The original documents are located in Box 56, folder "1976/02/06 - Economic Policy Board" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

EPB MEETING
February 6, 1976
8:30 a.m.

Roosevelt Room

Can. didn't attend

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

AGENDA
8:30 a.m.
Roosevelt Room

February 6, 1976

PRINCIPALS ONLY

1.	Report of the EPB/NSC Task Force on Commodities	Treasury/State
2.	Establishment of Labor Negotiations Committee	Seidman
3.	Administration Position on S. 1248	Treasury/Justice

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

February 5, 1976

MEMORANDUM TO: Economic Policy Board

FROM: Secretary Simon WES

SUBJECT: Title V of S.1284 (premerger notification and stay provision)

The Antitrust Improvements Act of 1975 (S.1284) has been scheduled for markup by the Senate Judiciary Committee on February 18 and 19. At hearings before the Subcommittee on Antitrust and Monopoly, the Justice Department generally supported the provisions of Title V of the bill relating to premerger notification and stay procedures. Senator Scott has asked the Attorney General for a clarification of the Administration's position on Title V.

Title V would enable the Antitrust Division or the Federal Trade Commission (FTC) to hold up a planned merger for an extended period without any review by a court. It does so in two ways:

1. By requiring the parties to give notice of a planned merger and barring the merger for 30 days while the Antitrust Division and FTC evaluate it. The Antitrust Division or the FTC could hold up the merger for another 45 days by asking for additional information about the merger or the parties.

2. By requiring a court to hold up the proposed merger when suit is filed if the Antitrust Division or the FTC certifies to the court that the public interest requires that the merger or acquisition not be completed until a final judgment is rendered.

Since the subcommittee reported the bill and since the EPB meeting on this bill on December 19, there have been discussions between the Justice Department, Treasury Department and various representatives of the business community concerning Title V. As a result of these discussions, the Justice Department has suggested a revision to Title V that would: (1) retain the premerger notification procedures; and (2) limit the period in which a merger could be held up pending notification litigation of the Justice Department's or FTC complaint challenging the merger to 30 days unless the court granted a 30-day extension of the stay "for good cause shown."

Title V would have the effect of creating a new regulatory scheme for all significant acquisitions. Mergers could be held up for extended periods unless the Antitrust Division and the FTC permitted them to go forward. This kind of new or additional governmental interference with business transactions should not be undertaken without a clear demonstration that it is necessary to achieve legitimate antitrust enforcement objectives, and that attainment of these objectives outweighs any adverse effects on the economy. Title V cannot be justified under either of these criteria.

Title V would discourage healthy, efficient, competitive change of ownership of businesses in response to economic conditions, decrease the availability of capital to firms and promote inefficient allocation of capital resources. It would give the Antitrust Division and the Federal Trade Commission the ability to hold up a proposed acquisition or merger for an indefinite period of time without having to make any showing in court that the transaction violates the antitrust laws. Even under the Justice Department's suggested revision of Title V, the government would have the ability to hold up an acquisition or merger for over 135 days without effective judicial review. The mere existence of this discretionary power in the antitrust enforcers could significantly deter lawful mergers and acquisitions to the detriment of the economy. More importantly by exercising this discretionary power, the Antitrust Division and the FTC could prevent -- not merely delay -- proposed acquisitions or mergers since the economic reasons for such transactions could well pass during the period of delay.

The Justice Department maintains that it needs greater ability to stay a proposed acquisition or merger pending antitrust litigation because divestiture of stock or assets is an inadequate remedy in most cases. Even accepting this contention, the Department has not demonstrated that existing procedure for enjoining a proposed acquisition or merger challenged by the government is inadequate.

Under present law, the Justice Department may obtain a court injunction barring a merger pending the outcome of its antitrust suit, if it can demonstrate a reasonable probability that it will succeed in establishing the illegality of the proposed transaction. Pending the hearing and determination of the Justice Department's request for an injunction, the court may at any time enjoin the challenged acquisition or merger for up to 20 days. This 20 days can, and frequently has been, extended by consent of the parties to give the court an opportunity to hear the merits of the case. Recent amendments to the Expediting Act have strengthened the Justice Department's power to secure preliminary injunctions by giving the Department, for the first time, the power to appeal at once from a denial of a preliminary injunction in an antitrust case.

The FTC is similarly authorized to obtain a court order enjoining an allegedly unlawful acquisition or merger.

Existing law allows the courts discretion to apply traditional standards of fairness and equity in determining the appropriateness of injunctive relief in merger cases. There has been no showing that the government needs the power to demand an automatic stay in order to guard against acquisitions that may be anticompetitive.

Nor has any demonstration been made of the need for the premerger notification requirements of Title V. This provision would permit the Antitrust Division and the FTC to delay an acquisition or merger for well over 75 days. Moreover, premerger notification would be required in any transaction involving two companies with annual sales or assets over $10 million. Present FTC premerger notification rules have a $250 million threshold and do not prevent the merger from going forward. Chairman Engman of the FTC testifying before Senator Hart's subcommittee on this provision, questioned the need for requiring notification of smaller merger transactions. He stated that the Federal Trade Commission's own premerger notification program appeared to be satisfactory.

Title V is inconsistent with the objectives of the Administration's program for regulatory reform and, therefore, Administration support of Title V is incongruous with these objectives. Title V represents a clear example of the failure to weigh the benefits of proposed regulation against its costs to the economy. It stands in stark contrast to the goal of achieving regulatory objectives in a manner that minimizes the cost impact on the economy generally. Finally, the broad coverage of the premerger notification requirements conflict with the goal of eliminating unnecessary government reporting requirements.

In view of these considerations, the Administration should oppose enactment of Title V, including its premerger notification and stay provisions.

ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

Department of Justice
Washington, D.C. 20530

February 4, 1976

MEMORANDUM TO: Economic Policy Board

FROM: Thomas E. Kauper
Assistant Attorney General
Antitrust Division

TEK

SUBJECT: Title V of S. 1284

Title V of S. 1284 would establish a procedural framework and substantive standard pursuant to which courts would evaluate motions for preliminary injunctive relief in cases brought by the Department of Justice or the Federal Trade Commission to challenge proposed mergers or acquisitions. Title V has undergone substantial modification since introduction of the bill, and this formulation of the stay provision represents the minimal intrusion upon business transactions that is consistent with the legitimate enforcement needs of the Department of Justice and the Commission.

I. The Need for Legislation

Under present law, there is no established mechanism by which economically significant mergers or acquisitions are brought to the attention of antitrust enforcement agencies. The Department of Justice learns of most proposed acquisitions through the Wall Street Journal and other such sources, and the Federal Trade Commission's pre-merger notice system is, as a practical matter, useful only when agreements to merge are reached substantially in advance of the proposed consummation date.

In those instances when either agency believes that a proposed merger or acquisition violates the antitrust laws, attempts are made to file a complaint before the transaction is consummated. Unless the parties agree to delay consummation pending resolution of the antitrust issues, our complaint will most frequently be accompanied by a motion for a temporary restraining order and a motion for a preliminary injunction. Historically, the purpose of a temporary restraining order is to assure that the plaintiff will not suffer irreparable harm until the court can rule on a motion for preliminary injunctive relief. In the merger setting, consummation of a merger itself constitutes irreparable harm since post-consummation relief in the form of divestiture has proven ineffective and a burden to all parties.

Although the Department is generally successful in obtaining a temporary restraining order, we have found that district courts frequently are unable to hold a thorough hearing on our motion for a preliminary injunction prior to the expiration of the temporary restraining order. As a practical matter, therefore, companies are able to consummate a merger or acquisition while the matter is being litigated simply because the complexity of the antitrust issues involved makes it impossible for the district court to rule on the government's motion for a preliminary injunction. Given the universal dissatisfaction with divestiture as an antitrust remedy, the existing procedural framework for resolving antitrust challenges to proposed transactions is deficient.

II. The Emergence of a Pre-Merger Stay Provision

As introduced in the 94th Congress, Title V would have provided for an automatic stay of any proposed acquisition upon institution of an action by the Federal Trade Commission or the United States and certification by the Commission or the Attorney General "that the public interest requires relief pendente lite." Under this standard, the district court would have been required to enter an order prohibiting consummation, which would remain in effect until the order of the Commission or judgment became final. The district court was further directed to expedite the proceeding or action.

The Department of Justice, testifying on behalf of the Administration, opposed this standard on the grounds that it was unnecessarily inflexible. Instead, we proposed that the district court be given discretion to lift a stay upon a showing by the defendant of irreparable harm or lack of merit of the government's suit. The Senate Subcommittee on Antitrust and Monopoly largely adopted this position when it reported the bill to the full Judiciary Committee on July 28, 1975.

Representatives of the investment banking community have contended that even this modified stay provision is too disruptive. They objected to the fact that the stay could be entered without any judicial determination of the merits of the government's case. To counter this concern, the Department suggested a standard under which an injunction would be entered only if a judge found a reasonable likelihood that the government would prevail on the merits of the case -- the standard presently applied by courts. The only condition to this proposal was that the court be guaranteed an opportunity to rule on the motion for a preliminary injunction before consummation of the merger or acquisition. To assure this condition, a temporary restraining order would be entered upon filing of the complaint and would remain in effect until the court's ruling on the preliminary injunction. The Department was committed to a timely ruling by the judge so that mergers or acquisitions would not be unduly delayed; to that end the judge was directed to give these matters priority and to expedite his ruling.

This formulation was unacceptable to representatives of the investment banking community. Although they professed to accept the Department's position on the need to preserve the status quo pending a ruling on the preliminary injunction, they were afraid that judges might not rule on these motions fast enough. Therefore they objected to any formulation that did not fix a maximum time on the temporary restraining order.

III. The Current Formulation

After a careful analysis of the steps necessary to allow a judge to make an intelligent ruling on a motion for a preliminary injunction, and in an effort to be as responsive to the various concerns raised as is consistent with sound antitrust enforcement policy, the Department presented the current formulation for a pre-merger stay provision. Under this proposal:

1. A temporary restraining order would be entered upon the filing of an antitrust complaint and certification by the appropriate antitrust official that immediate temporary relief is necessary.

2. The temporary restraining order would remain in effect for thirty days or until final disposition of the motion for a preliminary injunction, whichever period is shorter, unless extended.

3. The temporary restraining order could only be extended for up to an additional thirty days upon good cause, or for such period to which all the parties consent.

4. The Chief Judge of the United States Court of Appeals would be required to designate a District Judge who is available to hear the action in an expeditious manner, and that Judge would be directed to hold a hearing at the earliest possible time and to give the matter priority.

5. The preliminary injunction would be granted only upon a showing by the government of a reasonable probability of success on the merits. Even if such a showing is made, the defendant could have the injunction modified if it shows that it will be irreparably harmed by the injunction (except that loss of anticipated profits may not be considered).

The Department of Justice believes that any standard providing a shorter time period cannot assure the district court an opportunity to rule on the motion for a preliminary injunction before expiration of the temporary restraining order and would be unacceptable as a matter of antitrust enforcement policy. The steps a court must undertake in ruling on a motion for a preliminary injunction are numerous and include: pretrial conferences, evaluation of prehearing briefs, an evidentiary hearing, evaluation of posthearing briefs and proposed findings of fact and conclusions of law, and preparation of a written opinion. Historically, these proceedings have averaged about 50 days, although a significant number have taken over 100 days. Any period shorter than that contained in the present formulation is neither warranted by the concerns expressed nor consistent with affirmative enforcement efforts.

Under these circumstances, the only acceptable options for the Administration are: (1) continued support of the present bill, as amended pursuant to the Administration's suggestions; (2) suggest to the Judiciary Committee a substitute provision such as the current formulation; or (3) to withdraw Administration support for the concept of a stay procedure and express our preference for current law and procedure. The Department would favor these options in the order listed.

Notwithstanding which of these options is ultimately deemed preferable, the Department would support statutory language mandating the selection of a judge by the Chief Judge of the Circuit in which the case is filed, and requiring that such cases be given priority treatment. It is our understanding that, on this point, there is no disagreement among any of the interested parties.

FOR IMMEDIATE RELEASE   February 2, 1976

Office of the White House Press Secretary

THE WHITE HOUSE

EXECUTIVE ORDER

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MEMBERSHIP OF THE ECONOMIC POLICY BOARD

By virtue of the authority vested in me by the Constitution and laws of the United States of America, and as President of the United States of America, it is hereby ordered as follows:

Section 1. Section 2 of Executive Order No. 11808, as amended, is further amended by adding thereto "The President may, from time to time, designate additional members to serve on the Board.".

Sec. 2 Section 4(a) of Executive Order No. 11808, as amended, is further amended by adding thereto "The President may, from time to time, designate additional members of the Board to serve on the Executive Committee.".

GERALD R. FORD

THE WHITE HOUSE,
February 2, 1976

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~~CONFIDENTIAL~~ ATTACHED

THE WHITE HOUSE

WASHINGTON

February 5, 1976

MEMORANDUM FOR ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

FROM: ROGER B. PORTER RBP

SUBJECT: EPB/NSC Task Force on Commodities Report

The EPB/NSC Task Force on Commodities has completed an analysis of the Third International Coffee Agreement which is attached. This analysis will be reviewed at the Friday, February 6, 1976 EPB Executive Committee meeting.

THE THIRD INTERNATIONAL COFFEE AGREEMENT

An Analysis

Background

The original 1962 International Coffee Agreement (ICA) was a joint initiative of the U.S. and Brazil. The Agreement has historically been regarded by the USG as a way of improving our relations with a number of key Latin American countries (particularly Brazil, Colombia, and Central America). The first Agreement, and to a lesser degree, the 1968 Agreement, were both signed in periods of low coffee prices and surplus production. They were presented as instruments of our foreign policy, complementary to the Alliance for Progress.

Those Agreements worked reasonably well at holding a floor price, until a series of Brazilian frosts and disease problems beginning in 1969 cut Brazilian production. It became increasingly difficult for consumers and producers to agree on mutually satisfactory implementation of the Agreement and the economic provisions of the second Agreement were officially suspended in December of 1972. A major cause of disagreement was producing countries' demands that the price range should take into account the U.S. dollar devaluations. Producer countries, led by Brazil, attempted for a time to unilaterally stabilize world prices at a high level by limiting supplies on the market, but this effort failed. With prices on the downswing by early 1975, producing countries were expressing strong interest in a new Agreement. In July Brazil was hit by a disastrous frost which destroyed 60-70 percent of its next year's crop (1976/77), and coffee prices jumped from around 50 cents to over 80 cents a pound.

Major negotiations were held in London in April, July, and November. General agreement on a new ICA was reached November 26, 1975. Prior to the last negotiating session, the President decided the United States would pursue an activist negotiating role. The U.S. negotiating team was authorized to seek an agreement which, as in previous Agreements, relies on export quotas as its main instrument, but with:

"improvements in the traditional agreement which will provide more substantial protection of consumer interests, among others the upside risk. One important mechanism for improving the Agreement in this manner is the introduction of incentives to put any accumulated stocks on the market when the market is firm, through such devices as penalties or quota reductions for undershipments."

The Agreement is open for signature until July 31, 1976 and will go into effect October 1, 1976. For the Agreement to be implemented, countries representing at least 80 percent of world exports and 80 percent of world imports of coffee must join. As the United States accounts for more than one-third of the world's coffee imports, there can be no agreement without U.S. participation (unlike the Tin and Cocoa Agreements). If the United States decides to join, Senate consent is required, and implementing legislation will have to be passed by both House and Senate.

Analysis

Basic Mechanism

The new Coffee Agreement, as the previous ones, relies on export quotas as its basic operating mechanism. All operating decisions are by two-thirds distributed majority vote, giving the United States an effective veto. In contrast to earlier ICA's the Agreement will enter into force with quotas suspended and provides for periods when quotas would not be in effect.

After quotas are imposed the International Coffee Organization's (ICO) Council would each year determine a target price range based on its estimation of current and longer term trends. On this basis it would determine a global quota of coffee which would be shipped by all producer member countries. This global quota would then be divided among producer member countries, based on their automatically determined market shares (see below). When quotas are in effect, the ICO would issue member exporting countries stamps equal to their annual quota, and member importing countries would not accept coffee from member producing countries unless it is accompanied by such stamps.

The Council would establish rules whereby if the world coffee indicator prices move above the target price range for a certain number of market days, the global quota would be enlarged by a predetermined percentage established by the Council. In addition to the original quota entitlements, stamps representing the increment would be distributed to member exporting countries. If the indicator price drops below the target price range for a certain number of days, the global quota would be reduced by a predetermined percentage, and member country export quotas would be reduced proportionately. The number of times such quota enlargements or reductions could be made in a calendar year would also be set by the Council. Such adjustments are not intended to achieve or modify major shifts in market conditions, but to smooth out shorter term price variances.

Target Price Range

In the first two Agreements, members agreed that the general level of prices should not "decline below the level of coffee prices in 1962," or about 31 cents a pound. The Brazilians, with some support from other producers, argued during the recent negotiations for some new formula which would automatically set or index annual target price ranges. The United States and other consuming countries rejected any automatic formula. Agreement was ultimately reached that target price ranges should be set annually by the Council based on current market conditions, with no reference to any base price period or indexation. This is a plus over previous Agreements.

Quota Imposition and Suspension

The Agreement will begin on October 1, 1976 with quotas suspended. Quotas will be imposed when for 20 consecutive market days:

(1) prices fall to within a price range established by the Council; or, in the absence of Council decision on a price range when

(2) indicator prices drop 15 percent below the average price for the previous coffee year (beginning October 1, 1977), or

(3) they drop below the average price of coffee for calendar year 1975 (about 63 cents a pound).

Under the second condition, however, the formula would not come into play unless prices drop at least below a price 22.5 percent above the 1975 average (or about 77 cents a pound). Thus, for example, if prices for a coffee year average $1.00, a 15 cent drop would not trigger quotas. After the initial imposition the Executive Director could establish the global quota for four quarters, or less, subject to Council review.

Quotas would be suspended when prices rise for 20 market days by 15 percent over the ceiling of the price range set by the Council for the current year or, in the absence of such price range, when prices rise by 15 percent over the average price for the previous calendar year.

Comment

Suspension

The formula to suspend quotas automatically is a major improvement over the old Agreement, which foundered on this issue. In the case of a major Brazilian frost or other disaster, prices would quickly rise, with or without an Agreement. Under past Agreements the Council's inability to agree to greatly expand or suspend quotas in response to a tight market exacerbated the price problem, because countries able to supply coffee could not make up for those that could not. In the new Agreement, the automatic suspension of quotas is intended to assure that all available supplies can come on the market and that the Agreement will not increase prices above the level determined by the market. The formula would have been triggered by every Brazilian frost in the past 25 years.

Imposition

The Department of Agriculture projects that with favorable conditions world production of coffee could be back to long term trend levels by 1979-80 at the earliest. By that time if the rehabilitation program in Brazil is successful and there is no major frost, production would likely be close to consumption requirements. If there is any addition to stocks by 1979-80 it would be small and carryovers would not be excessive.

The study group agreed that quotas are not likely to be triggered before late 1978 or early 1979. It was noted that unless the United States signifies its intention to remain a member of the new Agreement before September 30, 1979, the United States would automatically cease to be a member of the Agreement for the final three year period.

The group was not able to agree on the most probable price levels at the time of initial quota imposition. As stated earlier, the automatic quota imposition formula in the absence of Council action will occur between 63 cents and 77 cents a pound. Some members of the group felt that as production is restored prices would drop sharply from their historic highs (just as they rose sharply in anticipation of coffee scarcity). Such a price drop would likely trigger quotas at a price above 70 cents. Some members further argued that because of the market power of Brazil, it could take actions to help trigger quotas at a high level.

Others felt that when production is restored there would be no large surpluses available to rebuild stocks from historically low levels, leading to a slower price erosion and the initial triggering of quotas at a mid-60 cents price level. Still others felt that it was too soon to assess the success of the Brazilian planting program and expansion in other areas and to make an accurate forecast of the most probable scenario.

Treasury representatives argued that producers would attempt to defend price levels at which quotas are reimposed and that psychologically producers would regard the 63 cents figure as an absolute floor price. Commerce representatives believe that the 63 cents figure may give the appearance of a floor price and may be used by the producers to pressure the U. S. and other consumers in the Council to establish and maintain any price above this level, although the consuming countries legally are not obligated to treat it other than as a trigger price. State felt that it was clear from the negotiating history that 63 cents was not a floor price and pointed out that in the annual negotiation of target price ranges the United States has a veto which in the past it threatened to use in order to move price ranges down as well as up.

The Setting of Quotas

The Agreement comes into effect with quotas in suspense. The Council may at any time, by two-thirds distributed majority vote, establish a price range and/or quotas. Whenever prices are within a price range established by the Council, quotas are in effect.

If quotas and price ranges have not been previously established by the Council, and quotas are triggered by the automatic mechanisms in the Agreement, they would be introduced no later than the beginning of the next quarter of the coffee year in the following manner:

(a) The Executive Director would set a quota on the basis of disappearance of coffee in quota markets estimated in accordance with criteria established in Article 34 and whatever regulations are issued by the Council.

(b) The Executive Director's quota would be fixed for a period of four quarters.

(c) In the first quarter after quotas come into effect, the Council shall be convened in order to establish price ranges and to review and, if necessary, revise the Executive Director's quota.

(d) If the Council does not agree on price ranges, the Executive Director's initial quota remains in effect for one year, but with no provision for automatic adjustment upward or downward to reflect further changes in market prices.

(e) If during the first year of quotas the Council cannot agree on its own quota, the quota would be suspended after the four quarters until the triggering mechanism would again be activated.

The Executive Director must set his quota based on coffee disappearance. Disappearance is defined in Article 34 and is basically the sum of the gross imports of green coffee of all importing countries; less re-exports, less changes between visible opening and closing inventories (i.e. a negative change in inventory has an increasing effect on disappearance; a positive change the opposite). Disappearance of coffee in member countries is a similar calculation except imports by non-members must be deducted.

Comment

There likely will be a lag of at least six months between the introduction of quotas and the establishment of an effective system of import controls. This lag is due to the lead time necessary for importing nations to apply import control measures and the time it takes coffee sold before the establishment of a quota to work its way through the system. Exporting nations are likely to temporarily boost exports to beat the quota deadline, which will exert additional downward pressure on prices.

Some members argued that disappearance over the next few years will reflect a period of tight supplies, steady consumption growth rates and high prices, and a global quota derived from such data would produce a higher price. This was of particular concern since the Executive Director's quota could only be altered with a two-thirds distributed majority of the Council. The U. S. could not therefore force a change in this situation(although we could block a change in quota if it should be in our interest).

Other agencies argued that disappearance was well defined in the ICO and that the Council could adequately instruct the Executive Director so as to assure that he would set an appropriate global quota. Furthermore, the continued price declines after quotas are imposed will put pressure on producers to obtain a price range by the Council (a range that may be defended by quota cuts if necessary) rather than accept the Executive Director's estimate of disappearance (which may be reduced only with Council approval).

The Setting of a Price Range

The Council, in addition to setting a global quota, may also set a price range (as it did in the previous Agreements), and a mechanism to defend that range. Guidelines for setting the price range are outlined in Article 38.

Among them are the prevailing level and trend of coffee prices, the levels and trends of consumption, production and stocks, as well as other relevant factors.

Comment

The criteria include all the logical variables which should be taken into account, but as in the old Agreement, different countries will weigh and interpret these variables differently. The Agreement and the criteria in Article 38 offer the potential for flexibility and a following of market trends. Some agencies noted that the annual negotiating process to determine quota levels and a price range is a political as well as an economic process (as well as a test of delegation stamina). They argued that the criteria in the Agreement for setting the price range and especially the global quota may tend to favor maintenance of the status quo.

Although no definite predictions can be made at this time these same agencies also argued that if the global quota established tends to maintain the status quo, prices could potentially be placed above market trends since quotas would come into effect after a period of high prices rather than a low price-surplus scenario as in previous Agreements. Other members noted that a similar formulation in past Agreements resulted in price ranges that proved to be flexible both upward and downward.

Market Shares

Previous Agreements set market shares which determined how much coffee each producer can annually supply. Market shares were established at the beginning of the 1962 and 1968 Agreements and held constant throughout the Agreements. African and Central American countries correctly argued that this system was biased in favor of Brazil and against the producers which were capable of increasing their production and exports beyond what their shares allowed, at competitive prices. The U. S., along with other consuming countries, the Africans, and Central Americans, argued strongly that the new Agreement should provide market share flexibility.

The new Agreement adopts a United States proposal which will divide market shares for producing countries into two parts - fixed and variable:

-- 70 percent of the annual global quota would be based on market shares fixed for the six year life of the Agreement. These fixed shares will be calculated on a basis of either (a) the average annual volume of each producer's shipments during the last four years of the old Agreement while economic provisions were in force (1968-1972), or (b) shipments during the first year or two of the new Agreement (while quotas are suspended). When the quotas are triggered and the fixed market shares must be calculated, countries may opt for using as their base either option (a) or (b) above. Thus we would expect that Brazil will select option (a), which will be higher, while most other countries will choose option (b), because they will be shipping as much coffee as possible over the next two years in response to high prices and the opportunity to increase their market share.

Comment

This mechanism gives dynamic producing countries an opportunity to gain a market share reflecting recent production capacity. The net effect would be a redistribution of market shares under the Agreement to African and Central American producers at the expense of Brazil. This redistribution could lower Brazil's market share from 38% in the previous Agreements to 31% of the total market when quotas are restored under the new Agreement.

Analysis indicates that the basis for quota division also provides an incentive in addition to high prices for producing countries to increase shipments to member markets over currently projected levels during the next two years. In effect, the new Agreement will reward producing countries that supply the United States and other consuming members during the impending period of shortage. The analysis indicates that the primary effect of the incentives would be the adoption of governmental policies that expedite the flow of coffee on the market, such as elimination of restrictions on exports (the coffee retention requirement in El Salvador was abandoned shortly after the negotiations ended in London) or measures that allow easier access to imported fertilizer.

-- 30 percent of the annual global quota will be allocated on a variable basis in proportion to the percentage of verified world coffee stocks (all coffee except in the hands of farmers) held in producing countries. No country will be allowed more than 40 percent of this quota (to protect against Brazil's ultimately dominating this quota share).

Comment

This system is an improvement over the old Agreement, in that it does permit dynamic producers to gain a larger market share when quotas are in effect. By accumulating stocks, they can further increase their variable market shares during the time quotas are in force and simultaneously build a reserve against future shortfalls in harvests. A wider distribution of stocks is an additional consumer safeguard against future frosts.

There are some drawbacks. There are difficulties involved in achieving an accurate count of stocks, and there will be a temptation to try to circumvent the verification process. Basing 30 percent of the quota on stocks may encourage governments in those Central American countries which historically have not intervened in their coffee trade to do so. A producer could decide prices were too low, build its stocks instead of shipping its quotas, and gain a larger market share the following year when prices might be higher. However, the magnitude of the price increase necessary to make this action profitable would automatically suspend quotas. This part of the quota allocation system would have been improved if a country's variable quota could not be increased in a year following an undeclared shortfall.

Undershipments and Shortfalls

The old Agreements urged exporting members to notify the ICO in advance of anticipated shortfalls (reductions in harvests), but provided no penalty for not doing so. It made no mention of undershipments (failure to ship one's quota, regardless of available supply in country). This was a defect the United States was particularly interested in remedying, as indicated in the negotiating instructions.

In the new Agreement, the distinction between shortfalls and undershipments is eliminated. The difference between a producer's actual exports and its export entitlement, for whatever reason, is defined as shortfalls. Producers have an obligation to declare anticipated shortfalls. Producers are urged, but not required, to notify the ICO within the first six months of the coffee year if they will not ship their full quota (for whatever reasons). In such cases the shortfall would be redistributed to other producers, primarily of the same type of coffee. A country that declares a shortfall in the first six months would be rewarded the following year with a quota increase by 30 percent of the declared shortfall. This increased quota would be deducted from countries which made up for the undershipment the previous year. Thus producers have an incentive to announce shortfalls in advance.

In setting annual global quotas the ICO is also to take into account a pattern of undeclared shortfalls by one or more producers. This institutionalizes a practice in the old Agreement in which importing members forced artificially large global quotas to compensate for a pattern of Brazil not shipping its quota allotment after frosts (either because it couldn't, or because it chose not to in order to boost prices).

Comment

Although they are not as strong as the United States hoped to get, the new mechanisms to deal with shortfalls are a definite improvement over the old Agreement. The negotiating instructions state that the United States should seek..."the introduction of incentives to put any accumulated stocks in the market when the market is firm, through such devices as penalties or quota reductions for undershipments." The Agreement does not contain penalties, although it does contain incentives. The best protection against sizeable undershipments by one or more producers is the quota suspension formula which would have operated in each case of significant Brazilian undershipment during the old Agreements.

Voting

As in previous Agreements, all decisions of the

Council regarding economic provisions must be made by distributed two-thirds majority vote. Under Article 15, the United States, joined by one other member, can block any action requiring such a vote. Where an action must be taken by Council in order to bind members (e.g. establishment of a global annual quota or price ranges), and the required majority cannot be obtained, then no member is bound (e.g. no quotas or prices ranges). However, under certain circumstances, when quotas are initially imposed the Executive Director may establish a quota, based on estimates of disappearance, for a meximum of four quarters.

2/4/76