Futures by Susan B. Cohn

Cartels break the laws

The U.S.A. may be heading into a depression, collapsing inflated prices, but strategic raw materials continue upward in value ... according to plan.

1980 could be the year that breaks all the so-called economic laws. Despite prospects of a severe U.S. recession or even depression, analysts expect that prices of many primary commodities, particularly copper, silver, and other industrial metals, will rise sharply.

Intensified inflationary pressures are partly to blame, but the reason why commodity prices are likely to soar in 1980 is primarily political. The Brandt Commission has called for increased channeling of advanced sector funds into price-propping commodity buffer stocks in the Third World. The plan has been given an unofficial stamp of approval by the U.S. State Department and is moving toward implementation.

Commodity markets are not awaiting the formal institution of this policy. Silver, which rose from about $5.50 an ounce at the end of 1978 to an incredible $34.45 on Dec. 31, 1979, provides the model for how commodity markets can be rigged by a small group of well-financed speculators. Beginning in August 1979, British and Swiss silver bullion dealers, acting in conjunction with U.S. firms like Continental Grain's Conti-Commodities, established a "corner" in the silver futures market. This artificially-induced silver squeeze has continued—especially in the wake of Federal Reserve head Volcker's October package—since rising interest rates have made it increasingly difficult for most investors to maintain a "short" position in the market. The "cartel" has been able to remain "long" on silver, because it obtains its financing from abroad for example, ContiCommodities makes use of an offshore fund it established for Arab investors) and is therefore not subject to the restrictions which the Fed has placed on U.S. bank lending for commodity speculation.

As a result of the "silver cartel's" activities, the gold/silver ratio has dropped from about 21/1 to 15.5/1 in little more than a week. According to ContiCommodities research director Paul Sarnoff, the Hunt family, rumored to have participated in the silver squeeze, expects that the ratio will decline further to 5/1, placing silver at $106 alongside current gold prices.

During the last week of December, a squeeze in the December copper futures contract, similar to that which occurred earlier in silver, was only narrowly averted. The New York Commodity Exchange earlier in the month ordered "liquidation only" trading in the contract but in the last few trading days it became clear that enough copper supplies were available from warehouses to meet delivery commitments. The two firms which had established the copper "corner" were Engelhard Minerals' Philip Brothers division (a firm closely linked to Harry Oppenheimer's South Africa-based Anglo American Corp.), and the Chicago broker Ray E. Friedman & Co. ("Refco"). Philip Brothers has also been active in bidding up silver and gold prices and plays an important role in the Rotterdam oil spot market.

This may be only the beginning of the copper squeeze. Phillip's and Refco took delivery on their December copper contracts and are apparently in no rush to resell. The Commodity Research Bureau, a private U.S. research firm, is predicting further increases in copper prices based on evidence of long-term stocking by industrial users and U.S. government plans to buy for its depleted strategic stockpiles.

Although agricultural commodities have been considerably less buoyant than metals, signs of attempted cartelization are also apparent here. Cocoa producers, including Ghana, the Ivory Coast, and Brazil, are reportedly planning to set up their own commodity buffer stock following the breakdown of negotiations for a new International Cocoa Agreement. The producers may use $200 million left over from the old ICA to finance the buffer stock. The cocoa effort is modeled on the coffee producers' cartel, the so-called "Bogota group," which helped jack up coffee prices during 1979.