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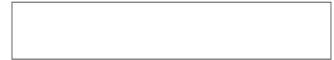

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International Economic & Energy Weekly

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13 May 1983

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International Economic & Energy Weekly

25X1

13 May 1983

iii	Synopsis
1	Perspective—Moscow's Energy Policy in the 1980s
3	Briefs: Energy; International Trade, Technology, and Finance; National Developments
13	USSR: Oil Supply Prospects for the 1980s
17	Zaire: Returning to the IMF
23	Summit Countries: Shifts in Competitiveness

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International Economic & Energy Weekly (U)

Synopsis

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Perspective—*Moscow's Energy Policy in the 1980s*

In addition to heavy emphasis on West Siberian oil and gas, the major elements of Soviet energy policy for the 1980s include increased substitution of gas for oil, conservation, and modernization of industrial facilities. Because of the investment squeeze and the increasingly complex technical requirements in energy production, we believe the USSR will have an even greater need for Western equipment and technical expertise in the 1980s than it did in the 1970s.

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USSR: Oil Supply Prospects for the 1980s 25X1

After three decades of large and steady increases, the rate of growth of Soviet oil production has begun to slow. In the second half of the decade, we believe production will level off and decline to 11 to 12 million b/d. 25X1

Zaire: Returning to the IMF 25X1

One year after approaching the IMF for a new standby agreement, Zaire is still finding it hard to meet Fund preconditions. The government's willingness to adopt a strict adjustment program will largely determine the country's eligibility for debt relief and its success in attracting additional international donor assistance. 25X1

Summit Countries: Shifts in Competitiveness 25X1

The enormous rise in the exchange value of the dollar and pound during 1981 and 1982 has caused a major loss of US and UK competitiveness. 25X1

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International Economic & Energy Weekly

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Perspective

Moscow's Energy Policy in the 1980s

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The driving force behind Soviet energy policy is Moscow's desire to remain self-sufficient in energy. As the Soviets have noted, "The Soviet Union is currently the only highly developed country in the world meeting its own fuel and energy needs from its own resources." That the Soviets intend to maintain energy independence is evidenced by their increased determination to exploit Siberian energy resources even though it exacts a high investment cost from the rest of the economy.

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In addition to heavy emphasis on West Siberian oil and gas, the major elements of Soviet energy policy for the 1980s include increased substitution of gas for oil, conservation, and modernization of industrial facilities. To a large extent, the current strategy is driven by an awareness on the part of the leadership that it may have to accept an oil production decline in the late 1980s. This prospective decline—already being acknowledged by planners—defines the need for conservation and substitution and forces continued heavy investment in West Siberia as a holding action. Despite Moscow's willingness to date to boost investment in energy, we believe that by the mid-to-late 1980s the USSR will be unable to provide the investment required to simultaneously:

- Keep oil production from falling.
- Expand secondary refining capacity to permit a shift in the structure of refined products.
- Provide processing, distribution, and storage facilities to handle increasing output of natural gas.
- Offset the drop in the energy content of coal.
- Speed development of nuclear power.
- Provide new energy-efficient equipment to meet the ambitious conservation and substitution goals.
- Satisfy the needs of the nonenergy sectors of the economy (including defense).

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Rapidly rising unit costs of energy production, processing, and distribution will accelerate the sharp decline in overall capital productivity. Soaring requirements for investment in energy will limit the opportunities to substitute capital for labor elsewhere in the economy. The energy sectors, including associated infrastructure, are scheduled to receive more than one-half of the increment in total investment during 1981-85, and this share will have to rise still further unless total investment growth is increased sharply. While some increase is possible, problems in metallurgy and machinery production will limit the Soviets' ability to rapidly accelerate the growth in Soviet investment.

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Because of the investment squeeze and the increasingly complex technical requirements in energy production, we believe the USSR will have an even greater need for Western equipment and technical expertise in the 1980s than it did in the 1970s. Our analysis of Soviet equipment manufacturing capabilities and the continuing problems in the oil industry indicate that requirements in the 1980s will center on Western equipment and technology for deeper drilling, fluidlift, and well completion and servicing. In addition, the Soviets will be in the market for sophisticated exploration equipment, offshore drilling platforms, and secondary oil refining technology. Because gas is critical to maintaining total Soviet energy production growth in this decade, continued imports of large-diameter pipe, pipelayers, pipe-wrapping and insulating materials, and turbine-compressors will be necessary. Western equipment and technology will be especially crucial for exploiting "sour" gas deposits.

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Despite the increased resource commitment to energy in the 11th Five-Year Plan, we believe the combined output of oil, natural gas, and coal will increase only 11 to 12 percent in 1981-85 compared with the 17 percent planned for this period and the 22 percent achieved in the last five-year plan. As yet, the Soviets have not specified their energy production goals for 1990, but, in our judgment, combined fuels output will grow only 6 to 7 percent in the latter half of the decade under the best of circumstances. At the start of the 1990s, gas will be the largest single source of Soviet energy. Indeed, with oil output in decline by the late 1980s and coal production stagnant in terms of energy content, the increases we foresee in fuel availability will be largely the result of rising gas output.

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If the cost of exploiting oil and gas becomes prohibitive in the late 1980s, the main thrust of Moscow's energy policy is likely to change. Indeed, coal and nuclear power may come to the fore as suggested by recent Soviet references to a new 20-year energy program. By the 1990s coal-slurry pipelines and advances in long-distance electricity transmission could make exploitation of remote coal deposits economic. Nuclear power is also likely to play a larger role in Soviet energy supplies in the 1990s. Nonetheless, until such programs become a reality, the Soviets face costly energy problems that will absorb much of their attention and resources.

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Briefs

Energy

OPEC Production Holds Steady

OPEC oil production in April averaged 15.4 million b/d, nearly matching the level in March. Production in Saudi Arabia rose to 3.9 million b/d in April on the heels of OPEC's recent pricing and production accord. Nigeria's production increased sharply in April, averaging 1.2 million b/d. The US Embassy has reported that Nigerian production could top the 1.6-million-b/d mark this month, which would violate its 1.3-million-b/d quota allowed under the OPEC agreement.

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OPEC: Crude Oil Production *Million b/d*

	1982	1983 Quota	1983 [a]				
			January	February	March	First Quarter	April
Total	**18.8**	**17.5**	**17.0**	**14.9**	**15.5**	**15.8**	**15.4**
Algeria	0.6	0.725	0.7	0.6	0.7	0.7	0.7
Ecuador	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Gabon	0.2	0.15	0.2	0.2	0.2	0.2	0.2
Indonesia	1.3	1.3	1.1	1.0	1.1	1.1	1.2
Iran	2.3	2.4	2.7	2.6	2.6	2.6	2.1
Iraq	1.0	1.2	0.8	0.8	0.6	0.8	0.7
Kuwait	0.7	1.05	0.6	0.8	0.9	0.8	0.7
Libya	1.2	1.1	1.4	1.2	1.1	1.2	1.1
Neutral Zone	0.3	[b]	0.3	0.2	0.2	0.2	0.4
Nigeria	1.3	1.3	0.8	0.7	0.9	0.8	1.2
Qatar	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Saudi Arabia	6.3	[c]	4.6	3.6	3.6	3.9	3.9
UAE	1.2	1.1	1.2	1.1	1.1	1.1	1.1
Venezuela	1.9	1.675	2.1	1.8	2.1	2.0	1.7

[a] Preliminary.
[b] Neutral Zone production is shared about equally between Saudi Arabia and Kuwait and is included in each country's production quota.
[c] Saudi Arabia has no formal quota; it will act as swing producer to meet market requirements.

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Iranian crude oil production slipped 500,000 b/d from March levels as some long-term customers—particularly the Japanese—remained reticent to sign new contracts.

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Press reports that Japanese buyers were awarded a $2-per-barrel discount on Iranian crudes have been denied by Iranian oil officials. Other countries maintained production levels within their OPEC-mandated ceilings. Venezuela cut production 400,000 b/d from March but drew down oil stocks to maintain export levels. Libya called off its barter and processing deals and held production to 1.1 million b/d in a show of support for the OPEC agreement.

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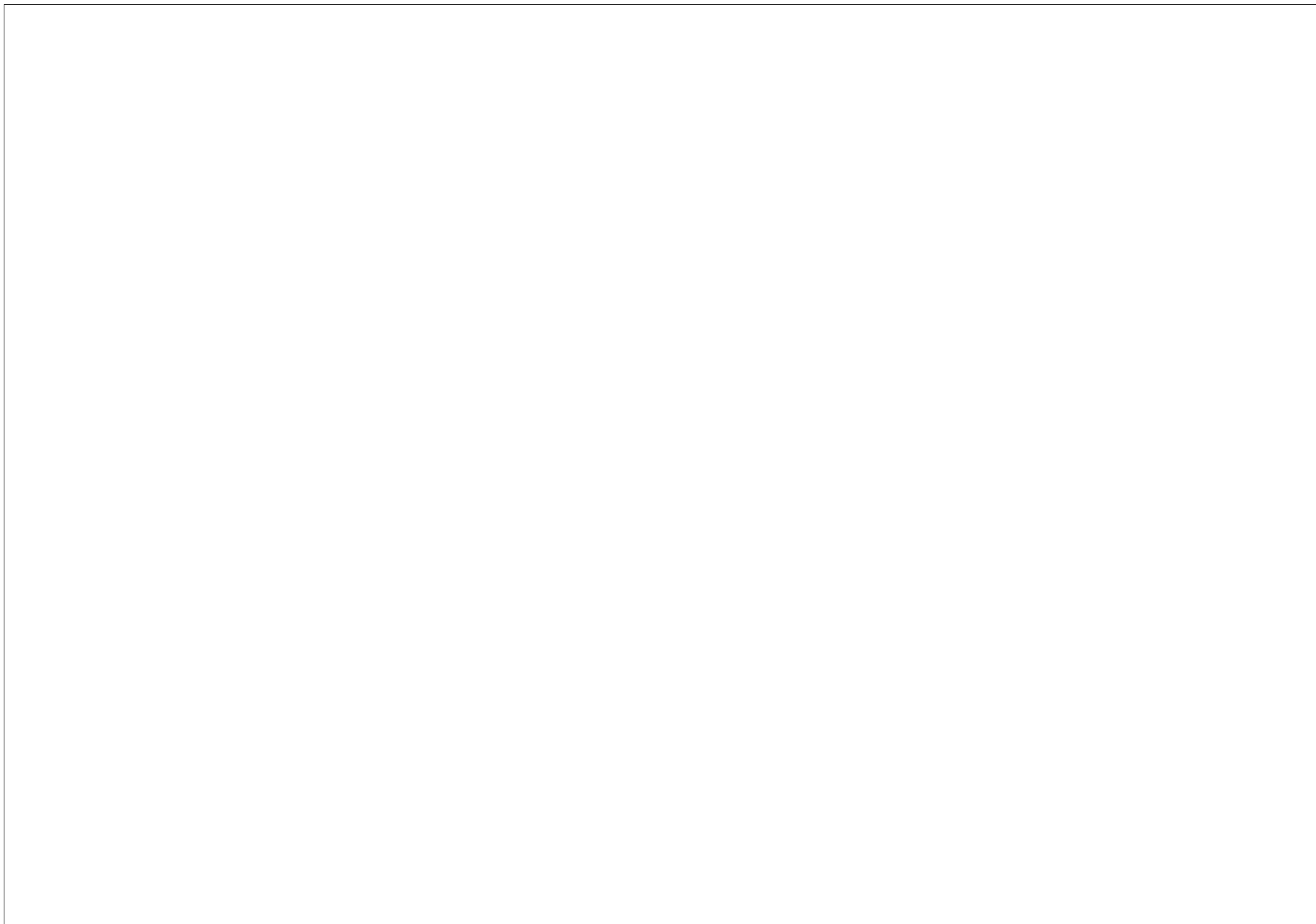

Dutch Gas Sales Continue To Fall

Dutch natural gas production in 1982 declined for the third consecutive year as mild weather, conservation efforts, and a sluggish economy reduced demand. Domestic sales were off 5 percent from year-earlier levels while export sales fell 19 percent. An increase in Italian gas production and the use

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of alternative supply sources by other countries contributed to the sharp drop in exports. Dutch gas exports to France, for example, were down 40 percent, largely as a result of increased French imports of Algerian gas. Recent data indicate that the fall in sales continued into 1983. Sales during the first quarter were down by 7 percent compared with year-earlier levels, with reduced exports accounting for nearly all of the decline. Officials of Gasunie—the Dutch gas distribution monopoly—now expect exports will decline to about 30 billion cubic meters annually by 1985 and remain around that level for a number of years.

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Netherlands: Natural Gas Sales

	Billion Cubic Meters			Percent Change in 1982
	1980	1981	1982	
Total	**87.3**	**80.7**	**70.8**	**−12**
Domestic sales	39.8	37.9	36.0	−5
Exports	47.5	42.8	34.8	−19
West Germany	19.1	16.7	16.5	−1
Belgium	9.7	8.6	6.8	−21
France	10.9	9.5	5.7	−40
Italy/Switzerland	7.8	8.0	5.8	−28

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EC Energy Proposals

The recent meeting of the EC energy council resulted in some movement toward a more comprehensive Community energy policy. At the meeting the EC Commission submitted two proposals aimed at promoting more efficient use of coal and natural gas. The proposals were generally supported by the member states but no final decisions were made. The first proposal encourages EC members to convert oil-fired systems used by industry and public buildings to coal. While each country would supply funds for its own conversions, members would be required to report on their progress to the EC Commission at the end of each year. The second proposal recommends allowing natural gas prices to adjust freely to changes in the cost of supplies and the price of competitive fuels. The Commission is not interested in aligning natural gas prices but wants to eliminate subsidies and avoid overly rigid or noneconomically justified rates. These proposals, along with several others such as new incentives for energy conservation and support for oil and natural gas exploration, will be further examined at the next energy council meeting scheduled for mid-June.

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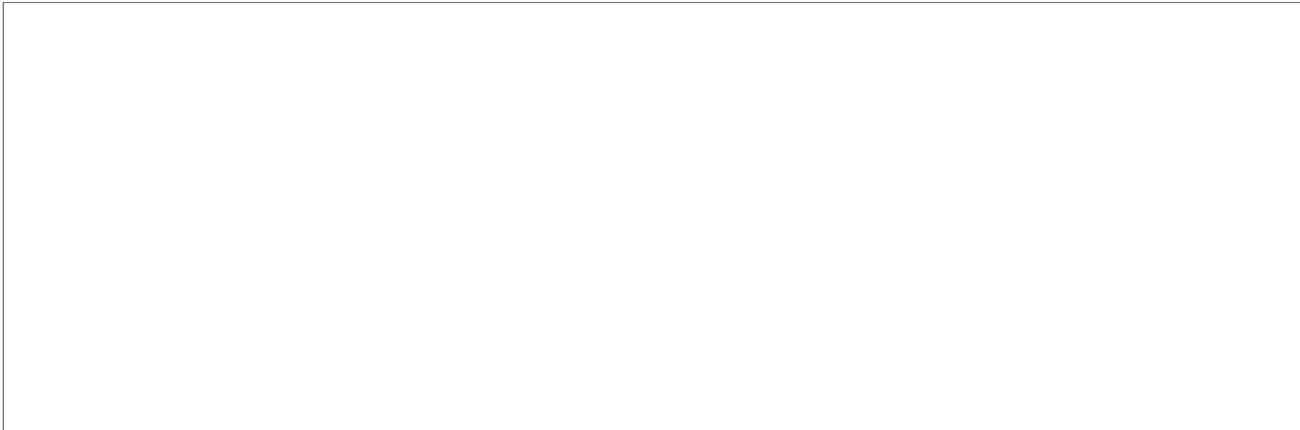

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International Trade, Technology, and Finance

Mexican Debt Discussions

At a recent meeting with creditor countries and IMF observers, Mexico City reluctantly agreed to a multilateral rescheduling for about $2 billion in private-sector debt owed to official institutions. The Mexicans chose not to reschedule via the Paris Club—the traditional method of resolving officially guaranteed debt payment problems—because they feared such talks would interrupt other ongoing negotiations and jeopardize government-to-government credit lines. Mexico City was concerned that part of the $2 billion of official export credits promised earlier this year would be diverted by the Paris Club to cover old debt. 25X1

Mexican officials prefer that their recent bilateral treaty with Spain serves as a model for any multilateral agreement. The Spanish agreement, which reschedules guaranteed private-sector principal over six years with a three-year grace period, represents Mexico City's efforts to assist the private sector in servicing its foreign debt to private banks and suppliers. The Mexicans believe this approach is the fastest means of restoring normal trade financing and satisfies the IMF condition that Mexico City not assume private-sector debt. Mexico City promised last week to send a formal statement of its position to all creditor governments and asked them to provide detailed information on official guarantees and credits subject to rescheduling. Because of technical problems involved in collecting precise data on amounts owed and the number of creditors involved, we believe the two-month timetable suggested for completing this rescheduling is too optimistic. 25X1

Budapest Seeks Trade Agreement With EC

Hungarian Vice Premier Marjai, in a meeting with EC Commissioner Haferkamp last month, proposed a basic trade agreement with the EC. Budapest wants the EC to reduce its restrictions on imports from Hungary, especially on beef and some industrial products, and it has raised the possibility of a free trade area and other preferential arrangements. Romania and

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Yugoslavia already have trade agreements with the EC. Budapest's desire for a trade agreement with the EC indicates the Hungarians are not turning further to the East in response to their hard currency payments problems. The EC would be interested in an agreement both to differentiate Hungary from some other CEMA countries and to move away from CEMA-EC dealings. Although the EC Foreign Ministers have instructed the Commission to prepare a counterproposal quickly, negotiations over concessions probably will be protracted. 25X1

Japanese Semiconductor Research

Japanese firms are making important gains in the development of gallium arsenide–based integrated circuit technology that could be important in future civil and military systems. The current Japanese leader, Fujitsu, recently announced the most advanced gallium arsenide device yet, with speed 10 times that of an equivalent silicon device. Japanese firms, with strong government support, are committing considerable research funds to develop gallium arsenide technology for supercomputers and optical communications. 25X1

Japanese Economic Aid to Thailand

During his visit to Thailand in early May, Japanese Prime Minister Nakasone announced Tokyo's 1983 aid package that included a $280 million low-interest loan—down from $294 million last year—and some minor trade concessions. Tokyo offered to reduce its contentious $1 billion trade surplus with Thailand by increasing quotas for Thai industrial exports and agreed to consider reducing tariffs for Thai agricultural exports. Bangkok is probably disappointed with this package. The measures to reduce the trade surplus are too modest to have much effect 25X1

Japan this year substantially increased its loans to two of Thailand's Asian neighbors, South Korea and Malaysia. 25X1

National Developments

Developed Countries

Spain Nationalizes Electric Utilities

The Spanish Government has effectively fulfilled its campaign promise to nationalize the seven main electric utilities. Under the terms of an agreement signed with the companies last week, Madrid will have a majority interest in a new corporation that will control all of Spain's electrical production. The Socialists hope the nationalization will both please their supporters and improve the operation of the electrical sector, which recorded a small deficit last year. The utilities' acquiescence in the takeover and the fact that the government already exerted considerable control over the industry suggest that the move will stir little opposition. 25X1

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Less Developed Countries

Cuban Private Debt Rescheduled

Western banks reportedly reached an agreement last month on rescheduling Cuba's private debt. All of Havana's medium- and long-term maturities due from September 1982 through this December—about $200 million—were rescheduled to be repaid over the next eight years, including a three-year grace period. In addition, the banks agreed to maintain $373 million in short-term credits through the end of this year

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The terms of the agreement are similar to those accepted by Cuba's official creditors in March, but they still leave Havana with insufficient short-term credit. Cuba needs at least $600 million in short-term credits to maintain a minimal level of imports. Even with an additional $117 million in hard currency available through Soviet and East European banks in the West, Havana will need another $110 million. As a result, the Cubans may look for guaranteed short-term credits from sympathetic governments to avoid even deeper cuts in imports.

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Kenyan Concern Over US Aid

Senior Kenyan officials told the US Embassy last week that they are particularly anxious to obtain nearly $30 million in promised US aid for budgetary support before the IMF's review next month. Kenyan finance officials know they must sharply reduce the country's projected midyear budget deficit of $40 million to qualify for continued access to IMF funds. The Kenyan Government also is aware that US budget constraints and bureaucratic procedures may stand in the way of disbursing the $30 million before midyear. Suspension of the nearly $200 million IMF program would significantly diminish Kenya's ability to pay for essential imports and development projects. Failure to obtain the requested US aid would be a major blow to President Moi, but, in our judgment, the country's financial situation is so precarious that he could not afford to alienate the United States.

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Financial Uncertainties for Jamaica

Prime Minister Seaga last week announced new taxes and a freeze on government spending in an effort to cut the growing budget deficit in the next three years. He says his government had overshot by $150 million the IMF target in March for net international reserves, but he expects that new loans will close this gap soon. Seaga appears to be counting on receiving a large loan from private Kuwaiti investors, but recent US Embassy reporting indicates this is unlikely. Moreover, traditional commercial lenders, mostly US and Canadian banks, seem unwilling to provide much additional financing. Jamaica's currency will probably continue to lose value when the government shifts additional imports to a more expensive exchange rate. Unemployment will remain an important political worry, and Seaga's attempt to avoid large

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government make-work schemes may crumble under political pressure. Any surge in public spending or failure to attract significant foreign financing could jeopardize continued IMF support and prompt Jamaica to seek at least a partial debt rescheduling before the end of 1983. 25X1

Suriname Reaches Preliminary Bauxite Accord

The tentative accord recently reached between Paramaribo and US-owned Suralco suggests that Suriname, at least for now, will not nationalize its aluminum industry. The agreement establishes a 15-percent retroactive increase in bauxite production taxes for 1982 in return for sizable tax reductions through 1985. These cuts are unlikely to restore Suriname's international competitiveness or significantly boost the bauxite sector's output—which contributes about 80 percent of the country's export earnings. The agreement thus may further squeeze government revenues and set back the regime's ambitious development program announced last week. Ongoing negotiations between Suriname and the aluminum companies over employment, wages, production, and marketing will provide a clearer indication of the role Paramaribo intends to play in the bauxite sector. 25X1

Zambian Price Increases Threaten Unrest

Zambia last week sharply raised prices of fertilizer and maize meal—the staple food in the country—in another austerity move aimed at bolstering support for special treatment at the meeting next week of the Paris Club, which will discuss rescheduling of Lusaka's debts to Western governments. Lusaka is requesting that official creditors take the unusual step of rescheduling the country's pressing short-term debt—in addition to a normal rescheduling of medium- and long-term obligations. 25X1

The new prices will mean substantial belt tightening for Zambian consumers and farmers already facing higher costs as a result of the lifting of price controls on most other goods last December and the devaluation of the kwacha by 20 percent in January. The increase of maize meal prices—a sensitive issue even in the best of times—could foment unrest, particularly in the copper belt where the country's most powerful labor unions are threatening a general strike to protest the inadequacy of recent wage increases. 25X1

Rising Unemployment in Panama

Panamanian officials fear that as many as 2,500 workers may be laid off in Colon this year because of sharply declining commercial activity. In addition a decline in sugarcane output this spring, coupled with the closing of the San Felipillo sugar mill outside of Panama City, is expected to result in the loss of 4,000 jobs. Panamanian officials are concerned over unrest in Colon—the country's second-largest city where an estimated 30 percent of the labor force already is unemployed. The US Embassy notes that it has received reports that the suspension of operations at the sugar mill and depressed economic conditions in general may spur increased street violence in Panama City, where unemployment may already be over 20 percent. 25X1

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Communist

Sharp Drop in Soviet Hard Currency Debt

Moscow's net hard currency debt apparently fell by $2.4 billion in 1982. Recently released data indicate that Soviet liabilities to Western commercial banks probably dropped by about $1.5 billion, whereas assets held in these banks rose by nearly $1.6 billion. The resulting $3.1 billion reduction in the USSR's net commercial debt more than offsets the estimated $700 million increase in the USSR's debt on Western government–backed credits. Most of the drop in the commercial debt was due to a sharply reduced need for short-term credits for agricultural products—purchases of which fell by about $2 billion in 1982. The increase in debt on Western official credits probably was primarily due to the startup of deliveries of equipment and large-diameter pipe for the Siberia–to–Western Europe natural gas pipeline.

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USSR: Estimated Hard Currency Debt to the West, Yearend *Billion US $*

	1975	1980	1981	1982
Gross debt	10.6	17.9	20.9	20.1
Commercial debt	6.9	10.0	13.0	11.5
Government and government-backed debt	3.6	7.8	7.9	8.6
Assets in Western banks	3.1	8.6	8.4	10.0
Net debt	**7.5**	**9.3**	**12.5**	**10.1**

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Chinese Economic Performance in 1982

China's agricultural sector posted strong and broadly based gains in 1982, but other sectors had mixed results. According to the State Statistical Bureau, grain production hit a record 353 million tons, up 9 percent from 1981. Overall agricultural output rose by 11 percent because of exceptionally favorable weather, increased inputs, and new policies linking peasant incomes to production.

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In other sectors of the economy:

- Exports rose by 6.5 percent in real terms, while imports increased by 0.3 percent. Holdings of foreign exchange reached record levels.

- Industry grew by 7.7 percent, almost double the 4-percent target, but heavy industry's 9.9-percent growth (versus a 1-percent target) strained energy

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supplies and siphoned off inputs earmarked for the production of consumer goods. Light industry's growth was only 5.7 percent—less than the 7-percent target and the lowest rate in several years.

- Recovery in heavy industry also helped boost labor productivity by 2.3 percent, but unit costs fell by only 0.04 percent—far less than the planned 2- to 3-percent reduction.

- Rural incomes grew by 5 to 10 percent in real terms, about twice the gain in urban incomes but slower than in the past. Personal savings deposits grew by 29 percent, in part reflecting shortages of desirable consumer goods.

- Investment spending, again far above plan (25 percent), was concentrated in less essential areas. Progress on key energy and transportation projects lagged because of shortages of funds and construction materials.

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China Seeks Increase in Equity Joint Ventures

Beijing last month announced several measures to increase foreign investment in its equity joint venture program. The most important are the greater access the joint ventures will have to China's domestic market—from which they are largely excluded—and the lifting of the requirement that such ventures earn sufficient foreign exchange to cover all external costs and repatriated profits. Beijing also has exempted these ventures from import duties and business taxes and has lengthened the forgiveness period for income taxes. Beijing also plans to publish later this month a complete set of rules supplementing its joint venture laws and will hold a national conference on foreign investment to deal with other stumblingblocks. Since its inception in 1979, Beijing's equity joint venture program has attracted only about $100 million—less than 10 percent of total foreign investment in China. Depite China's efforts, we believe some investors will continue to avoid equity joint ventures because of doubts about the long-term stability of China's investment climate.

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CEMA Summit Postponed Again

A meeting of Soviet and East European party economic secretaries in Moscow last month failed to set a date or an agenda for a CEMA summit. A Romanian diplomat says differences among the CEMA members could not be resolved at the political level and would have to be addressed again at the experts' level, issue by issue. The Soviets reportedly refused to consider Romania's call for increased supplies of Soviet oil. Other major disagreements involved mechanisms proposed for improving economic coordination within CEMA. A senior Soviet economist, who is a specialist on CEMA, has told the British Ambassador the differences are unlikely to be solved in time for a summit to be held before early next year.

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The USSR wants to limit its obligations to provide the East Europeans with oil and other raw materials at preferential prices. At the same time, however, it wants to ensure that the East European economies remain strong enough to maintain political stability. In addition, the Soviets are concerned about the economic dependence of their East European allies on the West. The continued delay in agreeing on an agenda reflects resistance—especially from Romania and Hungary—to Moscow's efforts to establish closer coordination within CEMA and tighter Soviet control. The Soviets want to accelerate integration of planning and production in order to ensure more efficient investment and to reduce duplication of production. Most of the East Europeans want trade concessions from the USSR, but Moscow apparently has not tried to attain its broader aims by being more responsive on trade.

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USSR: Oil Supply Prospects for the 1980s [1]

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After three decades of large and steady increases, the rate of growth of Soviet oil production has begun to slow. Production of oil and gas condensate in the USSR now stands at 12.4 million b/d, only about 400,000 b/d more than in 1980. Though still posting small increases—about 1 percent annually during the current five-year plan—the Soviet oil industry has not reached an annual production target since 1972. These recent small increases were made possible only by a willingness on the part of the Soviet Government to fund an enormous and costly development effort in West Siberia, which now supplies 58 percent of Soviet oil production. We believe Moscow should be able to approach its production goal of 12.6 million b/d for 1985. Thereafter, rising investment costs will probably cause production to level off and decline slowly to 11 to 12 million b/d by 1990.

Production Problems

The slow growth in Soviet oil production is a result of planning and strategy choices made during the 1970s, increasingly difficult field conditions, and often mediocre performance by the oil industry:

- Outside of West Siberia only two major onshore producing regions, Komi and Kazakhstan, are not in decline, and both will remain relatively small producers throughout this decade. The Soviets concede that their promising offshore areas will contribute little before the 1990s.

- By the late 1980s, production at most of the large fields on which the Soviets have relied for most of their oil over the past two decades will be declining rapidly. Production from smaller deposits yields lower returns per unit of effort.

- Although we estimate the Soviets have reserves of 50-70 billion barrels, reserve quality is declining. Since the mid-1970s, well flow rates have steadily declined and water cuts have rapidly increased even in oil-rich West Siberia, sure signs that the best reserves are being depleted and that the Soviets must devote greater effort just to keep production from falling. To make matters worse, new deposits tend to be deeper, harder to drill, and more remote.

- Emphasis on maintaining high rates of production growth has resulted in Soviet failure thus far to implement an exploration program adequate for proving up substantial new reserves, especially outside of West Siberia. Consequently, potentially oil-rich portions of the Arctic, East Siberia, and even parts of West Siberia will contribute little significant new oil output until the 1990s.

- Though the USSR produces the bulk of equipment used by its oil industry and Soviet researchers are well-versed in technical theory, special applications (such as sophisticated exploration, deeper drilling, sour gas, and offshore positioning and drilling) will require reliance on Western equipment and technology for the foreseeable future.

- Despite the priority accorded to oil production, the Soviet oil industry suffers from the same kind of inefficiency and mismanagement that tend to plague other civilian sectors of the economy.

Supply Outlook

No single one of the above problems would by itself preclude the Soviets' maintaining some growth in oil output over the rest of this decade. But taken

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together, they have dramatically raised the cost of producing a barrel of crude. The Soviets plan to increase the oil industry's share of industrial investment from 12 percent in the previous five-year plan to 16 percent in the current 1981-85 plan. By 1985, they will be allocating 26 percent of all incremental investment to the oil sector. Our estimates of investment requirements indicate that Moscow would have to increase investment in the oil industry from 8 billion rubles in 1981 to some 20 to 25 billion rubles in 1990 just to keep production at—or slightly above—its present level. In an era of slow economic growth and lackluster performance in other key sectors of the economy, the Soviets will find it difficult to accelerate the pace of oil industry investment.

Consequently, given the apparent adequacy of the reserve base, oil production during the rest of the decade will be largely determined by the investment options chosen by Soviet leaders. At least through the end of the 11th Five-Year Plan in 1985, most investment and field development choices have already been made. If the Soviets follow through with these investment plans, they will probably come very close to, if not meet, their announced target of 12.6 million b/d for 1985.

In the last half of this decade, Soviet planners will probably be choosing from among three investment options:

- The Soviets could continue to increase investment in the oil industry over the coming 12th Five-Year Plan but at a decreasing rate of growth. This strategy would most likely result in production plateauing in the vicinity of 12.5 million b/d and subsequently declining slowly to 11 to 12 million b/d by 1990. Though such a program would still be expensive—investment and drilling effort would have to grow by 50 to 100 percent between now and 1990—it would be consistent with Moscow's past willingness to make the effort needed to avoid an energy crisis.

- With an enormous increase in investment, the Soviets could hold production between 12 and 13 million b/d until 1990. We believe reserves are adequate, but the costs of exploiting them probably would be prohibitive: total investment and drilling would have to triple; 60,000 more wells would have to go on artificial lift to help pump an additional 19 million b/d of water; the industry work force would need to nearly double; and everything would have to "go right" in the oilfields and on the exploration front. This option would be very expensive, and, without some unforeseen windfall discoveries, would create a drag on other sectors of the economy.

- At the other end of the spectrum, the Soviets—if dogged by increasing production problems, worse-than-expected geologic conditions in the oilfields, and a need to shift investment to other hard-pressed industries—could choose to halt the growth of resources going to the oil industry after this five-year plan. Such an approach could result in production peaking by 1985 and subsequently falling to as low as 9 to 10 million b/d by 1990. This option would create a serious gap between Soviet oil supply and demand.

Though the situation might change, the Soviets are apparently moving in the direction of the first option. Recent speeches by Andropov, [redacted] statements by senior spokesmen of the oil and gas industries, and the still sketchy details of the Soviets' new 20-year energy plan indicate that Moscow is feeling the energy investment pinch. [redacted] Soviet planners are attempting to shift energy investment from oil to gas. If this process continues—and it certainly would represent a rational choice—little, if any, further growth in Soviet oil output would occur beyond 1985.

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Implications of the Slowdown

The possibility of an oil production plateau poses serious problems for the Soviet leadership, given the oil demand outlook for the 1980s. In 1990, Soviet internal requirements for crude oil should

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grow to 9.5 to 10 million b/d, up from 8.9 million b/d in 1980. By the Soviets' own admission, an ongoing conservation program has been largely unsuccessful, primarily because the structure of domestic oil consumption does not lend itself to substantial discretionary cuts in use and the price system does little to help reduce demand. Though some gains have been made in the substitution of gas for oil, opportunities to substitute both additional gas and coal appear to be limited by capital-stock considerations and the transportation network.

Neither can the Soviets afford to make substantial near-term cuts in the more than 3 million b/d of oil currently being exported. About two-thirds of this amount supplies Eastern Europe with roughly three-fourths of its oil needs. Though Moscow has imposed selective cuts of 10 percent on some of its soft-currency buyers, only small and gradual additional cuts in supplies to Eastern Europe are feasible during this decade. Further reductions over the short term of as little as 100,000 b/d could appreciably diminish Eastern Europe's economic prospects, and cuts greater than 200,000 b/d could risk driving some of these economies into absolute decline.

About one-third of Soviet exports are sold on the Western market, and represent the Soviets' principal source of hard currency. Moscow has indicated that it intends to sustain hard currency earnings—even to the point of accepting some reduction in domestic economic growth. Unless world oil prices firm and begin to rise, Moscow will need to maintain exports to the West at somewhere near the current level to achieve this goal.

Total requirements for Soviet oil, then, should remain between 12 and 13 million b/d, leaving Moscow in the most likely case with a total "paper" shortfall of some 500,000 to 1 million b/d during the latter half of the decade. Particularly distressing from the Soviet point of view are the unpleasant tradeoffs—between domestic needs, hard currency requirements, and economic growth and political stability in client states—that managing this shortfall will require.

Regardless of whether the high or low side of the projection of oil production is achieved, our projections of Soviet economic performance in the 1980s indicate that growth of GNP will continue to decline—from over 2 percent during the current five-year plan period to between 1 and 2 percent during the 12th Five-Year Plan (1986-90). Indeed, Soviet growth would be only marginally higher with oil production of 12 million b/d than with 11 million b/d.

Any shortfall in oil available to the domestic economy would result in reduced use of capital equipment if other fuels cannot provide an offset. Oil use could be reduced in various ways. The most efficient method would be to retire equipment that uses the most oil relative to what it produces for the economy. Given the USSR's cumbersome approach to economic management, however, we are more likely to see the imposition of restrictions on energy use across industrial sectors. Open sources make it clear that such limits have been used extensively over the past year or so to cope with electric power shortages. These restrictions are not an effective substitute for a more rational and longer term approach to energy-efficient use of capital resources and result in a larger than necessary penalty on economic performance.

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Zaire: Returning to the IMF

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One year after approaching the IMF for a new standby agreement, Zaire is still finding it hard to meet Fund preconditions. Kinshasa is struggling to stay within its budget targets because of falling revenues from key mineral exports and mounting spending pressures. Monetary and credit restraints are likely to be loosened. Moreover, Kinshasa is reluctant to enforce IMF proposals for a floating exchange rate because it does not wish to lose control over the value of its currency.

The government's willingness to adopt a strict adjustment program will largely determine the country's eligibility for debt relief and its success in attracting additional international donor assistance. We believe that President Mobutu realizes the seriousness of the country's financial situation, but we are less sure that he is willing to make any substantial new sacrifices. Moreover, even if an IMF stabilization program is concluded, as in the past there will probably be slippage in meeting performance targets.

1982 in Retrospect

Zairian economic performance last year was disappointing largely because the worldwide recession kept down demand for Zaire's key mineral exports. Export earnings fell to about $1.4 billion, for an overall decline of 30 percent since the demand for copper and cobalt began to fall in 1980. Despite a drop in imports of almost 10 percent, the current account still registered a $360 million deficit, which exhausted Kinshasa's scant foreign exchange reserves. Zaire barely managed to pay 15 percent of its more than $900 million medium- and long-term debt service obligation last year, most of it due to official creditors.

President Mobutu's unwillingness to clamp down on public spending made matters worse. The budget deficit rose to about 9 percent of GDP—almost double the figure for 1981—despite much-ballyhooed attempts to streamline the civil service and the temporary recall of almost half of the country's diplomatic personnel. Low revenues—a result of lax domestic tax collection and decreased customs receipts—and growing expenditures caused the deficit to balloon. Monetary expansion to help cover the deficit reached an annual rate of nearly 70 percent and reversed a deflationary trend that began in 1980. GDP declined by an estimated 2 percent.

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Mobutu initiated several reforms during the latter part of the year, but they proved to be too little and too late to have a positive effect on 1982 performance:

- He replaced the corrupt Zairian head of GECAMINES, the government mining company, with an experienced Belgian, Robert Crem.
- He imposed a new accord on GECAMINES and SOZACOM, the state-run minerals marketing agent, to provide a more accurate account of transactions between them.
- He reduced Zaire's exorbitant cobalt price to bring it in line with the world market in an effort to boost sales.
- He decontrolled most food crop prices in an effort to reduce imports and to increase production of Zaire's main staples—particularly maize.

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As earnings from the country's mineral exports dropped, however, the dearth of foreign exchange caused a tightening of longstanding shortages of petroleum, capital equipment, and machinery, further crimping economic growth.

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Zaire: Current Account *Million US $*

	1979	1980	1981 [a]	1982 [a]	1983 [b]
Current account balance	**15.4**	**1.7**	**−255.3**	**−360**	**−420**
Trade balance	728.6	752.3	420.3	457	380
Exports (f.o.b.)	1,834.6	1,953.6	1,477.3	1,420	1,390
Copper	678.9	912.1	723.0	686	740
Cobalt	570.8	377.8	161.4	81	40
Crude oil	152.7	225.2	264.2	270	220
Other	432.2	438.5	328.7	383	390
Imports (f.o.b.)	1,106.0	1,201.3	1,057.0	963	1,010
Crude oil	149.9	209.5	257.0	238	230
Other	956.1	991.8	800.0	725	780
Net services [c]	−780.4	−884.7	−780.0	−924	−930
Unrequited transfers	67.2	134.1	104.4	107	130

[a] Estimated.
[b] Projected.
[c] Figures for 1979-80 include interest due before rescheduling. Estimates for subsequent years include interest payments Zaire is expected to be able to meet.

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Catering to the IMF

Seeking relief from the country's economic bind, Kinshasa approached the IMF in late 1982 for a $220 million one-year standby loan. Zaire's last program, an Extended Fund Facility negotiated in mid-1981, had been quickly suspended after Kinshasa failed—by a wide margin—to meet budget targets. Compared with 1981, Zaire's domestic economic management has deteriorated so badly and its financing needs have grown so large that any accommodation with the Fund will be harder to achieve than in the past.

The IMF—with strong support from Kinshasa's international creditors and donors—is requiring Zaire to implement several Fund recommendations before an agreement is signed. Kinshasa is being asked to:

IMF Programs *Million US $*

March 1976	Compensatory Financing Facility	65
	Standby arrangement (12 month)	47; made all drawings
May 1977	Compensatory Financing Facility	33
April 1977	Standby arrangement (12 month)	53; 6 drawn
August 1979	Standby arrangement (18 month)	152; made all drawings
June 1981	Extended Fund Facility	1,075; 206 drawn
March 1982	Compensatory Financing Facility	120

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- Keep the government budget deficit within strictly monitored guidelines.
- Float the country's overvalued currency.
- Restrain credit and monetary expansion.

Meanwhile, international donors are conditioning future aid on Kinshasa's willingness and ability to reduce corruption further and to reform the mining and agriculture sectors.

The Budget Deficit and Monetary Policies. In an attempt to strengthen its case with the IMF, Zaire has announced a budget for this year that projects a deficit exactly equal to the amount—$420 million—that Fund staffers have said would be tolerable. The US Embassy in Kinshasa reports that, by deferring all public spending except for employee salaries, Zaire has built up a surplus during the first few months of 1983 and has remained well within suggested IMF budget targets. Kinshasa will find it increasingly difficult to avoid incurring budget deficits, however, as spending pressures mount later this year. We see little evidence of monetary or credit restraint.

Officials in Kinshasa have been less quick to respond to the Fund's request for an exchange rate realignment. The Bank of Zaire has resisted IMF proposals to adopt a floating exchange rate regime, hoping that the Fund will settle for a series of devaluations. According to the US Embassy in Kinshasa, the IMF will be reluctant to accept this approach because it distrusts leaving the related decisions to Zaire's political leaders.

Reforms in Mining. Kinshasa's main reform achievements so far this year have been in the mining sector. Crem, the newly appointed director of GECAMINES, has moved swiftly to gain control of the company's financial accounts and to monitor sales. He has also slashed GECAMINES's budget expenditures by laying off large numbers of expatriate workers, divesting the company of many money-losing, nonmineral-producing subsidiaries, and decreasing production of cobalt in the face of slack demand. In addition, GECAMINES and SOZACOM have been able to agree on a competitive pricing strategy for cobalt.

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Crem nevertheless faces several obstacles in implementing the GECAMINES-SOZACOM accord. According to Embassy reporting, SOZACOM director Lukusa Mwengula resents the authority GECAMINES has acquired, and he attempts to obstruct Crem's initiatives whenever possible. GECAMINES and SOZACOM have also failed to agree on a repayment scheme for the massive cobalt prefinancing debt to Zaire's Belgian marketing agent, Societe Generale des Minerais (SGM).

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Dealing With Corruption. In response to international pressure—particularly from the United States—Mobutu has launched a highly touted anticorruption campaign. By early March, approximately 70 people had been arrested, 150 were under investigation, and 116 civil servants and businessmen had fled the country to avoid questioning. Even so, the campaign has barely scratched the surface of the system of patronage and graft that pervades the country. The campaign has focused on prosecuting individuals—mostly small businessmen and midlevel officials—rather than establishing measures to prevent corrupt practices or to monitor and limit their scope. Moreover, Mobutu has been in no hurry to process these cases.

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Dim Outlook for 1983

In our view, Zaire will continue to experience severe financial strains even if Kinshasa manages to secure an IMF loan. Even though an agreement would probably lead to a rescheduling of much of Zaire's $1.6 billion medium- and long-term debt service obligation for 1983, we doubt—based on Kinshasa's track record—that the country would be able to meet even substantially lower payment schedules. Mobutu would, therefore, be likely to turn increasingly to various forms of international

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aid to carry him through. He can probably expect to receive about $400 million in concessional economic support from the OECD countries if an IMF agreement is concluded, but much of this would be slated for longer term technical and development assistance rather than short-term financial support.

Kinshasa's international trade situation is grim. Although copper prices have picked up this year, the increase in revenues—the US Embassy estimates an increase in revenues of only $60 million—will not be enough to compensate for losses in other areas. We expect world prices for three of the country's other major exports—cobalt, oil, and diamonds—to remain depressed throughout the year. Moreover, until GECAMINES frees itself from its debt to SGM, much of the country's copper and cobalt earnings from prefinanced stocks will go to the Belgian marketing company. In addition, fire damage to petroleum production facilities several months ago is expected to cause oil earnings to fall further. According to the US Embassy in Kinshasa, imports this year will edge upward slightly.

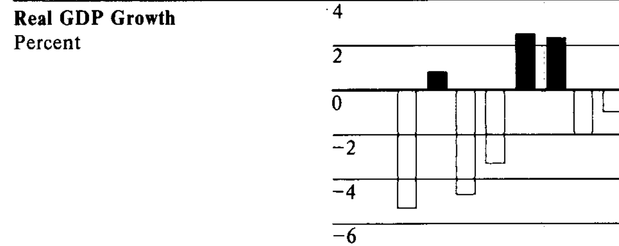
Zaire faces another year of declining GNP and rising inflation and unemployment. We expect the fall in GNP to be at least 1 percent in 1983. Kinshasa will probably not expand mining output because of continuing low world prices—particularly for cobalt. Factories will continue to operate at only 20 to 40 percent of their capacity because they will not be able to import the intermediate and capital goods they need. Agricultural output is not likely to increase appreciably this year, and unemployment will probably remain at current high levels—60 percent, according to an analysis by Zaire's national labor union. Inflation is likely to increase again this year as government officials continue to pump money into the economy.

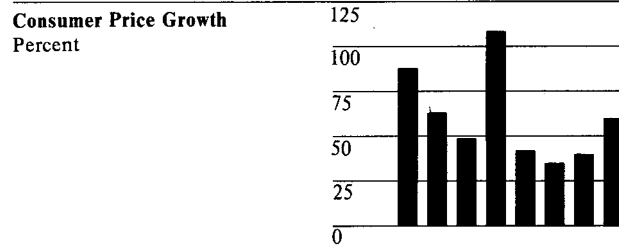
Prospects for Change

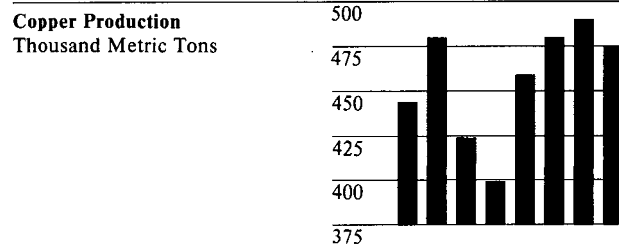
We believe that Mobutu is adroit at appearing to be responsive to international pressure while doing

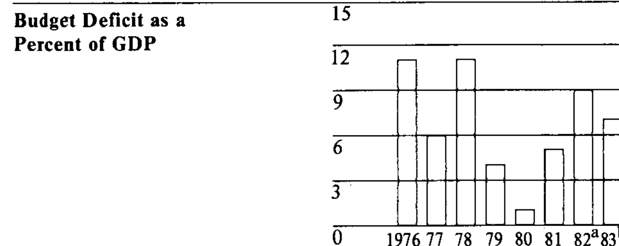
Zaire: Selected Economic Indicators

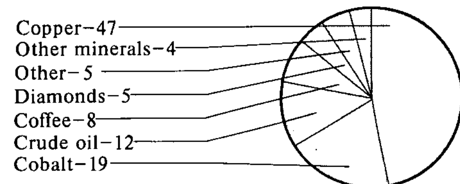
Note change in scales











[a] Estimated.
[b] Projected.

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no more than the minimum needed to win support. His record in avoiding US Brooke Amendment sanctions this year provides a good example of his willingness to respond to specific demands. He will, however, accept specific guidelines particularly regarding budget deficits and repayment of debt, but we anticipate slippage in meeting targets.

Recent measures to bolster the mineral sector appear likely to stick over the longer term. World Bank and EC loans to GECAMINES totaling almost $50 million should help to renovate the mines and to overhaul GECAMINES's administrative structure.

Contrary to its agreement under the SOZACOM-GECAMINES accord, however, the government probably will continue to tap GECAMINES's share of mineral receipts for non-mining-related purposes.

It is still too early to tell how serious Kinshasa is about implementing a sustained agricultural development policy. Even though the government has announced a program aimed primarily at increasing self-sufficiency in basic foods—thus slashing Zaire's enormous annual food import payments to South Africa and Zimbabwe—farmers and urban consumers will not benefit unless the government follows through with concrete measures to back it up. For example, price decontrol, if pursued, will probably not have a major impact on production for several years because of inadequate purchasing and distribution networks in Zaire. Even then, producers will be reluctant to make additional investments until they have been assured that the government will continue to pursue a policy of price deregulation. Lack of funds and organization will cause further difficulties.

Kinshasa's ability to implement a comprehensive program of economic reform over the next few years will depend greatly on demand for its mineral exports. In the last nine months, copper prices have risen 20 percent above the record lows of mid-1982. If the recent trend toward world economic recovery continues, Zaire's mineral sector reforms and its decision to increase copper production over the longer term would help ease the country's financial squeeze.

More important is what role Mobutu will play. While we believe his actions will be guided for a time by a desire for continued financial support from his foreign patrons—particularly the United States, France, and Belgium—his political patronage system, graft at high levels, and neglect of the national economy in favor of special regions and interest groups is unlikely to change. Mobutu has relied on this system to maintain control since he seized power in 1965, and we see no reason why he would be willing to abandon it now.

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Summit Countries: Shifts in Competitiveness

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Since late 1978 relative cost competitiveness among the Summit countries has shifted by magnitudes not experienced since the advent of floating exchange rates in early 1973:

- The United Kingdom has suffered the sharpest competitive loss followed by the United States. Since 1978 the United Kingdom's exchange rate–adjusted unit labor costs have risen by 40 percent relative to those of its competitors; those of the United States by 30 percent.
- In contrast, particularly sharp improvements have occurred in Japan and West Germany where domestic costs relative to those of competitors, when adjusted for exchange rate movements, are down 25 percent and 10 percent, respectively, from 1978 levels.

On a bilateral basis, the shifts in relative costs are even more pronounced, particularly those for the United States and Britain. Since 1978, for example, US unit labor costs have risen 50 percent compared with dollar-based unit labor costs in Japan and by 40 percent compared with those in West Germany. Among the other Summit countries, US bilateral competitiveness has worsened against all except Britain and Canada over the last four years.

Exchange Rates and Domestic Costs

Changes in exchange rates have played an important, although not exclusive, role in the competitiveness shifts. In the case of the United States, the 30-percent worsening in relative competitiveness since 1978 has been due almost entirely to the strengthening of the dollar. In the case of the United Kingdom, the stronger pound contributed to British losses in competitiveness, but so did substantially higher domestic cost inflation than experienced by its competitors. Japan's improved competitiveness was due chiefly to extremely low domestic cost increases, but, in its bilateral position with the United States, the drop in the yen-dollar rate played an equally important role.

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Among the other Summit countries, the components of West Germany's change in overall competitiveness were much like Japan's. Sharply lower domestic cost rises were the key element; vis-a-vis the United States, however, the depreciation of the mark was just as important. France and Italy each experienced gains in competitiveness because the effect of their depreciating currencies outweighed that of their more-rapid-than-average domestic cost inflation.

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Why the Exchange Rate Shifts

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The shifts in exchange rates that have been of substantial importance in the realignment of competitiveness over the past few years have been a source of controversy. In particular, two factors popularly thought to determine exchange rate movement—a country's inflation rate relative to those of its competitors and its current account position—seemed to have been outweighed by international differences in interest rates. The United States and Britain, for example, had the largest increases in real short-term interest rates and also experienced the largest appreciations.

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The role of demand management policies is less clear-cut, although in some countries they did seem to contribute to exchange rate movements. In

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Summit Countries: Trends in Cost Competitivness[a]

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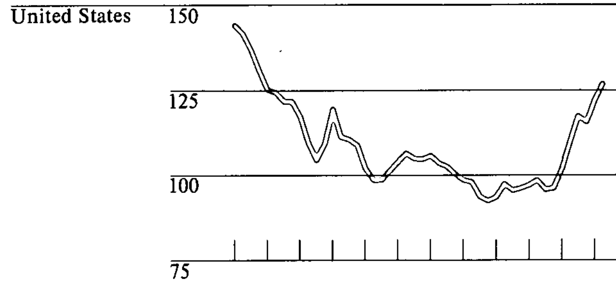

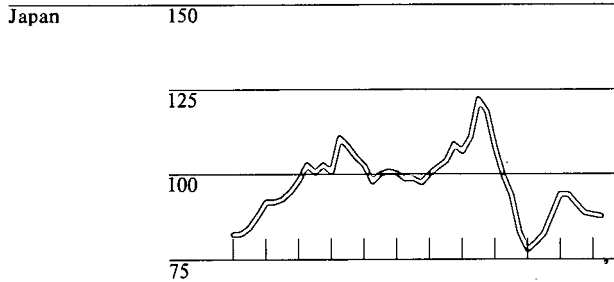

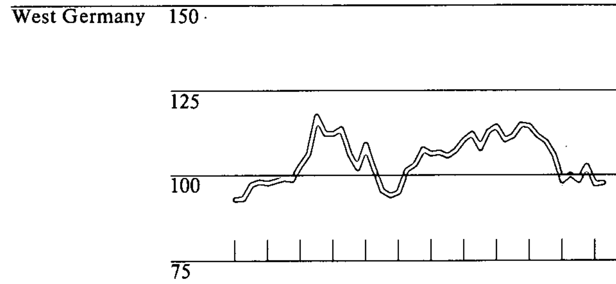

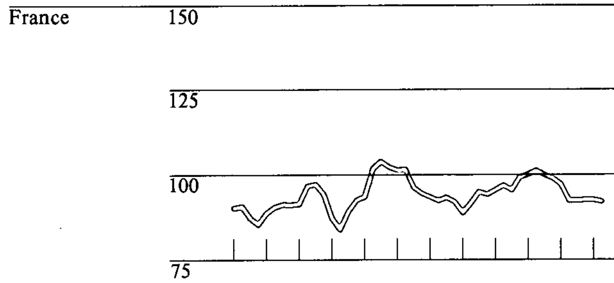

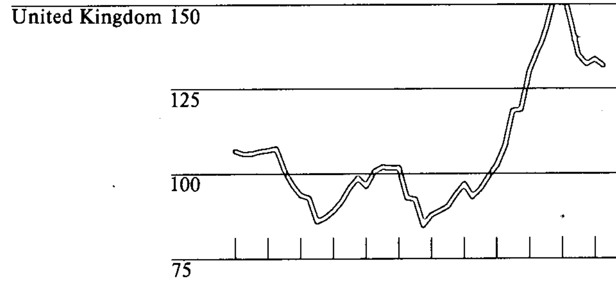

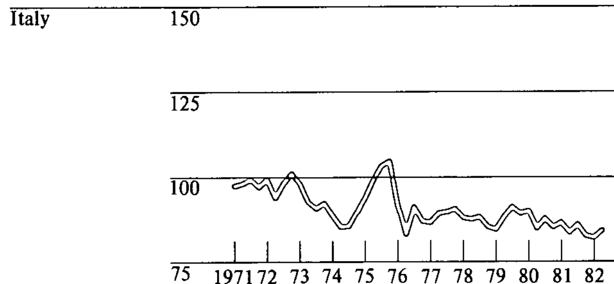

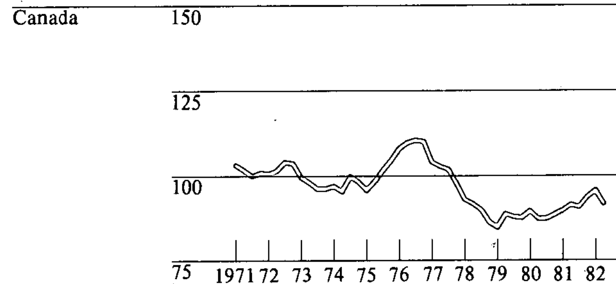

[a] Relative exchange rate adjusted unit labor costs.

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Summit Countries: Changes in Relative Bilateral Costs, 1979-82[a]

	United States	Japan	West Germany	France	United Kingdom	Italy	Canada
United States		51	40	28	−6	19	−5
Japan	−34		−8	−15	−38	−21	−38
West Germany	−29	8		−9	−33	−15	−32
France	−23	18	9		−27	−7	−26
United Kingdom	6	61	49	36		27	1
Italy	−16	27	17	7	−21		−20
Canada	5	60	47	35	−1	25	

[a] Percent change in ratio of dollar-based unit labor costs of countries in rows to dollar-based unit labor costs of countries in columns.

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Summit Countries: Components of Shifts in Cost Competitiveness, 1979-82 [a]

Percent

	Change in Exchange Rate–Adjusted Relative Unit Labor Cost	Change in Relative Unit Labor Cost	Change in Weighted Exchange Rate
United States	31.6	−1.0	19.8
Japan	−25.0	−22.7	−8.2
West Germany	−8.9	−14.6	9.1
France	−3.2	12.5	−10.4
United Kingdom	39.2	15.6	16.4
Italy	−3.3	32.1	−21.9
Canada	7.0	12.4	−3.0

[a] Due to a divergence of sources for the data on which this table is based, components will not add to total shift.

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France, for example, monetary growth rates were well above average, real interest rate increases were small, and the franc did depreciate. On the other hand, Britain also had rapid monetary growth and a smaller budget deficit, but interest rates rose and the pound appreciated. Japan and West Germany, with the lowest growth for M1, experienced small real interest rate rises and relatively small changes in the value of their currencies.

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Summit Countries: Changes in Exchange Rates, Interest Rates, Money Supplies, and Budget Deficits, 1979-1982

	Change in Weighted Exchange Rates (*percent*)	Change in Real Short-Term Interest Rates (*percentage points*)	Change in M1 (*percent*)	Change in Budget Balance (*percent of GNP*)
United States	19.8	5.6	14.5	−3.7
Japan	−8.2	3.7	8.0	2.2
West Germany	9.1	2.7	4.9	−1.6
France	−10.4	3.7	44.0	−1.0
United Kingdom	16.4	7.6	38.5	2.2
Italy	−21.9	5.3	44.8	−2.5
Canada	−3.0	3.2	14.8	−3.3

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Implications and Outlook

The enormous rise in the exchange value of the dollar and pound since 1978 has caused a major loss of US and UK competitiveness. As a result, real net exports have declined significantly, worsening the US and British recessions and unemployment rates, and creating a record deficit in the US merchandise trade balance. Since 1980 US real net exports declined by $20 billion, despite the deep US recession, and UK real net exports dropped by $4 billion. On the other hand, Japan and West Germany have seen their lower costs lead to sharp rises in real net exports. Without a reversal of these competitiveness shifts, the trends in net export balances likely will continue, retarding economic recovery in the United States and Britain while boosting it in Japan and West Germany.

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