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Arrangement Regarding Bovine Meat

INTERNATIONAL MEAT COUNCIL

Long-term supply arrangements and implications for international market stability

Note by the secretariat

This note has been prepared in response to the request made at the December 1981 meeting of the International Meat Council to be used as a basis for discussion at the December 1982 meeting of the IMC. The following sources inter alia have been used: OECD "The instability of agricultural commodity markets" Paris, 1980; C. Leubusher "Bulk buying from the colonies" 1956; FAO Commodity Policy Studies "The long-term contract" April 1956; J.D. Coppock "International trade instability", 1977; L. Baranyai and J.L. Mills "International commodity agreements", 1963; UN "Review of international commodity arrangements", Geneva, November 1947; and information received from delegations.

Introduction and historical background of the long-term supply arrangement

1. The long-term bilateral arrangement or contract* has been defined as "a flexible agreement between two countries stating the intention to trade in a commodity over two or more seasons and stipulating within wide limits the conditions under which this trade is to be transacted... The purpose depends on the commodity and the country to which contracts apply"[1]. Modern long term supply arrangements for beef have their origin in the depression of the 1930's when the slump in prices made it necessary for the United Kingdom, the main if not the sole importer of beef for many years, to negotiate agreements with suppliers in order to protect its own livestock industry. The first of these agreements (the Ottawa Agreement of 1932 and the United Kingdom-Argentina No. 1 Agreement of 1936 contained provisions for the quantitative regulation of imports of beef, lamb and mutton, bacon and hams into the United Kingdom from principal exporting countries[2]. A few years later, an International Beef Conference (1937) was established with the objective of regulating the supply of beef[3] to the United Kingdom while ensuring "in the interest of consumers and producers alike, an orderly adjustment of supply to demand, having due regard, among other things, to the seasonality of supplies of beef from all sources, including United Kingdom home production, and the potentialities of production of the several producing countries"[1]. At the outbreak of the Second World War, all previous arrangements were ended.

2. The terms of the long-term supply arrangement, as developed mainly by the United Kingdom and its suppliers during and after the war, differed among individual contracts as to period covered, quantity and price, and depended on the production period (reproductive cycle), the availability of supply and the supplying country's special requirements. In its early stages the contract was generally limited to one year but evolved soon into arrangements covering several years. Beef arrangements of that time covered periods of five (later reduced to three), seven and as many as 15 years. The quantity provisions of the long-term supply arrangement varied considerably but seemingly not because of the commodity. Thus, for beef there were arrangements which stipulated a minimum volume to be supplied each year, others where the total exportable surplus was to be imported by the United Kingdom and still others where the total exportable surplus less agreed reservations

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[1] The Long-Term Contract, Thomas Eastwood, Commodity Policy Studies No. 3, FAO, April 1953. p.2.

[2] Review of International Commodity Arrangements, Geneva, November, 1947, p.31.

[3] Fresh, chilled, frozen salted and canned beef and veal, edible offals thereof and live cattle ready for slaughter.

* Note: "contract", "arrangement" and "agreement" are used interchangeably in this paper. Also this paper does not cover access commitments negotiated during the MTN's or elsewhere. Even though some aspects of the access commitment may be comparable to those of the long term supply arrangement, it is considered that there are some fundamental differences that exclude access commitments from the scope of this study.

for other destinations was to be exported to the United Kingdom. There were also arrangements where quantities were negotiated annually. Sometimes an arrangement started out as a "United Kingdom take all" contract but was revised later to take into account emerging new markets, the wish of some suppliers to diversify their trade and the existence of higher prices elsewhere.

3. The price provisions in the long-term contract generally stated that prices should be set "so as to give the producer a fair return" and also to act as an incentive to increase production. Annual reviews of the price was a general feature of these contracts. Special provisions were negotiated, stating on what basis these reviews should take place, for instance one contract linked the changes in price to changes in cost of production, whereas another limited changes to a certain percentage up or down. Over time contract terms became more flexible and susceptible to renegotiation under certain circumstances. This reflected in part changing economic conditions, a growing world meat market and a better understanding of that market. But it reflected mainly, in the 1950's, the diminishing relative importance of the United Kingdom as an importer of beef compared to its position in the 1930's and 1940's.[1]

Why long-term supply arrangements?

4. The interest for long-term bilateral arrangements for a series of products appears to have risen sharply in the last several years as a means, it has been said, inter alia, of supplementing multilateral commodity arrangements. Bilateral commodity arrangements have lately ranged from loosely fitted framework agreements to more specific agreements concerning one or more products where detailed provisions have been elaborated concerning, for instance, quantities, quality, price and payment conditions. Some agreements have been for specific quantities while others have had minimum and/or maximum quantity provisions. Price-setting provisions have varied considerably: world market price at the time of shipment, to a set price for a certain period established according to a negotiated formula, minimum and maximum price bands, etc. The modes of payment have varied between cash on delivery, credits limited to a certain period, to barter deals (the latter having seemingly gained a certain amount of popularity in the last few years[2]). Most contracts, if not all, have been negotiated for a limited time period, sometimes subject to review.

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[1] In the 1930's the United Kingdom took virtually all of the world's beef exports, but during the 1940's and later the proportion of meat exports that went to the United Kingdom diminished. (On average for the years 1948-1950, the United Kingdom still imported 75 per cent of world exports of beef).

[2] In 1974 barter trade represented 2 per cent of world trade in value terms, a figure that by 1981 had risen to 30 per cent according to the Journal of Commerce from 6 September 1982. It would appear that in these figures "countertrade" and "back-to-back deals" have been included even though it may be disputed that "back-to-back deals" can be assimilated to barter deals, since the former are three-way arrangements while barter deals are usually two ways.

5. Importers interest in long-term supply agreements, especially in international deficit situations or when demand is buoyant seems to stem from the advantage of supply security, often at fixed prices, for a relatively long period of time, for at least part of its import requirements of the product in question. It makes for a higher degree of stability of imports and assures consumers of at least the contracted volume. It would also tend to help planning imports and financing thereof, since at least part of the volume and its cost is known well in advance.

6. Exporting countries may find long-term contracts of interest, in particular in international surplus situations or when demand is low or falling, since it assures them of access to markets for at least some of their production at prices agreed to in advance (specifically or by reference to ruling world prices). Producers in the exporting country may gain some confidence knowing that at least part of their production is already contracted for and are thus able to plan ahead more adequately. The exporting country is also assured of a certain amount of export earnings for a longer period as a result of the long-term supply agreement.

7. Possible disadvantages for importers and exporters respectively could be that in a surplus situation the importer may be able to find beef cheaper on the residual market, while the exporter in a deficit situation may regret the possibility of selling his products at a higher price elsewhere. These inconveniences may, however, be considered minor compared to the advantages of long-term access and supply security, especially if the price of the meat is based on the world market price.

Effects of long-term supply arrangements

8. It is generally considered that the effects of long-term supply arrangements on the world market (third parties) depend very much upon the proportion of world trade, of production and of consumption influenced by the contract, upon the flexibility of terms of contract, and upon the purpose of the contract. The larger the part of the world trade that is under contract (arrangement), the bigger the effects on the residual markets would tend to be, since the latter are shrunk by the former and become "more prone to fluctuations by reacting sharply to any changes in supply and demand"[1*]. In times of shortages the decreased supplies outside the arrangement(s) will tend to drive prices higher up than if all supplies had been available on the "open" market. In a surplus situation, however, it would seem that the quantities held from the residual market by the arrangement(s) would tend to help keep

[1] Leubuscher, C. "Bulk buying from the colonies", Oxford University Press, 1952, p. 132

[*] A good example is the oil market where perhaps only 10 per cent of the product is sold outside long-term arrangements, resulting in sharp swings on the spot market as response to even small changes in supply and demand.

prices from falling more than would otherwise be the case. However, if only a small proportion of the market is under bilateral arrangements, these would have only a minor influence, if any, on the market forces of the "free" market.It would also seem that a large number of importers and exporters bound by bilateral contracts in a particular product could have relatively less influence on the residual market than contracts between a monopsonistic importer or monopolistic exporter and a number of exporters/importers. The monopsonistic importer or monopolistic exporter would tend to be able to impose, within limits, its own terms, for instance setting prices at an "abnormal" level. Also of relevance in this connexion, it would seem, is the degree of fluctuation in the availability of supplies due to factors which are not directly controlled by the producer (for instance climate), and surplus disposal policies of individual producing countries.

9. However, for long-term contracts to have a beneficial effect on the stability of the market, it has been said[1] that the contract would have to provide for some flexibility in its terms. In a situation when an importing country fails to import a large quantity of a product under contract due to, say, balance-of-payments difficulties and the exporter offers this quantity on the free market the balance of the market may very well be upset. In such situations, flexibility in the terms of the contract may help to attenuate the effects on the residual market. However, if the contract terms are too flexible both importing and exporting country as well as third markets will loose some measure of predictability.

10. The purpose of the arrangement may well have some influence on the residual market. If, for instance, the stated objective of the arrangement is to increase production of the product under contract by assuring a steady outlet at stable prices, preferably above the current market price, producers outside the contract may very well feel inspired to increase their production also. (However, it appears that the reverse could also happen). The cumulative effect of the production increases inside and outside of the arrangement may, as has happened in the past, amount to oversupply of the market with consequent effects on prices. If, on the other hand, the purpose of the arrangement is a simple supply commitment, at current world market prices, the effects on the market may be contained to those of constricting a certain amount of supply and demand.

Long-term supply arrangements concerning bovine meat

11. The interest in long-term contracts for bovine meat appears to have increased considerably in the last few years. The reasons for this appear to be inter alia: the contraction of demand in traditional importing countries due mainly to the general precarious economic situation in the world; a certain saturation of meat consumption in

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[1] See for instance, OECD: "The instability of agricultural commodity markets", Paris 1980 p. 62-63.

some countries and higher self sufficiency in others. This has induced some exporting countries to look for export opportunities elsewhere and to secure these as far as possible with long-term contracts. At the same time some "new" meat importing countries were interested in securing a steady supply of meat, some because of a higher standard of living made choice of more expensive meats possible; others because of dietary requirements, coupled with higher incomes, made it desirable. Thus it would seem that under present circumstances both importer and exporter (or at least some of them) find an advantage in a long-term supply arrangement concerning bovine meat.

12. As far as is known only three countries - Argentina, Finland and Uruguay - have lately entered into long-term arrangements concerning bovine meat. On the importing side five countries are involved: Algeria, Egypt, Ghana, Israel and USSR, and two of those have contracts both with Argentina and Uruguay (Egypt and Israel) while another (USSR), has arrangements with both Argentina and Finland. In all instances except one, arrangements were negotiated and concluded between governmental or official agencies in both exporting and importing countries. However, the products are to be purchased directly from private exporting firms. Most of the contracts are for a duration of three years, one, it appears, is for less than a year and two are for five years. At least one of the contracts have an option of a two year extension. It is understood that prices are set on the basis of world market prices and some of the arrangements provide for renegotiation of the prices periodically on that basis. Total quantities currently under contract amount to a maximum of 253,500 tons and a minimum of 207,500 tons. Most arrangements are for a fixed quantity but two have a minimum and a maximum quantity included in the arrangement and one a maximum quantity but no minimum.

13. As far as is known, around 69 per cent of the contracted quantities (calculated on the basis of maximum quantities) are for bone-out meat, most of which, it appears, are from unspecified animals (mentioned only as "beef"), between 15 and 32 per cent from steers, and an unspecified quantity from cows. (Note that one contract does not appear to specify quality, cuts etc., leaving that to be negotiated between exporting and importing companies). Bone-out meat cuts vary between unspecified (the majority), incomplete compensated quarters, and forequarters. Bone-in meat is contracted for in at least four contracts and represents around 15 per cent of total maximum amount under arrangement. These are specified, as far as is known, as "beef, bone-in, compensated quarters, cointinental quality", "beef, bone-in, forequarters, continental quality", beef, frozen, continental B, in compensated quarters, bone-in", and beef frozen, manufacturing grade in compensated quarters, bone-in".

14. According to the information available, three of the arrangements specify that deliveries shall in principle be made by monthly instalments while a fourth arrangement indicates deliveries of a certain quantity (1000-2000 tons) each 30-45 days. Four other contracts appear to leave the frequency of delivery open. As concerns modes of payment, information available indicate that at least three of the arrangements provide for payment through documentary credits payable on sight.

15. Other exporting countries have shown an interest in concluding long-term supply arrangements but little, if anything, is so far known about whether negotiations are in progress or not. One major exporter have been contemplating a series of framework agreements in which beef would be included. It has been suggested that these framework agreements, to be negotiated on a bilateral basis according to the individual importer's requirements, should run for a period of three years with an option of extension for a further three years. Quantities to be supplied would be subject to a minimum and maximum amount. Prices would be based on world market prices. However, recent information suggests that the conclusion of such framework arrangements are currently not feasible.

16. Thus, so far, long-term beef arrangements, have been concluded for approximately 10 per cent (calculated on maximum volume under contract) of total exports* (1981) of countries which take part in the Arrangement Regarding Bovine Meat or around 9 per cent of world exports. Export quantities under contract correspond to roughly 49 per cent of the three exporting countries' annual global exports (based on 1981 exports) of fresh chilled and frozen beef. For each exporting country the long-term arrangements account for 47.7 per cent, nearly 100 per cent and 40.5 per cent respectively of their total exports (1981). For the two importing countries with the largest long-term contracts (USSR and Egypt), imports under contracts correspond to approximately 28 per cent and 75.8 per cent (calculated on basis of estimates of total 1981 imports) of total imports. Thus, as can be seen, current long-term supply arrangements cover a major part of the three exporting countries' export availabilities as well as a major part of at least one importing country's requirements and an appreciable part of another importing country's imports.

17. It would seem that the implications for the stability of world trade in bovine meat of these supply arrangements are minor, if any, in particular in view of the proportion of world trade outside arrangements, and the fact that prices within arrangements appear to be set according to world prices thus not distorting competition on the basis of price. It would seem that a much more substantial part of world trade in bovine meat would have to be tied up under long-term supply arrangements before any effects of significance would be discerned on the residual market. Thus, the importance of long-term arrangements today and under present conditions would be that they do secure access of a certain major volume of three exporting countries' beef exports at world market prices, making production and export requirements more predictable for producers and assuring the exporting country of a certain amount of foreign exchange. At the same time, it assures the importer of a certain volume of his import requirements, making it easier for him and his country to plan ahead. However, the future impact of long-term supply arrangements on the residual market is uncertain and will depend on many factors such as economic conditions and supply and demand as well as prices.

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*Mainly fresh, chilled and frozen bovine meat.