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Directorate of
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International Economic & Energy Weekly

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24 June 1983

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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Synopsis

Perspective—*Mitterrand's Austerity Headed for a Fall?*

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The austerity program of France's Socialist government is in trouble as evidenced by some government backsliding on its implementation and several unwelcome price and wage developments. The toughest test is likely this fall when the government's resolve to hold the line against catchup wage demands from the major unions will come under renewed pressure on the franc.

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West Germany: On the Verge of a Modest Upswing

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After three years of weak performance, the West German economy shows signs of recovery. Nonetheless, we doubt the recovery will be robust enough to have much impact on unemployment.

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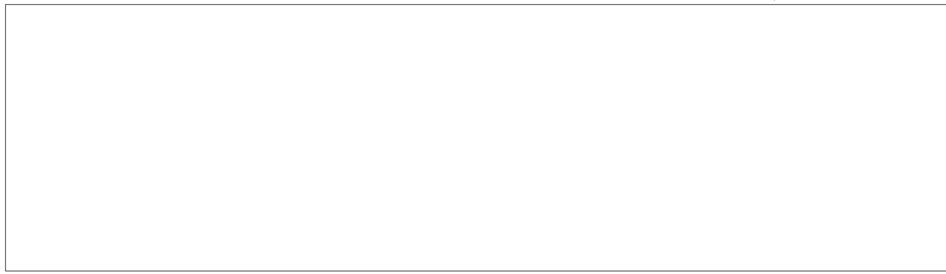

Foreign Labor in the USSR

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The economic impact of foreign labor in the USSR has been commensurate with its small share of the Soviet labor force. Even in construction and timber—where most foreign labor is concentrated—it accounts for a very small proportion of total employment. Foreign workers in the USSR are generally volunteers, despite rumors among Vietnamese refugees that their countrymen are there as forced labor.

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24 June 1983

Perspective

Mitterrand's Austerity Headed for a Fall?

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The austerity program of France's Socialist government is in trouble as evidenced by some government backsliding on its implementation and several unwelcome price and wage developments. A wave of demonstrations and scattered violence this spring, some of which can be attributed to dissatisfaction over the program, has contributed to a climate of malaise and falling confidence.

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The toughest test is likely this fall when the government's resolve to hold the line against catchup wage demands from the major unions will come under pressure. President Mitterrand will again be faced with the choice of sticking to his guns or giving in to increasingly vocal criticism from both the Communists and leftwing Socialists to return to growth-oriented policies that failed disastrously. We believe it unlikely that Mitterrand will write off the political and economic capital that his government has already invested in the austerity program. Nonetheless, the continuing pressure from the left for an "alternative" approach emphasizes the importance of achieving favorable results soon.

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The current version of Socialist austerity was announced in late March as a complement to the franc's third devaluation under Mitterrand. The new program was tough in outline. Taxes were increased, public utility prices were hiked, and Paris cut government and public-sector outlays. Monetary growth targets were also lowered. In addition, the government reaffirmed its 8-percent target for nominal wage growth in 1983. The stated goals for the year were to limit inflation to 8 percent and to halve the trade deficit. Next year, inflation was to be reduced further and the trade deficit eliminated.

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Reducing the trade deficit has been given greater urgency by a rapid buildup in the level of French foreign debt. Although estimates of the size of the debt vary, the effect of mounting interest payments has become noticeable. The practice of widespread foreign borrowing began during the Giscard administration, and Mitterrand's margin for additional borrowing was thus already limited when he took office.

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The government has somewhat diminished the potential effect of the austerity program by modifying and delaying some of the measures. Moreover, the

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Finance Ministry has admitted that the 1983 targets—perhaps too ambitious at the outset—are not likely to be met:

- The seasonally adjusted trade deficit for the first quarter was $3.5 billion, about half the target for the year as a whole.
- Consumer prices increased during the first quarter at a nearly 11-percent annual rate.

A semiofficial forecast prepared in mid-May estimates that the trade deficit will exceed the target by at least 40 percent and that prices will increase by 9.0 to 9.5 percent. Moreover, the trade deficit forecast is based on a franc/dollar exchange rate for the second half that could well prove optimistic. [ ] 25X1

Wage settlements, up at a 12.5-percent annual rate in the first quarter, are also worrisome. The government has played down the significance of a single statistic, but public perceptions flowing from an increase of this magnitude will make it harder for the government to resist demands for wage catchups, especially in the bellwether civil service. Better monthly CPI results between now and the fall will be necessary if Paris is to have much of a chance to lower the rate of wage growth. [ ] 25X1

To hold the program together, the government will need to stop whittling away at it. Whatever the motivation, changes have done nothing to instill confidence. The government will need to brace itself for a rash of strikes this fall over the wage issue, relying on sympathetic union leaders to make sure the strikes do not get out of hand. And Paris will need to ignore the sniping from its critics on the left, who assume the program will fail. Given the need to come as close to hitting the price and trade deficit goals as possible, Mitterrand will probably find that supplementary steps to reduce purchasing power in the economy are necessary. [ ] 25X1

Mitterrand would do well to act sooner rather than later. Better results on inflation and trade would not remove the need for another devaluation later this year or early next because France's inflation differential is still too great. In addition, they would not take the steam out of labor demands but would allow Mitterrand to demonstrate that the government is on the right track. Even if he finds it politically necessary to link new measures with import restraints for a specified period, he will be better able to answer his domestic critics without moving too far toward the economic nationalism they advocate. [ ] 25X1

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Briefs

Energy

Spot Oil Market Trends

Spot crude oil prices rebounded slightly in recent weeks and are now close to or above official levels for many crudes. Arab Light is selling at $28.85 per barrel versus the official price of $29; Bonny Light is quoted at $30.30 per barrel, $0.30 above the official price. The increase in spot crude oil prices was led by strengthening spot product prices, which led to an improvement in refiner margins for the fifth straight week. US gasoline demand increased 2 percent over the same period a year ago, and total product demand was only 1 percent lower than year-earlier levels for the most recent four-week period. We expect spot crude oil prices to continue to fluctuate within a narrow range in coming weeks as buyers wait for clear signals of supply and demand patterns. 25X1

Nigerian Oil Production Exceeds Quota

According to official Nigerian oil production figures, crude production in early June averaged 1.5 million b/d—200,000 b/d above Nigeria's OPEC-mandated quota. Continued production at this level would put Nigeria's second-quarter output over its allocation by 100,000 b/d. The Nigerians already drew attention from OPEC's monitoring committee for even higher production levels in May and claimed that oil production in June would be cut back to meet its quarterly quota. Lagos reportedly was irritated that its May production rate was well publicized in the open press and has told companies to hold June figures closely. As long as the present price advantage for Nigerian crude remains and buyer interest is keen, we believe Nigeria will continue to produce oil in excess of its quota. 25X1
Lagos is hopeful that OPEC will raise Nigeria's quota to at least 1.4 million b/d when it meets in Helsinki next month. 25X1

Increased Saudi Oil Sales to Iraqi Customers

Saudi exports of crude oil to Iraq's customers jumped to over 300,000 barrels per day during the one-month period ending in mid-June—up from 80,000 barrels per day the previous month. Almost all this oil, worth a total of nearly $300 million, was taken by Japan and the USSR. The Soviets are shipping their portion to India to satisfy their contracts with New Delhi. The US Interests Section in Baghdad reports Iraq had agreed to provide the Soviets $1.2 billion worth of oil this year to pay for military hardware, and it will owe the Japanese an estimated $1.8 billion for imports and work on economic projects. 25X1

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The current Saudi deliveries, combined with Baghdad's own output, are almost equal to Iraq's OPEC production quota of 1.2 million barrels per day. Unless Saudi Arabia further increases the amount of oil it makes available for Iraq in the second half of the year, Baghdad will not be able to meet its payments to Moscow and Tokyo. The Saudis, however, may not be willing to do so. 25X1

Canada's Incentive Price Plan for Natural Gas Exports Delayed

According to Embassy reporting, an incentive plan to encourage US purchases of Canadian natural gas is still being discussed by Ottawa and Alberta in the context of a more general energy agreement between the two parties. Although a Canadian official believes that such an agreement is possible by mid-July, this may be optimistic in light of the contentious relationship between Ottawa and Alberta. Canada's gas producing provinces—which continue to experience a substantial volume of shut-in gas production—and Minister of Energy Chreiten still appear to favor granting US importers an incentive price of $3.30 per thousand cubic feet (tcf) for purchases above 50 percent of contract volumes. Opposition from other Cabinet members, however, could force a compromise incentive price of $3.40 to $3.50 per tcf. The uniform border price for natural gas currently is $4.40 per tcf. 25X1

International Finance

Bankers More Optimistic on Lending to USSR and Eastern Europe

25X1 Western commercial banks expect lending to the USSR and to some East European countries—but not to Poland and Yugoslavia—to pick up soon. This more optimistic outlook is contingent upon an anticipated improvement in the balance of payments and economic growth in most of Eastern Europe. 25X1 trade balances are expected to improve if recovery in the major developed countries does not falter. 25X1 expand their loan portfolios in favor of some East European countries over opportunities in Latin America, where loan rescheduling is widespread, and in Western Europe, where interest rate margins on loans are still narrow. West European bankers are generally more sanguine than their US counterparts about future lending opportunities in Eastern Europe. 25X1

The optimism expressed by the bank officials is fragile. Banks are aware that early signs of improvement in the East European economies can be quickly reversed and that there are still basic economic adjustments that the East European countries will have to make. West European banks have more customers involved in trade with Eastern Europe than the US banks. As a result, they are likely to be more receptive to credit requests. For the rest of the year at least, the West European banks probably will favor shorter loan terms and seek official guarantees for trade credits to the USSR and Eastern Europe. 25X1

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Nigerian Refinancing Negotiations

Nigerian officials and representatives of 24 international banks have agreed in principle to refinance one-fourth of Nigeria's $6 billion in overdue commercial bills, although several difficult questions have yet to be resolved. [redacted] 25X1 [redacted] a formula to determine the size of new loans, has yet to be worked out. The bankers, however, have agreed that additional funds should be advanced. As a show of good faith in the negotiations, some banks once again are confirming letters of credit for Nigeria. [redacted] 25X1

President Shagari has to move quickly to reach a final agreement with the banks so that he can use the new money to increase the flow of imports before elections in August. He hopes this will continue to keep the economy from becoming an issue. Meanwhile, the government remains vulnerable to another sudden downturn in the price of oil. More than 90 percent of Nigeria's foreign exchange earnings are derived from oil exports. [redacted] 25X1

Financial Strains in the Philippines

The Philippines, [redacted] needs up to $1 billion in emergency financing from foreign private banks to tide it over its current cash shortage and to avoid rescheduling its foreign debts this year. [redacted] 25X1 [redacted] over the next 18 months the Philippines cannot meet its foreign debt repayment obligations—about $3 billion annually—without a large infusion of funds. [redacted] 25X1 banks this week began working on a program in cooperation with government officials in Manila. The Philippines' balance of payments has not deteriorated appreciably during the past six months, but [redacted] 25X1 short-term credit lines have been substantially curtailed since early this year. Manila also is under pressure from the IMF to limit new short-term borrowing. [redacted] 25X1

The government is increasingly liable for the foreign debt obligations of the private sector as a result of assistance in underwriting the debts of financially distressed firms. A bridge loan would ease the government's liquidity problems, enabling Manila to buy time until the country's external accounts improve. The international banking community, however, probably would be alarmed by an attempt to raise a large amount of money. When it secured a $325 million commercial loan in January, Manila told participating banks that its financing requirements were limited and would not compel more foreign borrowing in 1983. The government is likely to wait until mid-July, after a consortium of its aid donors and private creditors holds its annual meeting in Paris, to decide on a course of action. [redacted] 25X1

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Global and Regional Developments

OECD Export Credit Arrangement

The participants in the OECD agreement on officially supported export credits will reconvene next week in Paris to try to extend and revise the arrangement. The current accord, which was due to expire 1 May, was extended through 1 July because of an impasse in negotiations. The arrangement, designed to limit government subsidization of export financing, established minimum interest rates for different categories of borrowers. Consensus rates now range from 10.0 percent for loans to the least developed countries to 12.4 percent for long-term loans to relatively rich countries. Over the past year commercial lending rates in many OECD countries have fallen below consensus rates, creating new divisions within the arrangement. Among the major participants, only France and Italy at present have interest rates exceeding consensus rates.

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According to diplomatic traffic, most countries with below-consensus rates, such as Japan, want a new differentiated rate system (DRS) under which export credit agencies would be required to lend at rates that approximate commercial borrowing costs. The United States favors an unsubsidized DRS across the board, while Japan wants unsubsidized rates only for relatively rich countries. France, on the other hand, prefers to stay with the present system of consensus rates. According to Embassy reporting, France is prepared to bear the budgetary burden of interest rate subsidies so long as its trade deficits and high interest rates continue. The chairman of the arrangement will probably propose a compromise that will extend the agreement for at least another year. While keeping relatively higher consensus rates, preferred by France, such a compromise will also probably include a DRS for low interest rate participants. The threat of renewed export credit competition will probably lead to agreement by all the members, including France, whose views have been moderated by pressure from other EC members, particularly West Germany.

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East German Purchase of Grain From Canada

East Germany purchased 1.5 million tons of Canadian feed wheat and barley earlier this month with two- to three-year credits guaranteed by the Canadian Government. At current market prices, the contract would be worth an estimated $170 million.

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The sale is equal to about one-half of East Germany's annual grain import requirements. It will further erode the US market share, which in recent years has amounted to two-thirds of East German grain imports. Unlike their Canadian and West European counterparts, US banks and grain companies over the past 18 months have generally been unwilling to extend financing beyond one year. This has prompted many East European countries to turn elsewhere for their grain import needs.

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Tentative EC Budget Rebate for the United Kingdom

The United Kingdom has won a $675 million refund this year from the European Community, contingent on endorsement of a plan to reform EC finances. Prime Minister Thatcher had hoped for a $1.2 billion rebate and insisted that the acrimonious budget debate take precedence at the EC Summit in Stuttgart last weekend. West German Chancellor Kohl played a mediator's role, acknowledging the legitimacy of the United Kingdom's claim that it pays the EC far more than it receives in benefits. Kohl insisted, however, on linking the refund to reductions in the costly agricultural subsidy program and corrections in the uneven distribution of contributions to the $24 billion EC budget. Most EC members—especially those with the greatest profit from EC farm programs—have rejected making any cuts in subsidies solely to accommodate British demands. 25X1

EC leaders may have difficulty achieving final approval of the rebate because of continuing divisions over the agricultural subsidy issue and because Thatcher has rejected the leaders' demands for increased contributions from value-added taxes—a major source of EC income. The EC will run out of money next year if it fails to reform its financing arrangements. Thatcher, however, has won large rebates for the past three years by threatening to withhold the British budget contribution. The Prime Minister's adamant position on a rebate increases her image among British voters as a tough and capable leader, although it has angered her EC partners. By reducing the British budget deficit, the rebate will help Thatcher carry out a main plank in the Tories' economic program. 25X1

Israeli Actions Keep Southern Lebanon's Economy Depressed

Israeli actions in occupied southern Lebanon and Lebanese reactions to them are depressing the south's primarily agricultural economy. Israel continues routinely to violate its 1982 pledge not to export to Lebanon any goods—mainly foodstuffs—that compete with Lebanese commodities. Inexpensive Israeli produce shipped in Lebanese trucks has taken a large share of the Beirut fruit markets traditionally supplied by the Shiite farmers of southern Lebanon. Farmers are also being hurt by the Israeli Defense Forces' (IDF) practice of detaining trucks carrying Lebanese produce north to Beirut and holding them in the hot sun until the produce is spoiled. Although the IDF frequently closes the Sidon-Beirut road—citing the need for strict security checks of passing traffic—the IDF usually keeps open the highway from Sidon to Israel. Israel also continues to allow Lebanese to import goods duty free via the Israeli port of Haifa. 25X1

These IDF moves lead many Lebanese to suspect that Israel wants to disrupt the south's ties to Beirut and redirect its trade to Israel. Local resentment is heightened by a recent Lebanese press report that the IDF will not permit merchandise from Beirut or elsewhere in Lebanon to enter the Israeli-occupied area without prior approval of the Israeli military commander in Sidon. To protest these moves and other perceived IDF injustices, merchants in Sidon—

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the major city in the south—recently went on two general strikes. The strikes in turn provoked a short-lived IDF retaliation, the temporary closing of some shops of the activists. 25X1

We believe the main goal of these Israeli moves is to ensure that politically powerful groups in Lebanon have a financial interest in maintaining close economic and political ties with Israel. Israel probably recognizes that those segments of Lebanese society that profit from the Israeli moves—importers of manufactured goods and consumers in Beirut—are primarily politically influential Christians and Sunnis. By contrast, the farmers in the south who suffer from the Israeli restrictions are mostly powerless Shia, who would have little say in Beirut's decisions regarding Israeli-Lebanese ties. 25X1

Libya Terminates Barter Accord With USSR

25X1 their barter arrangement, under which Libya shipped oil at discounted prices to the USSR in exchange for arms, would be ended and future Libyan trade with the USSR would be for cash only. 25X1 25X1 25X1 The improvement in the economy and the recent firming of spot oil prices have strengthened Tripoli's ability to pay cash for Soviet arms. Tripoli has been disturbed by Soviet dumping of Libyan oil on the spot market because it undercut Libyan oil sales and depressed the price of OPEC crude. The USSR's request for increased payment for its advisers may be an effort to recoup some of the income that will be lost through the termination of the barter accord. 25X1

Formation of Tin Producers Association

Malaysia, Thailand, and Indonesia, which account for almost two-thirds of world tin output, last week ratified an agreement to establish the Association of Tin Producing Countries (ATPC). We believe Bolivia, Australia, Nigeria, and Zaire, which provide an additional 23 percent of world tin production and actively participated in discussions that led to the formation of the ATPC, probably will also ratify the agreement. The ATPC was formed primarily to promote tin usage, research, development, and marketing but also is empowered to establish export and production controls, a buffer stock, minimum pricing, and market intervention through financial and institutional arrangements—measures Malaysia has traditionally advocated. The pact serves notice to the International Tin Council (ITC)—a consortium of producers and consumers—that producers are unhappy about its price support efforts and offers a fallback position in the event the ITC fails to adequately address producer concerns. 25X1

West Germany Seeking To Restrict Turkish Guest Workers

25X1 West German Interior Minister Zimmermann will present Bonn's proposals for limiting the size of the Turkish population in West Germany during a meeting next month with President Evren and other Turkish leaders. The West Germans will ask that Turkey

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voluntarily restrict the movement of its citizens to West Germany and accept a plan under which Bonn would offer financial payments to Turkish guest workers who agree to return to Turkey.

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The West German Government is unlikely to halt aid to Turkey. Zimmermann, however, hopes a hard line will help persuade the Turkish Government of the importance Bonn places on this issue. Although the return of large numbers of Turks would aggravate Turkey's unemployment problem, Ankara in the end probably would accommodate the West German initiatives. It would not want to strain its close economic and security ties with Bonn.

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National Developments

Developed Countries

Italian Economy on Eve of Elections

Recently released government statistics indicate the Italian economy is in a continuing slump and economic growth will, at best, stagnate this year. Depressed capital investment and declining exports held real GDP to a 1.2 percent annual growth rate during the first quarter. Seasonally adjusted industrial production fell nearly 13 percent in April, and the cumulative January-April index was down 8.7 percent from the same period last year. With inflation at about last year's 16-percent level because of a burgeoning budget deficit and the depreciating lira, the monetary authorities probably will keep a tight rein on the money supply and maintain high interest rates—the prime rate is currently 19.5 percent. Another worrisome factor is that recent labor unrest over the lack of progress in key wage negotiations could result in a wave of strikes if an agreement is not reached soon.

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The state of the economy has become a major issue in national elections scheduled for 26 and 27 June. Italian voters, however, disenchanted with the power brokering activities of the parties, have generally been apathetic toward campaign developments. Polls indicate that the outcome will be a relatively unchanged coaliton government dominated by the Christian Democrats, who advocate a stronger anti-inflation program, than the Socialists. If the coalition can hold together, Rome is likely to adopt some watered-down version of austerity this fall, consisting of a fiscal policy less expansionary than many coalition members would like. The stimulative effects of any expansionary policy will be blunted if the Bank of Italy keeps monetary policy restrictive.

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Less Developed Countries

Drought in Philippines

The worst drought to hit the Philippines in 20 years will result in lower agricultural exports and thus worsen balance-of-payments strains, according to recent US Embassy reports. The Embassy estimates that production declines in coconut and sugar—which together generate one-fifth of export earnings—will total 10 and 25 percent, respectively. Corn and banana production is also down significantly; government officials predict that corn imports alone will exceed $100 million during 1983—roughly double last year's level. To avoid becoming a net rice importer this year, Manila will draw down its 1.3-million-ton buffer stock. The decline in agricultural exports will probably more than offset expected gains from the rebound in international commodity prices this year, which Manila had counted on to improve on the $2.8 billion trade deficit recorded last year.

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Food Shortages in Southwest Afghanistan

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the war has cut food availability in southwest Afghanistan by reducing farm output and disrupting the internal distribution system. Western observers and doctors working in hospitals in Pakistan, near the southwest border of Afghanistan, report high levels of malnutrition among wounded Afghan insurgents and Afghan refugees entering Pakistan during the first half of 1983. Although farmers are planting

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crops, yields reportedly have dropped sharply because of a lack of equipment and labor and inadequate supplies of fertilizer and pesticides. We believe, however, that distribution is a more immediate problem than domestic food availability. Even under normal conditions, most of Afghanistan was dependent at least in part on outside supplies, distributed both by government and private traders.

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Mauritian Elections

Prime Minister Jugnauth has decided to hold elections on 21 August rather than risk a legislative defeat on the austerity budget that he had planned to implement next month. A program to reduce government spending is crucial for Mauritius to obtain assistance from the IMF and World Bank. Jugnauth needs a strong popular mandate to push through not only the budget but also other measures, including currency devaluation and a slowdown in wage increases for government workers required by Western donors. We expect that economic problems, particularly mounting unemployment and inflation, will be important campaign issues; Jugnauth's principal opponent is his former finance minister and the architect of the proposed austerity budget. Although both leading contenders are avowed leftists, whoever emerges the winner will be reluctant to pursue radical economic policies that would jeopardize access to desperately needed Western funds.

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Communist

Soviet Grain Prospects

Soviet grain prospects have deteriorated somewhat in recent weeks because of crop damage caused by sukhovey conditions (hot, dry winds) in the southern European USSR and a likely shortfall in the planned sown area. During late May and early June, the southern portion of the Ukraine, the lower Volga Valley, and the northern half of the North Caucasus were hit intermittently with sukhovey conditions. We estimate that overall crop losses caused by the sukhoveys totaled approximately 10 million tons. Nevertheless, an above average crop of 205-210 million tons—well above the estimated annual output of 185 million tons averaged during 1978-82—is still possible if excellent weather prevails throughout the remainder of the season.

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An additional 2-3 million tons of potential grain production has been lost because of an estimated shortfall in plantings. On the basis of statistics released by the USSR's Central Statistical Administration (CSA) on 6 June, we believe that the area sown to grain this year will fall some 2-3 million hectares short of the 124-million-hectare target. The CSA report indicated that planting in the spring grain regions east of the Ural Mountains was running seven to 10 days behind the average pace of recent years. Because the planting season there ends in mid-June, we believe that 1-2 million hectares will not be planted. In addition, a recent Soviet press report indicated that 1 million hectares of land originally earmarked for grain were instead put into fallow.

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Areas Hardest Hit by Recent *Sukhovey* Conditions

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Delays at Chinese Ports

Because of backward facilities Chinese ports have been unable to handle shipments of US logs, wood pulp, and railroad ties. Imports of US timber and pulp have increased rapidly since Beijing began purchases in 1980 and last year totaled $237 million. Although the Chinese reportedly are working with US suppliers to develop a computerized system whereby shipments would be labeled for specific lumber mills, outdated port facilities will prevent an increase in imports of wood and wood products from the United States for a number of years.

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West Germany: On the Verge of a Modest Upswing

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After three years of weak performance the West German economy shows signs of recovery. The government is convinced that accelerated private investment is the key to reviving the economy and reducing unemployment, and Chancellor Kohl has pledged to provide incentives to industry while curbing government spending. Nonetheless, we doubt the recovery will be robust enough to have much impact on unemployment. Moreover, achieving Kohl's budgetary goals will be difficult; troubled industries are demanding aid, and social welfare costs stemming from the worst unemployment in 30 years threaten to exceed projections.

West Germany's five major economic research institutes agree that a modest recovery is under way. Their recent joint forecast puts real GNP growth at 0.5 percent in 1983, with investment leading the upturn. Our model yields slightly faster growth, led by exports. If world import demand picks up by the 2 percent expected by the IMF and if oil prices remain stable or decline, we believe that GNP growth could reach 1 percent. Should interest rates rebound sharply, however, the recovery could stall before it really gets started.

West Germany: Real GNP Growth and Trade

Percent (except where noted)

	1982	1983 Projections	
		Five Institutes' Forecast [a]	CIA Model Forecast
GNP	**−1.1**	**0.5**	**1.0**
Domestic demand	−2.2	0.7	−0.1
Private consumption	−2.3	0	0.3
Government consumption	−0.1	0	−0.4
Investment	−5.6	2.0	2.8
Equipment	−7.2	1.0	1.2
Construction	−4.5	3.0	3.7
Net foreign demand	29.3	−3.5	20.9
Exports of goods and services	3.7	0	2.8
Imports of goods and services	0.6	0.5	−0.6
Consumer price index	5.2	3.0	3.0
Current account balance *(billion US $)*	3	7	10.5

[a] The five leading economic research institutes in West Germany—Kiel Institute of the World Economy; HWWA Institute, Hamburg; IFO Institute, Munich; West German Institute for Economics (DIW), Berlin; and Rhine Westphalian Institute, Essen—issued their semiannual forecast on 2 May 1983.

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Gaining Momentum

The West German economy appears to be turning upward after three years of declining industrial production and two years without any real GNP growth. Except for a slight dip in April, business sentiment has been noticeably upbeat since November, according to surveys taken by the Munich Institute for Economic Research (IFO). IFO attributes the brighter outlook to the reduced oil bill, lower interest rates, Kohl's election victory in March, and prospects for a revival in the world economy—especially in the United States.

Domestic orders for industrial goods, which had been dropping off until last autumn, are picking up. Although the expiration of the investment tax credit in December influenced the sharp jump in orders for capital goods late in 1982, orders for consumer goods, basic materials, and manufactures have improved steadily. The decline in foreign orders appears to be leveling off as well. Recent government programs to subsidize housing should

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keep the construction industry moving. Housing starts in February were 7 percent higher than at the same time last year. Industrial production grew at a 4-percent annual rate in the first quarter of this year, suggesting that a broad upturn has begun.

Consumer spending, which had been a drag on the economy, was surprisingly strong in January-March, exceeding the last quarter of 1982 by 2 percent, according to preliminary statistics. This surge came largely through a drop in the savings rate, and polls indicate that consumer attitudes are growing more buoyant.

Current Policy Stance

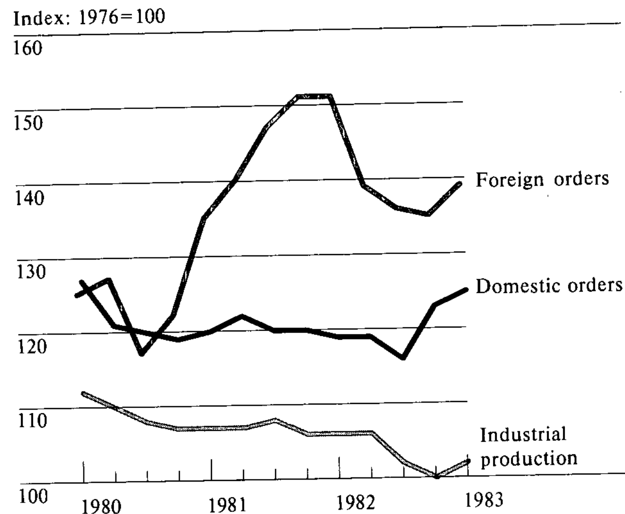
Kohl's Christian Democratic–Free Democratic coalition, which came to power last October, has pledged to trim the budget deficit and reduce the government's role in the economy. As an initial step, Bonn approved last December a revised budget for 1983 that calls for a spending increase of 2.8 percent and a $17 billion borrowing requirement—about 3 percent of GNP. To implement its plan, Bonn has:

- Cut family allowances and student grants.
- Reduced some subsidies to industry and agriculture.
- Restricted government salaries for employees not covered by collective bargaining to 2 percent in 1983.
- Delayed regular January increases in pensions until 1 July.
- Boosted the private-sector share of unemployment insurance and pension contributions.
- Reduced ministry budgets across the board.

In addition, the value-added tax will be raised from 13 to 14 percent this July, and a controversial tax surcharge for high income earners has been implemented to finance additional subsidies to industry, especially construction.

To assure budget restraint in 1984, the coalition parties have agreed that spending increases should be limited to 2 percent and borrowing should not exceed $16 billion. To help meet this goal, the

West Germany: Industrial Production



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cabinet last month approved reductions in benefits for the unemployed and imposed a pay freeze for public-sector employees through March 1985. On the revenue side, the coalition agreed that no new taxes will be introduced in 1984. In fact, Bonn is considering reductions in the corporate property tax and higher depreciation allowances. The government has given no hints as to how it would offset these tax losses.

The Bundesbank has gradually eased its monetary policy to help stimulate private investment. The central bank progressively lowered the Lombard rate (a facility that supplements discount borrowing) from 12 percent in October 1981 to 5 percent in March 1983; the discount rate was cut from 7.5 percent to 4 percent over the same period. Firms are now paying 8 to 9 percent for long-term funds instead of the 14 to 15 percent that prevailed in 1981. The Bundesbank monetary growth target is 4 to 7 percent, but the intervention required to

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support the French franc within the European Monetary System has caused a faster expansion. Given the fragility of the economic upturn, the Bundesbank has been reluctant to try to absorb the excess liquidity. Bank President Poehl has stated that the Bundesbank has gone as far as it can to bring down interest rates, given the high budget deficits in the United States and continued high US interest rates. We believe the recent strength of the US dollar and fear of rekindling inflationary expectations could force the central bank to bring monetary growth within the target range more quickly, even if it causes a temporary increase in interest rates.

Short-Term Outlook

Mild Domestic Upturn. We expect the upturn in investment that began in the first quarter to continue throughout 1983. Investment as a whole could register about a 3-percent gain, with construction—boosted by lower interest rates and government investment incentives—rising almost 4 percent. On the other hand, the revival in machinery and equipment investment probably will be weak until firms are confident that the domestic recovery has taken hold. Firms will look especially for signs that foreign demand has picked up significantly. Depressed equipment investment over the last several years has created a replacement need, not only because some facilities are old, but also because some are technologically outdated. If a world recovery develops, we expect equipment spending to make a strong rebound in 1984. Stockbuilding will probably not pick up until later this year when business activity increases.

Even with the strong rebound in the first quarter, we expect consumer spending to register a gain of under 0.5 percent for the year. Confidence in the recovery, the drop in heating oil prices that offset income losses somewhat, and the relatively mild winter probably account for the surprising first-quarter performance. However, shorter working hours and modest wage settlements—3.2 percent by the Metal Workers Union and the Chemical Workers Union and 2.6 percent by the steelworkers—have set the stage for limited pay increases and suggest that, for the third year in a row, West German workers could take a cut in real wages.

Moreover, reduced government transfers and the prospect of still higher unemployment will further dampen consumer behavior. Unemployment—more than 9 percent in May—will remain high throughout 1983, in part due to the unusually large numbers of new entrants to the labor force. According to Bonn's calculations, real GNP growth needs to reach at least 2.5 percent before unemployment will begin to decline. Officials anticipate that unemployment this year will average 2.35 million and possibly reach 2.8 million—10.4 percent—during the winter.

A particularly bright spot in the joint institutes' forecast is the falling inflation rate. Inflation peaked at more than 6.5 percent in the fall of 1981 and is currently 3 percent. We, along with the institutes, believe that reduced oil prices, modest wage hikes, and low levels of capacity utilization could keep inflation at the current rate for at least the rest of the year.

The External Account. Neither Bonn nor private West German economists expect much stimulus from the foreign sector this year. The economic institutes see exports holding at last year's level while imports pick up slightly in response to the domestic recovery. Export prices should rise moderately while import prices continue to drop slightly. The institutes estimate the current account surplus could more than double in 1983 to $7 billion.

We estimate, however, that exports, equivalent to 25 percent of West Germany's GNP, will grow slightly faster than the 2-percent growth generally projected for world import demand. Lower oil prices will not only hold down West Germany's import bill, but they will have a positive impact in most of West Germany's industrial trading partners—a group that buys almost 80 percent of West

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German exports. On the negative side, the strong mark, boosted by the March revaluation within the European Monetary System, will hurt West Germany's competitiveness in some major European markets—particularly France.

Import volume should pick up slightly as the domestic economy recovers—growing 1.4 percent this year compared with about 0.8 percent last year. The recent strength of the dollar will offset some savings from oil price cuts; nonetheless, exports in value terms will be substantially larger than imports, the difference contributing to most of the expansion in GNP and swelling the current account surplus to over $10 billion.

Among the uncertainties about West German export performance are the impact of international debt problems, falling incomes of oil exporters, protectionism, and policy adjustments in France. Our model of the West German economy shows that GNP growth is quite sensitive to changes in world demand. If world import demand expands by less than 1 percent instead of the 2 percent we have assumed, the West German GNP growth rate would fall by half, fixed investment would slow, and machinery and equipment investment would actually decline slightly. Even with export growth held to 1 percent, however, the current account surplus still would reach about $8 billion.

Clouds on the Policymaking Horizon

Chancellor Kohl apparently is banking both on the global recovery and on his ability to foster business confidence through facilitating the growth of business profits. However, if the redistribution of national income away from wages toward profits is too pronounced—especially in the face of continued high unemployment—some labor militancy could result.

For Kohl to retain public support for his belt-tightening measures, progress in creating jobs will be necessary along with some evidence that labor is not bearing all of the burden of economic adjustment. In general, Kohl will not ignore labor's concerns: labor's moderation and good working relations with business and government have been instrumental in West Germany's postwar prosperity. Moreover, Kohl will not want to offend the Christian Democrats' growing labor constituency, or challenge the consensus in West Germany that a certain level of social-welfare spending is desirable.

Some unions have publicly opposed the government's economizing efforts, especially the proposed delay in the cost-of-living increases for pensioners, and have threatened "clashes" if this measure is implemented. Moreover, both the West German Trade Union Federation (DGB) and industry leaders are demanding new subsidies for the ailing steel and shipbuilding industries. The DGB claims that a cut in the subsidies would lead to more job losses. Acquiescence in either demand would undermine Bonn's budget goals. Despite Finance Minister Stoltenberg's adamant defense of the need to maintain austerity for several years, the government may have reached the limits of this approach.

With unemployment running somewhat higher than had been anticipated when the current budget was drafted, Bonn may have to soften its stance. The opposition, which has labeled the government's course as long on principle but short on specifics, is calling for stimulus in the form of additional job creation programs. Because of his political commitments, the widespread consensus that financial order must be restored, and the current weakness of the opposition, we do not believe Kohl will soon abandon fiscal austerity. Instead, he might advance the time schedule for public works projects in 1984. Apparently Bonn is already speeding up by six months such projects incorporated in this year's budget. With unemployment expected to worsen and some major industries still in serious trouble, Kohl and his financial planners ultimately may be forced to consider some further stimulus in the form of a supplemental budget late in the year.

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Foreign Labor in the USSR [1]

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Most of the estimated 135,000 foreign workers in the USSR come from Communist countries and are employed primarily on construction and timber cutting projects in remote areas of the USSR. The economic impact of foreign labor in the USSR has been commensurate with its small share of the Soviet labor force. Even in construction and timber it accounts for a very small proportion of total employment. Foreign workers in the USSR are generally volunteers, despite rumors among Vietnamese refugees that their countrymen are there as forced labor. By exporting labor, Communist countries are in effect bartering manpower for goods, including energy and raw materials that might be much more expensive if obtained elsewhere. In our view, labor shortages in the primary labor exporting countries of Eastern Europe, as well as possible Soviet concern for the political consequences of allowing foreigners within Soviet borders, will continue to limit the use of foreign labor in the USSR.

Foreign Workers in the USSR in 1982 [a]

Country	Estimated Number of Workers
Total without Vietnamese	**115,500**
Total with 20,000 Vietnamese	**135,500**
Total with highest estimate of Vietnamese	**365,500**
Communist countries	
Bulgaria	50,000
Czechoslovakia	10,500
East Germany	7,000
Hungary	1,500
North Korea	10,000
Poland	11,000
Romania	500
Yugoslavia	2,000
Vietnam	5,000-250,000
Other	13,500
Western countries	
Finland	7,000
Other	2,500

[a] Maximum number of foreign workers believed to have been in the USSR at any time in 1982.

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The Estimate

Neither the Soviet Government nor other Communist governments sending workers to the USSR publish figures on the number of foreign workers in the Soviet Union. Our estimate, which is based on fragmentary evidence and is intended primarily to provide a proper order of magnitude, indicates that in 1982 there were about 135,000 foreign workers in the USSR. The principal source of uncertainty is the wide range of figures—5,000 to 250,000—provided in several conflicting reports on the number of Vietnamese workers in the USSR. We believe the actual total is near the lower end of the range—between 10,000 and 20,000. Even in the unlikely event that the upper end of the range were correct and there were 365,000 foreign workers in the USSR, the share of foreign labor in the work force would still be only about one-fourth of 1 percent.

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The largest contingent of foreign workers now in the USSR is probably from Bulgaria. At a private US-Soviet seminar in January 1982, the director of

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the World Economics and International Relations Institute in Moscow stated that there were 50,000 Bulgarians working in the Soviet Union. Most of the remaining workers come from the other East European countries, North Korea, Vietnam, and possibly Cuba. Less than 10 percent are from Western countries, mainly Finland.

Soviet Motives in Using Foreign Labor

The Soviet Union has used foreign labor to:

- Facilitate construction work. Foreigners are sought in large measure to provide labor for construction projects in forbidding and remote areas of the country where it is difficult to attract Soviet workers.
- Help assimilate imported plant and equipment. A small number of highly trained technicians, generally though not exclusively from Western countries, are hired to ensure that the facilities operate according to specifications and to instruct the Soviets in their use.
- Help keep the USSR's external financial accounts with other Communist countries in balance. Foreign labor services can be used to pay for current Soviet exports of goods and services, for future deliveries, or to repay debt, and the Soviets frequently prefer to import labor as the balancing item or as payment for future deliveries.

So far, the Soviets do not seem to have relied on foreign labor to help relieve the general labor shortage they have been experiencing in recent years. The number of workers imported has been too small and the uses of these workers too restricted to have served that goal. Even where most foreign workers are concentrated—the timber and construction industries—they do not constitute a large share of total workers. In 1982 foreign timber workers were slightly over 1 percent of the overall timber labor force of 2.5 million. For construction the figure was slightly less than 1 percent of 11.3 million.

The best examples of major construction projects in which foreign workers have participated have been the joint investment projects with other CEMA countries. The largest of these was the Orenburg pipeline, begun in 1974 and completed in 1979. Although East European countries provided only one-half the number of workers they originally promised and also reneged on commitments to furnish skilled labor, participation was substantial. In 1977, for example, according to a Soviet newspaper, a total of 13,550 workers from Czechoslovakia, East Germany, Hungary, and Poland were employed on the project. Other Soviet construction projects employ mainly Bulgarians.

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The timber settlements in which foreigners work are located in remote areas of the country. Since 1967, roughly 7,000 to 10,000 North Koreans have been cutting timber in the Soviet Far East for export to North Korea. In 1980 some 19,000 Bulgarians also were cutting timber in Siberia,

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For supplying labor, the countries participating in the forest projects retain part of the timber, 40 percent in the case of the Soviet-Bulgarian timber agreement.

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Western technicians have participated in major projects such as the construction of the Tol'yatti automobile plant and hotels for the Moscow 1980 Olympics. American, Italian, West German, and French technicians helped build the Kama River truck factory. US companies also participated in construction of the Orenburg gas pipeline and various chemical plants. Recent or current projects using Western technicians include:

- Construction of the Kostamuksha town and mining complex in Soviet Karelia by Finnish construction workers.
- Construction of the Novolipetsk and Kursk steel plants, with the help of French and West German technicians.

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Researchers from CEMA countries are also partic-

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Researchers from CEMA countries are also participating in projects conducted at joint research institutes such as the International Center for Scientific and Technical Information, the CEMA International Institute of Economic Problems, and the Institute for Atomic Physics in Dubna near Moscow.

Why Other Countries Supply Labor to the USSR

Most Communist countries and Finland provide manpower to the USSR as payment for present or future deliveries of goods, notably raw materials and energy. For example, in return for work on the Orenburg pipeline, the five East European countries that participated are each guaranteed annual supplies of 2.8 billion cubic meters of gas over a 20-year period; a portion is to be supplied by the USSR free of charge, according to a Western article on the project. Finnish construction services and other exports are credited against imports of Soviet raw materials and goods, particularly oil, natural gas, electricity, and lumber.

It is difficult to determine whether a country is getting a good deal by exporting workers in return for Soviet resources; data on the terms of these goods for labor exchanges are not available. Many countries trading on bilateral accounts with the USSR would find it difficult to pay hard currency for much-needed energy and raw materials if they turned to Western suppliers. On the other hand, some of the East European countries that are short of labor face a substantial cost in lost production resulting from the export of workers.

Conditions of Work

East Europeans and North Koreans. Questions of selection and compensation of workers and labor codes are decided beforehand in agreements between the USSR and the country or firm supplying the labor. The home country is responsible for hiring individual workers or groups of workers, according to a Hungarian emigre study.

Foreign workers are offered substantial material and financial benefits to work in the USSR since the conditions under which they labor are frequently harsh. Food is cheap, medical care free, and lodging is available either free or for a nominal rent. Wages are higher than in their native countries and often higher than Soviet pay rates. Payment is made either in rubles, in the worker's home currency, or in special checks denominated in dollars entitling the user to shop at stores closed to ordinary consumers; the last two forms of payment are supplemented by a ruble per diem.

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Contact between foreign workers in the USSR and the local populace is often limited. Foreign workers are not allowed to travel freely in the USSR, and they live apart from the populace. The higher wages paid foreign workers and the more favorable living standards enjoyed by the foreigners in their home countries could lead to discontent among Soviet nationals. Soviet leaders also may hope to prevent "political contamination" of the populace.

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Despite the substantial financial and material incentives offered, some countries, especially the more affluent East European nations, find it difficult to recruit and retain laborers for work in the Soviet Union. 50 percent of the Bulgarians who signed on for work did not stay to fulfill their two-year contract.

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Vietnamese Workers. The USSR recently began importing Vietnamese workers on a substantial scale under labor cooperation agreements signed in early 1981. Despite Soviet claims that the current program is a training program, the Vietnamese Minister of Labor in the Vietnamese press referred to it as "a new form of labor cooperation," distinct from earlier programs. A refugee whose friend escorted workers to CEMA countries said that Vietnam initiated the export program in order to:

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- Pay back foreign aid debts to the USSR and East European countries.
- Resolve unemployment problems in Vietnam by sending Vietnamese abroad.

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- Lessen the impact of food shortages by having fewer people dependent on the consumer market.
- Bring in foreign exchange.

The information available indicates that the use of Vietnamese workers differs from that of other groups of foreign workers in three respects—the kinds of industries in which Vietnamese work, the wages paid, and the length of stay in the USSR. According to Soviet and Vietnamese labor officials, Vietnamese are working in Soviet enterprises producing textiles, chemicals, and machinery as well as in irrigation, land reclamation, coal mining, and construction. This may reflect the Vietnamese Government's desire that Vietnamese youth learn skills that will be useful when they return to Vietnam. To date, however, we have no evidence that Vietnamese are helping to construct oil or gas pipelines in the Soviet Union.

Contrary to East European experience and Soviet press reports that wages of Vietnamese workers equal those of their Soviet coworkers (and therefore are less than those of other foreign workers), portions of the wages earned by Vietnamese workers are being withheld in repayment of Hanoi's debt to the USSR, according to diplomatic, refugee, and other reports. The Vietnamese Government collects a portion of workers' wages in the form of a tax that is used to pay Hanoi's import bill to the Soviet Union. The size of the reduction made for debt repayment is not known—estimates from these reports range from 30 to 70 percent.

A review of the often contradictory evidence indicates that Vietnamese workers are not coerced into working in the Soviet Union. For its part, the USSR probably would be reluctant to accept a large number of "politically unreliable" workers, if only because of the difficulty of totally isolating workers from the local populace. Diplomatic, refugee, and other sources who have obtained their information directly from participants or officials involved in the Vietnamese labor cooperation program say that it is voluntary. These reports seem on balance more reliable than the reports—largely based on rumor—that the program is involuntary. The export program reportedly is popular with Vietnamese as a means of legally escaping unemployment and the low standard of living in Vietnam; selection apparently is limited to reliable Vietnamese. Vietnamese families are eager to have family members go abroad and send home consumer goods that are in short supply in Vietnam or can be sold on the black market. Young Vietnamese reportedly often bribe their way into the program.

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Prospects

We doubt that tightening labor conditions in the USSR will lead to a significant increase in the use of foreign labor—either in the short or long term:

- The USSR's ability to increase its foreign labor force is restricted by labor shortages in Eastern Europe. Only Vietnam has a domestic economic situation conducive to shipping labor abroad.

- The Soviet regime would probably oppose large-scale expansion of labor from abroad, primarily because of the potential that guest workers have for causing discontent among the local populace. (U)

The largest increment in foreign workers during the 1983-85 period will come from Vietnam. Refugee reports and Western press statements suggest that the number of Vietnamese could reach a few hundred thousand by 1985, but based on more reliable reports from Vietnamese and Soviet officials and refugees connected with the program, we think it much more likely that the number will not exceed 100,000.

The largest increase in non-Vietnamese workers in the next two or three years could come from East Germans working on the West Siberia–Western Europe natural gas pipeline. However, joint CEMA projects in the USSR planned for the 1981-85 period are using no more, and possibly even fewer, foreigners than projects under way during the 1970s. Therefore a large net increase in non-Vietnamese foreign workers is unlikely.

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