

Research Department
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Mini-OPEC's?

More than a thousand delegates will meet next month in Nairobi, Kenya, to discuss development problems under the auspices of the United Nations Conference on Trade and Development (UNCTAD). At these negotiations, the oil-importing less-developed countries (LDC's) will make a strong attempt to improve their economic position relative to the industrialized world, as they have been trying to do ever since the success of the Arab oil embargo.

Less-developed countries argue that non-oil commodity prices have fallen relative to manufactured-goods prices for practically all of the past quarter-century—the commodity boom of the 1972-74 period being a brief exception—and thus they propose that commodity prices be set at higher levels and then pegged to a manufactured-goods price index to ensure future parity. However, they may find from the experience of other would-be cartelists that boosting prices is not always quite so simple.

Recurring weakness

Exports of primary products account for some 75 percent of the total export earnings of the non-oil producing LDC's. Consequently, fluctuations in commodity prices and quantities can have a destabilizing effect on their economies, which generally have little margin for error. Yet with few exceptions, the market for their major products is relatively unstable. First, prices of these products fluctuate widely, reflecting the vagaries of the business cycle, speculative influences

and weather conditions. Second, demand grows rather slowly, in relation to both available capacity and manufactured-goods demand, so that increased sales often occur only at declining prices. Following the Korean war boom, export prices received by non-oil producing LDC's dropped more than 8 percent over the 1951-72 period, while their import prices rose by 15 percent. Consequently, this shift in the terms of trade seriously eroded their purchasing power.

For a brief span in the 1972-74 period, the LDC's thought that a new era of prosperity had dawned. Non-oil commodity prices nearly doubled, as a synchronized boom throughout the industrialized world and a wave of speculative buying fueled by the Arab oil embargo pushed the demand for commodities beyond the limits of currently available capacity. But then the bubble burst with the deepening of the world-wide recession and the liquidation of excess speculative inventories. Indeed, despite a recent upturn, the spot-price index of two-dozen internationally-traded commodities still stands about 22 percent below its July 1974 peak. Moreover, with import prices sharply rising and export prices weakening, the combined balance-of-payments deficit of oil-importing LDC's surged from \$9 billion in 1973 to \$38 billion in 1975.

Stabilization efforts

For decades developing countries have sought to stabilize their export earnings by entering into international commodity agreements to

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regulate production, export quantities and prices. Prior to the Arab oil embargo, agreements were in effect for wheat, coffee, sugar and tin, utilizing such stabilization techniques as buffer stocks, long-term purchase contracts and export quotas. Immediately after the oil embargo, however, many of the developing countries tried to apply the OPEC tactics elsewhere. However, efforts of this type have succeeded only in periods of sharply rising demand. Thus, when four major copper exporters attempted in late 1974 to halt slumping copper prices with a 10-percent cut in exports, their efforts were singularly unsuccessful. Instead, the foreign producer price dropped from an all-time high of \$1.52 per pound in April 1974 to only \$0.53 per pound in December 1975, and rose only to \$0.63 in the ensuing recovery.

Mini-OPEC's?

The ability of a group of restrictionist producers to raise prices above competitive levels depends on the size of their share of world output and exports, the lack of easily available substitute materials, and the cohesiveness of the group. In the case of copper, the four cartel members (Chile, Peru, Zaire and Zambia) account for over 40 percent of non-Communist world production. But four developed countries—the United States, Canada, South Africa and Australia—account for a slightly greater share, while a large number of small producers account for the remainder.

The cartel's control over the market also has been diluted by an increase in the supply of recycled scrap, which accounts for over one-fifth of total production. On the demand side, copper is sensitive to recession because its markets are dependent upon the highly cyclical durable-goods and construction industries. Given the sharp decline in consumer demand and the producing countries' reluctance to reduce employment in the industry, the copper cartel's members have been unable to reduce production sufficiently to prevent an excessive buildup of producer inventories.

In fact, most analysts question whether any other producer groups can duplicate the success of the OPEC cartel in limiting production and boosting prices. Petroleum is influenced much less than other commodities by cyclical movements in business activity. With a cushion of large foreign-exchange reserves built up in past years, most oil-producing nations have been able to curtail production without suffering short-run repercussions. The industry is capital rather than labor intensive, so that restrictions on production have not had serious employment effects. For most of the members, enmity against a common political adversary has served as a unifying factor.

In contrast, most other basic-materials industries lack the characteristics required for the establishment of workable cartels. For most minerals, sources of supply are

widespread among both industrialized and developing countries, substitutes and stockpile metal are readily available—while industry employment is too labor intensive, and foreign-exchange reserves too small, to make production cutbacks feasible. Moreover, even if a producer association tried to establish a minimum price, individual producers might try to undercut the fixed price to expand production and to increase their share of the market.

For many primary commodities, industrialized nations account for a substantial share of world production. The United States and Canada are prominent producers of copper, lead and zinc, for example, while Canada, Australia and South Africa are important producers of nickel and iron ore. It is unlikely that these countries would be willing to join formal producer cartels, although they might follow price-raising actions by others during periods of market strength. In fact, less-developed countries account for only one-quarter of the world's total non-oil primary exports, and their share has been drifting downward during the past two decades.

Strong U.S. position

Overall, the United States is in a relatively favorable position with regard to the two-dozen or so non-fuel industrial materials deemed critical to national security. Imports of these materials, mostly ores and metals, comprise only about 15 percent of total U.S. consumption, in

marked contrast to the dependency of Western Europe (75 percent) and Japan (90 percent).

U.S. reliance on foreign imports varies greatly with respect to individual materials. For example, this country is nearly self-sufficient in copper but totally dependent on foreign tin. Canada, Australia and South Africa supply over two thirds of total U.S. industrial raw-material imports, but developing countries are significant sources for such materials as bauxite, manganese, tin and natural rubber. The United States also relies on the U.S.S.R. for significant amounts of two items—platinum and chromium—necessary for steel production.

None of these materials approaches petroleum in terms of significance to the U.S. economy, however. In 1975, U.S. petroleum imports amounted to \$24.8 billion, or about one-fourth of total imports, but purchases of iron ore, the second ranking import, amounted to only \$0.8 billion. The 1973-75 quadrupling of oil import prices increased the U.S. oil-import bill by about \$17 billion, causing nearly a 25-percent hike in overall import costs. A similar price increase for iron ore would raise total import costs by only 2 percent. Nevertheless, despite its strong position as one of the world's largest diversified raw-material producers, the United States has an important stake in ensuring an adequate supply of non-fuel materials.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 3/24/76	Change from 3/17/76	Change from year ago	
			Dollar	Percent
Loans (gross, adjusted) and investments*	87,045	- 100	+ 1,652	+ 1.93
Loans (gross, adjusted)—total	64,645	- 76	- 791	- 1.21
Security loans	875	- 134	- 564	- 39.19
Commercial and industrial	23,102	+ 6	- 983	- 4.08
Real estate	19,526	+ 15	- 262	- 1.32
Consumer instalment	10,633	+ 23	+ 780	+ 7.92
U.S. Treasury securities	9,707	+ 20	+ 2,237	+ 29.95
Other securities	12,693	- 44	+ 206	+ 1.65
Deposits (less cash items)—total*	87,133	+ 33	+ 2,583	+ 3.05
Demand deposits (adjusted)	23,989	+ 292	+ 1,153	+ 5.05
U.S. Government deposits	242	- 195	- 129	- 34.77
Time deposits—total*	61,666	+ 184	+ 1,446	+ 2.40
States and political subdivisions	6,144	- 33	- 544	- 8.13
Savings deposits	25,217	+ 146	+ 5,818	+ 29.99
Other time deposits‡	27,833	+ 122	- 2,570	- 8.45
Large negotiable CD's	12,695	+ 75	- 4,322	- 25.40
Weekly Averages of Daily Figures	Week ended 3/24/76	Week ended 3/17/76	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves	89	13		35
Borrowings	2	1		15
Net free(+)/Net borrowed (-)	+ 87	- 14		+ 20
Federal Funds—Seven Large Banks				
Interbank Federal fund transactions				
Net purchases (+)/Net sales (-)	+ 1,287	+ 1,543		+ 1,740
Transactions of U.S. security dealers				
Net loans (+)/Net borrowings (-)	+ 25	+ 310		+ 715

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . . Information on this and other publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.