusted automatically in relation to buffer stock purchases be retained from the 1980 Agreement. This would ensure that the reference price dropped by, say, 5¢/lb for every 50,000 tonnes purchased into the buffer stock within a specified period. The reference price would therefore have reduced by 15¢ when the buffer stock was full (250,000 tonnes, of which 150,000 of new purchases). An arrangement of this kind will be very difficult to negotiate satisfactorily, since the Ivory Coast say they will not join any Agreement with such a provision.

17. Second, provision also needs to be made for the price range to be adjusted to take account of exchange rate variations. The 1980 Agreement is denominated in US cents and the United Kingdom industry suffered as a result during most of its lifetime. As mentioned above, the 1980 Agreement had a provision allowing (but not requiring) the price range to be altered in these circumstances, but the Council did not agree to its implementation. So far we have argued with the strong support of our industry, that any new Agreement must provide either for denomination of prices in the Agreement to be made in a suitable basket of currencies (perhaps SDR) or for automatic adjustment of the price range in response to a divergence trigger. Indeed our industry advisers now say that this is the single most important issue for them, and they will object strongly if an Agreement is reached without such an adjustment. Of course one could work against us on occasion: the industry says they prefer that certainty to the

present uncertainty. Unfortunately within the EC Germany is firmly opposed to any such measure, but there are a number of consumers outside the EC - notably the USSR - who share our view. We should continue to argue this point strongly.

Membership

18. Following earlier Ministerial instructions we have made it clear that we would not be prepared to participate in a new Agreement which failed to get very close to the coverage required by the text of the present Agreement, ie one representing 80% of export volume and 70% of imports (paragraph 3 above). We should continue to insist on this point. In practical terms this will mean that an Agreement without the Ivory Coast would not be worth having especially if other major producers such as Malaysia did not join. Similarly, considering consumers, although it is expected that the United States will not participate, if the USSR and their satelites were to withdraw, the criterion would probably not be met.

Financing

19. The economic provisions of the current Agreement are financed by a 2¢/lb levy on trade. A provision exists (never exercised) for securing loans against the value of the buffer stock. Draft proposals from the President of the negotiating Conference provide for the possibility of similar borrowing under a new Agreement, but include a disclaimer of individual members' responsibility for the repayment of loans. The principle of such borrowing was agreed by the EC Council of Ministers in March 1984. However, the disastrous circumstances of the collapse of the Tin Agreement suggests reconsideration of this case would now be wise. Cocoa trading on the terminal markets by the buffer stock manager is expressly prohibited by the Cocoa Agreement, so there is no exact parallel with tin. Any new Cocoa Agreement would in any case be financially viable. Even with the most rapid rate of buffer stock purchasing possible there would only need to be a small contingency provision for temporary borrowing. It is recommended that we should press for the borrowing provision to be dropped. Should this line fail we should argue that a small limit for borrowing, perhaps related to a proportion of annual levy

income, could be defined in the Agreement, and this limit explicitly be precluded from subsequent adjustment by the Council. Under no conditions should borrowing be allowed against the value of the buffer stock. (Officials would agree the terms with HMT, and UK lawyers would need to be satisfied that the text of the Agreement contained no loopholes and that the UK's financial obligations under all circumstances were clearly defined).

Developments since the Third Conference

20. It has become clear that failure of the renegotiation is not unlikely. Even before the collapse of the Tin Agreement, producers seemed to have realised that there is now much less support for the kind of price-supportive commodity agreements concluded in the past (of which the 1980 Cocoa Agreement was typical). It may be that the level of prices we could accept (and which many producers might privately accept), involve such a political loss of face for producing governments as to be insupportable. Liquidation of the buffer stock would occur automatically if a new Agreement with economic provisions was not in force after 1 October 1986. We would need to insist that any liquidation of buffer stock cocoa was on terms acceptable to us. In these circumstances the possibility of producers collaborating in a cartel so as to manipulate market prices successfully seems slim, given their divergent interests.

23. At this stage it seems quite likely that an economic agreement acceptable to a reasonable majority will not be found. The most likely outcome would then be an administrative agreement (as for sugar) with no economic provisions. Such an outcome would be acceptable - even welcome - to the United Kingdom trade and industry.

Recommendations

22. The Minister is invited to instruct officials to proceed accordingly in the various negotiating forums. In summary:-

(i) The United Kingdom should continue to participate in the negotiations, while making it clear that we are opposed to any Agreement which could be economically unsound in our judgement or would be unbalanced in terms of producer and consumer advantage.

(ii) We should aim for a <u>reference price level</u> of no more than 100¢/lb or, if most other conditions are satisfactory including notably (iii) below 105¢/lb.

(iii) We should press for <u>automatic adjustments in the price range</u> related to changes in the level of the <u>buffer stock</u> and <u>exchange rate fluctuations</u> as essential components of a satisfactory package.

(iv) We should urge strongly that a new Agreement should only come into force if the membership criteria of the 1980 Agreement are met.

(v) We should press for the removal of all provision for borrowing to fund purchases for the buffer stock. If absolutely necessary we might accept some very limited provision for borrowing which would need to be agreed in detail with the Treasury beforehand, but in no circumstances could buffer stock cocoa be used as security.

(vi) We should be prepared, if need be, to encourage discussion of alternatives to an economic Agreement, namely a purely administrative Agreement or failing that none at all.

(vii) We should insist that buffer stock liquidation is effected on terms acceptable to us before agreeing to an administrative Agreement.

FOOD, DRINK AND
MARKETING POLICY GROUP

27 January 1986