SM/83/83

May 16, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Buffer Stock Financing Facility - Report on the 1977 International Sugar Agreement

Attached for the information of the Executive Directors is the staff report on the operation of the buffer stock and other developments in connection with the present International Sugar Agreement.

Att: (1)

Other Distribution:
Department Heads

The ISO, with participation by delegates from the European Community (EC), which is now the leading supplier of sugar to the free market but not a member of the ISO, has been exploring the possibility of implementing various measures to alleviate the pressure on sugar prices by reducing the availability of supplies on the free market. However, agreement has thus far not been reached, and the International Sugar Council decided in November 1982 that a new and more effective Agreement, with full EC participation, would provide the best prospect for achieving a long-term solution to what has been characterized as the "world crisis in sugar." A conference to negotiate a new ISA is in progress in Geneva (May 2-20), under the auspices of UNCTAD. A Preparatory Committee held meetings at the ISO headquarters in London in December 1982 and in January and March of this year to establish a framework for a new Agreement which could enter into force in January 1984, a year before the formal expiry of the present ISA.

This paper consists of three sections. The first section discusses use of Fund resources in relation to special stocks of sugar; the second reviews recent market developments and the operation of the Agreement; and the third discusses the factors affecting the operation of the 1977 ISA.

1. Use of Fund resources in relation to special stocks of sugar

In December 1977, a decision was taken by the Fund to provide financial assistance to Fund members in connection with the establishment of special stocks, which would be nationally-owned but internationally controlled under the 1977 ISA. 1/ A Fund member may purchase from the Fund an amount equivalent to the value of the special stocks of sugar, which is determined on the basis of the monthly average market price during the month in which stocks are constituted, or the floor price of the Agreement, if the latter is below the market price. In order to qualify for a drawing, a member must have a balance of payments need, and must satisfy the Fund that it will cooperate with the Fund in efforts to find, where required, appropriate solutions to its balance of payments difficulties. Drawings under the buffer stock financing facility are subject to a limit of 50 per cent of members' quotas, and are additional to members' access to all other facilities. Members are required to repurchase within three to five years, and are expected to do so earlier, if stocks are released from the control of the ISO. In addition, a member is expected to repurchase earlier if it obtains a loan in foreign exchange for which the special stocks are used as collateral.

During the period July 1982 to April 1983 the Fund provided financial assistance amounting to SDR 48.5 million to five members (Dominican Republic, Australia, Malawi, Mauritius, and Swaziland) in connection with their accumulation of special stocks of sugar. Each purchase was substantially lower than the limit of 50 per cent of the member's quota (Table 1). The total amount purchased related to an aggregate accumulation of 258 thousand tons of stocks. Only two of these five countries (Malawi and Mauritius)

1/ Decision No. 5597-(77/171), adopted December 16, 1977.

Table 1. Purchases by Fund Members in 1982-83 (January-April) in Connection with Special Stocks Under the 1977 International Sugar Agreement

Member	Stock Accumulation				Related Purchases		
			Price 1/				
	Date	Quantity ('000 Tons)	U.S. Cents Per Pound	SDRs Per Ton	Date	Amount (SDR Millions)	Per Cent of Quota
Dominican Republic (EBS/82/114)	May 1982	66.933	8.11	157.570	7/19/82	10.547	12.8
Australia (EBS/82/183)	February 1982	100.000	13.00	252.984		25.298	
	June 1982	52.363	6.84	136.826		7.165	
		152.363	10.88	213.064	11/10/82	32.463	2.7
Malawi EBS/82/201)	May 1982	2.340	8.11	157.566		0.369	
	July 1982	3.509	7.80	157.547		0.553	
		5.849	7.92	157.554	12/6/82	0.922	3.2
Mauritius (EBS/82/231)	July 1982	10.786	7.80	157.547		1.699	
	September 1982	16.180	5.77	117.806		1.906	
		26.966	6.58	133.702	1/13/83	3.605	8.9
Swaziland (EBS/82/204)	May 1982	6.185	8.11	157.566	1/6/83	0.975	5.4
Total		258.296	9.58	187.812		48.512	

1/ Monthly average of daily prices during months in which stocks were accumulated, converted to SDRs at the monthly average of the daily SDR/$ rate.

purchased amounts from the Fund corresponding to the maximum level of the sugar stocks that they are obligated to accumulate in the period ending December 31, 1983. Purchases by the other three countries were in respect of their minimum stocking obligation in the period ended June 1982. Since then, these three countries as well as other Fund members which are also exporting members of the ISA have accumulated much larger volumes of stocks than the minimum obligatory levels, and it is expected that additional requests for purchases under the buffer stock financing facility will be forthcoming.

In the previous downswing of the sugar price cycle in 1978-79, six Fund members (Australia, Dominican Republic, Guyana, Jamaica, Nicaragua, and the Philippines) were provided financial assistance amounting to a total of SDR 73.7 million in relation to the accumulation of special stocks of sugar. From January 1978 to September 1979 the price of sugar on the free market was below the floor price (11 cents per pound at that time); consequently, all of the economic provisions of the ISA, including the obligation to accumulate special stocks, were in effect during that period. Subsequently, the free market price rose sharply and in February 1980, after the prevailing price had risen above 21 cents per pound, the special stocks were released from the control of the ISO. By May 1980, all of the outstanding amounts were repurchased from the Fund, thus ending the first cycle of Fund purchases and repurchases in connection with the stabilization operations under the 1977 ISA.

If a new International Sugar Agreement is adopted at the ongoing Conference, or at a subsequent meeting, and becomes effective in early 1984, the staff will prepare a paper for the consideration of the Executive Board analyzing the suitability of the Agreement for Fund support under the buffer stock financing facility. It has been suggested at the ISO's Preparatory Committee meetings that any new Agreement should be framed in such a way as to maintain IMF support for members by including obligatory stocking provisions.

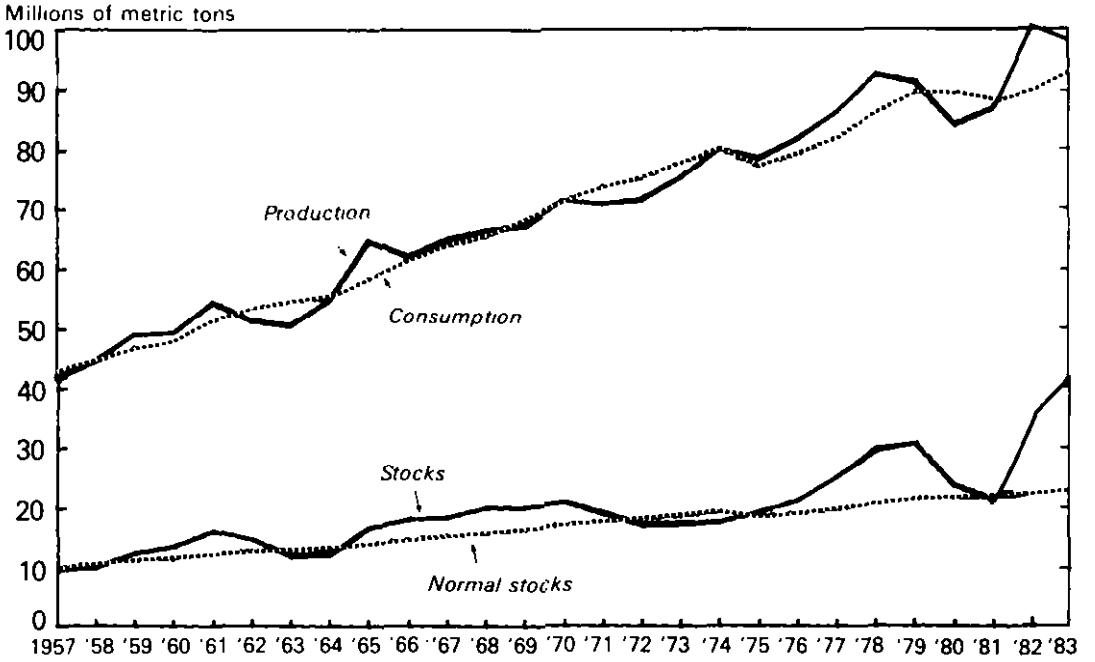
2. Recent market developments and operation of the Agreement

After declining sharply during the 1979/80 season (crop year ending August), world sugar output recovered in 1980/81 owing to improved weather conditions, and it reached an unprecedented level in 1981/82, as record crops were harvested in India, Thailand, and Western Europe. World consumption has virtually stagnated in the last two years, partly reflecting the inroads made by sugar substitutes, particularly high fructose corn syrup (HFCS). World stocks, which had declined to 28 per cent of world consumption in 1980/81, increased to 40 per cent in 1981/82, the highest level recorded in over 25 years (Table 2, Chart).

The outlook for 1982/83 is for a further significant increase in the level of world stocks. World consumption is expected to remain weak and to be exceeded by another large crop, possibly raising the stock/consumption ratio to 45 per cent in 1982/83.

CHART

WORLD SUGAR PRODUCTION, CONSUMPTION, STOCKS AND PRICES



FREE MARKET SUGAR PRICES[1]

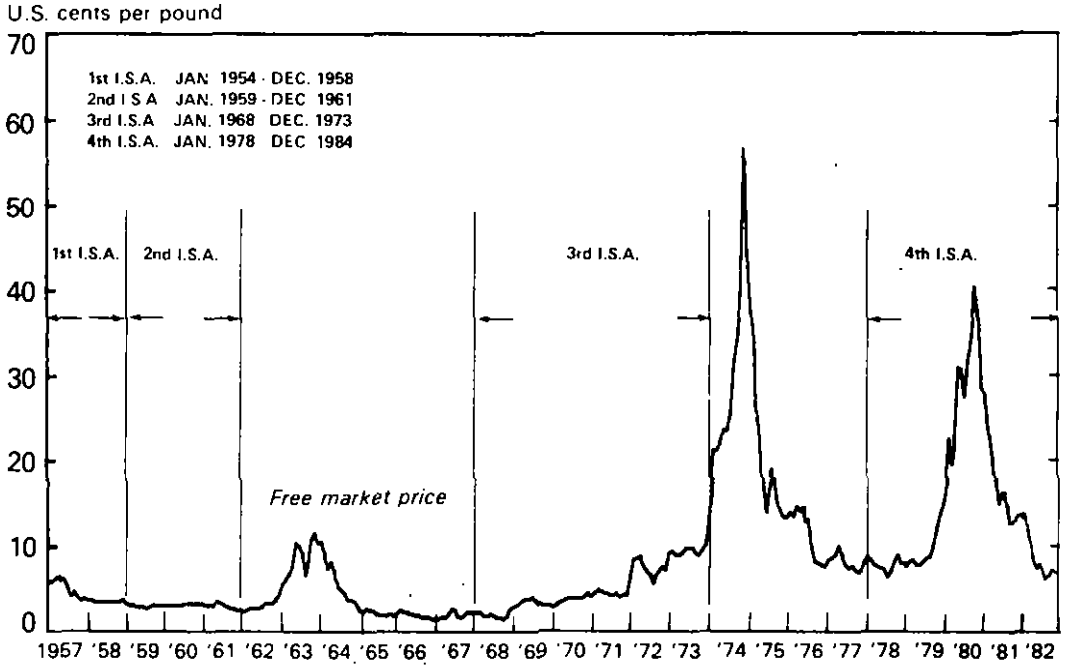


Table 2. Sugar: World Supply, Demand, Stocks and Prices

Years Ending August	Production (1)	Consumption (2)	Ending Stocks (3)	Normal Stock Level 1/ (4)	Stocks/ Consumption Ratio (5)	World Prices 2/ (6)
	- - - (In millions of metric tons) - - -				(In per cent)	(U.S. cents per pound)
1957	41.4	42.2	9.6	10.1	22.7	5.2
1958	44.5	44.3	10.0	10.6	22.6	3.7
1959	48.9	46.7	12.4	11.2	26.6	3.1
1960	49.1	48.0	13.5	11.5	28.1	3.1
1961	54.4	51.2	16.0	12.3	31.2	3.1
1962	51.3	53.3	14.7	12.8	27.6	2.6
1963	50.4	54.6	11.9	13.1	21.8	6.4
1964	54.8	55.2	12.2	13.2	22.1	8.1
1965	64.5	58.3	16.6	14.0	28.5	2.6
1966	62.1	61.4	18.0	14.7	29.3	2.0
1967	64.9	63.8	18.4	15.3	28.8	1.8
1968	66.5	65.3	20.0	15.7	30.6	2.0
1969	67.1	67.8	20.1	16.3	29.6	3.1
1970	71.2	71.1	20.8	17.1	29.2	3.4
1971	70.7	73.5	19.0	17.6	25.8	4.3
1972	71.4	74.9	17.0	18.0	22.7	6.4
1973	75.1	77.7	17.3	18.6	22.3	8.8
1974	80.0	80.0	17.5	19.2	21.9	18.7
1975	78.5	77.0	19.1	18.5	24.8	30.5
1976	81.7	79.2	21.2	19.0	26.8	13.6
1977	86.3	81.9	25.0	19.6	30.5	8.3
1978	92.5	85.1	29.8	20.7	34.6	7.5
1979	91.6	90.3	31.9	21.5	35.3	8.2
1980	84.6	90.7	25.8	21.5	28.4	21.0
1981	88.3	89.0	25.0	21.4	28.1	24.7
1982	100.0	89.6	35.4	21.5	39.5	10.4
1983 E	98.5	92.1	41.7	22.1	45.0	6.2 3/

Source: USDA - Foreign Agricultural Service.

E = Estimate.
1/ Calculated as 24 per cent of current consumption.
2/ Average of the New York No. 11 spot price and the London daily price.
3/ September 1982 to April 1983.

The marked rise in the stock/consumption ratio has exerted strong downward pressure on free market prices. Prices declined from 41 cents per pound in October 1980 to less than 16 cents per pound in May 1981, which is the ISA's trigger point for corrective action when prices are falling. 1/ Export quotas were then automatically imposed and thereafter reduced in tranches of 5 per cent to their minimum permissible level of 85 per cent. Special stocks amounting to an aggregate volume of 1 million tons had to be accumulated by exporting members by June 30, 1982 (Table 3). Despite these measures, the free market price continued to fall, reaching a level of 8 cents per pound in May 1982, when the ISO decided to take further measures, including acceleration of the rate of accumulation of special stocks.

The present Agreement provides for the accumulation of a total of 2.5 million tons of special stocks over a three-year period from the date on which quotas are imposed. 2/ With sugar prices still depressed after the accumulation of the first tranche (1 million tons by end-June 1982), it was decided to advance by six months the date by which members had to accumulate the remaining 1.5 million tons of special stocks (to end-December 1983, instead of end-June 1984). In addition, the level of basic export tonnages, which is used to determine export quotas for individual countries, was frozen for 1983 and 1984 at the 1982 level. 3/ Subsequently, the ISO Executive Committee passed a resolution asking exporting members also voluntarily to accumulate additional special stocks of up to 50 per cent of their total stocking obligation.

All of these measures proved to be inadequate to achieve a recovery in prices consistent with the stabilization objectives of the Agreement. During the 64 months since the 1977 ISA came into effect on January 1, 1978, the free market price has remained within the agreed price range for only 12 months and outside that range for 52 months, or about 80 per cent of the time. 4/ Performance under the Agreement clearly has not been as favorable as had been expected.

1/ The relevant provisions of the 1977 ISA are explained in SM/82/78.

2/ According to the Agreement, not less than 40 per cent of a member's total stocking obligation shall be accumulated during the first 12 months from the date on which quotas become operative; not less than 80 per cent in the first 24 months; and the balance in the first 36 months after the date on which quotas are imposed.

3/ The International Sugar Council also decided not to redistribute declarations of expected 1982 shortfalls by 7 countries amounting to 407 thousand tons, which virtually offset increases in export entitlements awarded to other members.

4/ The price was above the agreed range in February 1980 and from May 1980 until February 1981, and below the agreed range from January 1978 until September 1979 and again from September 1981 until April 1983.

Table 3. Special Stocks of Sugar

(In tons, raw value)

Member	Maximum 1/	Minimum 2/
Argentina	74,687	29,875
Australia	380,908	152,363
Austria	16,080	6,432
Bolivia	7,721	3,088
Brazil	401,970	160,788
Colombia	47,693	19,077
Costa Rica	4,921	1,968
Cuba 3/	387,253	154,901
Dominican Republic	167,332	66,933
Ecuador	2,124	850
El Salvador	27,403	10,961
Fiji	45,838	18,335
Guatemala	38,332	15,333
Guyana	13,299	5,320
India	125,357	50,143
Jamaica	2,910	1,164
Malawi	5,849	2,340
Mauritius	26,966	10,786
Mexico	10,235	4,094
Mozambique 3/	2,140	856
Nicaragua	9,052	3,621
Panama	25,801	10,320
Peru	41,502	16,601
Philippines	255,995	102,398
South Africa	141,562	56,625
Swaziland	15,463	6,185
Thailand	183,264	73,306
Zimbabwe	38,343	15,337
Total	2,500,000	1,000,000

Source: International Sugar Organization.

1/ The final date of accumulation was moved from June 30, 1984 (total period of three years) to December 31, 1983 by an ISO Council decision of May 1982.

2/ Represents 40 per cent of the maximum stocking obligations. These stocks had to be accumulated by all members by June 30, 1982.

3/ Not members of the Fund.

3. Factors affecting the operation of the 1977 ISA

The Agreement came into force at a difficult time for the world sugar market: prices were very low (around 8 cents per pound on the free market) and world stocks were high (equivalent to about 35 per cent of consumption). The imposition of export quotas upon entry into force of the Agreement in January 1978 helped stabilize prices during the first two years of operation (1978-79), but the sharp rise in prices in the following year (1980) was perhaps primarily attributable to the unusual occurrence of simultaneous declines in output in a number of major producing countries.

The current prolonged period of low sugar prices reflects surplus world production on a scale that was not foreseen when the 1977 Agreement was negotiated and which it is not designed to cope with. The two factors which are largely responsible for the Agreement's failure to stabilize the sugar market are: (a) the nonparticipation of the EC, which, as a result of its price support policy, has been transformed from a net importer of sugar in 1975/76 to the largest supplier of sugar to the free market; (b) the unanticipated increase in EC supplies had the effect of exposing an important shortcoming in the design of the Agreement itself--the formula used to calculate the basic export tonnages has prevented export quotas from being set at realistic (low) levels. Two other factors have contributed to the lack of success of the Agreement in stabilizing sugar prices: (c) the price support measures in terms of import quotas introduced by the United States in May 1982 because of depressed world prices; and (d) the rapid growth of alternative sweeteners, such as high fructose corn syrup, particularly in the United States, which has had the effect of exacerbating the supply imbalance.

a. Nonparticipation of the European Community

The European Community was a net importer of sugar through 1976, when negotiation of the present ISA began, but since then, its exports have increased to the extent that it has become the largest net exporter to the free market. By 1981, its share of that market increased to 26 per cent, while the share of ISA members declined from about 94 per cent in 1975 to 71 per cent. The growth in EC exports reflects increased production in response to special incentives adopted in 1975, following a period of world shortages and high sugar prices. EC intervention prices for sugar have exceeded world market prices by an average of 78 per cent during the period 1976/77-1982/83. The expansion in EC output was accompanied by virtually stagnant consumption, leading to the turnaround in the EC position from a net importer of 183 thousand tons in 1975 to a net exporter of 5.3 million tons in 1981. 1/

1/ While virtually all exports from the EC are channeled to the free market, most imports are handled outside the free market under special arrangements. In particular the EC imports about 1.4 million tons of raw sugar annually from developing countries in Africa, the Caribbean and the Pacific (ACP countries), which have special status to export to the EC on favorable terms under the Lome Convention. EC imports, including those under special arrangements, exceeded the EC's exports by 1.5 million tons in 1975, but this was reversed in 1977; in 1981, net exports by the EC amounted to about 4 million tons.

Recently the EC has taken measures designed to reduce its surpluses and to alleviate their effects on the world sugar market. In 1981/82, the area planted with sugar beet was reduced by 9 per cent and the level of stocks was increased by about 1.7 million tons. In October 1982, the Community also committed itself to significantly reduce the areas sown with sugar beet in the spring of 1983 and to maintain the overall quantity of stocks in 1982/83 at the previous year's level.

b. Formula regarding export quotas

Under the 1977 ISA, export quotas for individual countries are set in terms of Basic Export Tonnages (BETs), 1/ which represent the distribution of market shares among exporting members. 2/

The formula, which is contained in Article 34(2) of the Agreement has led to an unjustified inflation of BETs in 1981 and 1982. 3/ According to the formula, the BET for each member in these years was to be based upon the average of its relative export performance during the previous three years, excluding the year of its lowest export performance. As a result, the aggregate of BETs increased by 9 per cent in each of 1981 and 1982 during a period when demand was shrinking. In absolute terms, the global BET was increased from 16.2 million tons in 1980 to 17.7 million tons in 1981, compared with an estimate for free market demand for sugar from ISA members of 14.7 million tons. Similarly, in 1982 the global BET amounted to 19.4 million tons and minimum export entitlements to 16.5 million tons, compared with estimated demand of 12 million tons. 4/

Other provisions of Article 34(2) of the Agreement have also resulted in the inflation of BETs from one year to another, including additions to BETs as a result of allocations under the Hardship Reserve, 5/ and increased sugar production for the free market from expansion projects registered with

---

1/ Each exporting member with net annual sugar exports of over 70,000 tons has a BET entitlement. Smaller exporting countries have an export entitlement of up to 70,000 tons per year, which is not subject to any adjustment under the export quota provision, and such members are not obligated to accumulate special stocks.

2/ Export quotas are imposed when the prevailing price remains below 16 cents per pound for five consecutive days and are reduced by tranches of 5 per cent each if the price continues to fall below each of three other trigger points to a minimum of 85 per cent of the BETs. BETs were specified in the Agreement for the first two quota years but were to be revised annually for 1980 and subsequent years.

3/ International Sugar Organization, "Inflation of BETs Under the Formula in Article 34(2)," E(81)29, September 30, 1981.

4/ To the extent that export shortfalls in 1982 were not redistributed, actual export quotas were reduced somewhat below the 85 per cent of BETs.

5/ The Hardship Reserve applies to developing countries in need of additional export entitlements because of hardships experienced as a result of special difficulties (Article 39).

the ISO 1/ as well as other adjustments. 2/ However, these involved relatively small amounts.

c. U.S. sugar import quotas

The U.S. Government has adopted sugar price support programs from time to time when world market prices have not provided adequate returns for domestic beet and cane producers. During periods when free market prices were high, as in 1975-76 and 1980-81, no price support programs were in effect. In 1981, the free market price declined sharply from about 28 cents per pound at the beginning of the year to less than 12 cents per pound in November. As a result, a domestic price support program covering the 1982-85 crops was introduced in December 1981. The aim is to achieve a market stabilization price (MSP) through a system of duties and fees on sugar imported into the United States. 3/ The initial MSPs under the program were set at 19.08 cents per pound for the period January-May 5, 1982 and 19.88 cents per pound for the period May 6-September 30, 1982, and import duties and fees were increased in order to raise the price of imported sugar to those levels. However, even with import duties and fees set at the legal maxima--2.8125 cents per pound and 50 per cent of the world free market price, respectively--the domestic spot price for raw sugar could not be raised to the MSP level when the free market price fell below 9 cents per pound in early May 1982. Consequently, on May 11, 1982, the Government adopted the first restrictive quota system since 1974. Under this system, the quotas for individual countries were set in accordance with their average exports to the United States during the period 1975-81.

As a result of the import quota system, U.S. sugar imports declined from an average of 5.0 million short tons of raw sugar annually in the five years ended 1981 to slightly less than 3.0 million tons in 1982, 4/ and the domestic spot price rose above the MSP to a level of 21.03 cents per pound in June and has been maintained at over 20 cents per pound since then. However, the price umbrella established by the quota system has also increased the protection provided to competitive sweeteners, particularly HFCS. The system has reduced the access of foreign exporters to the U.S. market, but assured them of a stable and higher price for their reduced supplies. Supplies in excess of U.S. quota limitations have had to be channeled to other free market outlets and this has had a further depressing effect on free market prices.

1/ Article 34, subparagraph (2)(g).

2/ Article 34, subparagraph (2)(c).

3/ The MSP is set above loan rates (cents per pound of sugar) to farmers under price support loan programs and guaranteed purchase prices to minimize the risk of farmers forfeiting sugar at the loan rate to the Commodity Credit Corporation as well as purchases of sugar by the CCC.

4/ For the three most important exporting countries to the U.S. market, export volumes to the United States declined in 1982 from: an average of 780 tons annually (1977-81) to 363 tons for the Dominican Republic; an average of 1,261 tons annually (1977-81) to 273 tons for Brazil; and an average of 670 tons annually (1977-81) to 203 tons for the Philippines.

d. Sugar substitutes

One important factor contributing to the the longer term difficulties faced by sugar has been increasing competition from substitutes. The growth in the market share of substitutes is mainly reflected in the declining share in world sugar consumption of the industrialized countries, where most of the substitutes are produced and consumed.

Apart from noncaloric sweeteners, which still represent a very small share of the world sweetener market, the only important competitor of sugar is high fructose corn syrup (HFCS), a liquid sweetener produced mainly in the United States (70 per cent) and Japan (18 per cent) and used by the food manufacturing industry. In the United States, consumption of refined sugar is estimated to have declined from 89 to 74 pounds per capita from 1975 to 1982, while that of HFCS has increased from 5 to 27 pounds per capita over the same period. As a result, the share of HFCS in caloric U.S. sweetener consumption has risen from 4 per cent to 22 per cent in the United States in those years. The share of HFCS is expected to increase further, as major beverage manufacturers take advantage of the substantial price advantage that HFCS enjoys over sugar in the United States. HFCS is also rapidly increasing its share of the sweetener market in Japan, whereas in the EC, production has remained relatively stagnant, partly because it is subject to quotas under the EC Sugar Regime.