



Directorate of  
Intelligence



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**International  
Economic & Energy  
Weekly** 

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23 September 1983

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23 September 1983

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**International  
Economic & Energy  
Weekly** [Redacted]

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*Comments and queries regarding this publication are welcome. They may be directed to [Redacted] Directorate of Intelligence, telephone [Redacted]*

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**International  
Economic & Energy  
Weekly** [redacted]

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**Synopsis**

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**Perspective—*Restive Banks*** [redacted]

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As the international financial crisis drags on into its second year, many financial analysts believe it will be increasingly difficult to maintain the cooperation of the hundreds of small banks with loans to LDCs—a necessary ingredient for the smooth resolution of debtors' financial problems. [redacted]

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**IMF/IBRD Annual Meeting: Key Issues** [redacted]

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This year's IMF/IBRD meetings are likely to be dominated by discussions of IMF conditionality, IMF funding, and a new issue of Special Drawing Rights. [redacted]

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**Eastern Europe: Facing Up to the Debt Crisis** [redacted]

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Most of Eastern Europe has withstood the severe credit crunch that began in 1980, but the region remains financially vulnerable. [redacted]

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**LDCs: Worst Economic Performance in Three Decades** [redacted]

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After three decades of strong economic performance, the LDC's growth has come to a near standstill in the past few years. Real GNP growth in 1981 and 1982 was the lowest of the past 30 years, and we expect little or no improvement this year. [redacted]

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**South America: The Export Challenge** [redacted]

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For the third successive year, faltering exports are impeding South American economic growth and eroding debt servicing capabilities. Moreover, the likely failure by South America to increase export earnings in 1984 will seriously aggravate debt servicing difficulties and endanger rescheduling agreements and IMF programs. [redacted]

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**Perspective****Restive Banks**

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As the international financial crisis drags on into its second year, many financial analysts believe it will be increasingly difficult to encourage any new lending from the hundreds of small banks with loans to LDCs—a necessary ingredient for the smooth resolution of debtors' financial problems. So far, tensions among banks with different size, exposure, flexibility, and corporate strategies have generally been kept within the banking system and out of the courts. This situation may change as smaller banks become more frustrated with carrying risky or nonperforming loans on their books and increasingly disinterested in international business.

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The large role played by smaller US banks in lending to LDCs is a fairly recent phenomenon. As the structure of LDC external financing shifted from predominantly official credits in the 1960s to predominantly commercial bank credits in the 1970s, the smaller banks saw profit opportunities in the Third World and enhanced prestige in the banking community by riding the coattails of the large international banks in their overseas operations. The smaller banks joined in syndicated loans managed by the large banks or bought into parts of loans held by them. In Mexico, Brazil, Venezuela, and Argentina, US banks smaller in size than the top 24 account for about 20 percent of total US bank exposure of \$65 billion.

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The smaller banks' concerns about their exposure in debt-troubled LDCs were heightened by Argentina's Falklands-related financial crisis in early 1982. They were the first to sharply curtail new lending to Mexico and other Latin American countries, and to refuse to roll over short-term loans or refinance medium- and long-term loans. The major banks recognized early on that the smaller banks were weak links in any extensive debt restructuring effort.

The smaller banks have raised a number of complaints about their subordinate role:

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- They point to what they believe is unjustified pressure by the International Monetary Fund and the Federal Reserve to continue lending to countries experiencing debt repayment difficulties.
- They resent the tendency of financial rescue programs to stretch out principal repayments on short- and medium-term loans, locking them into maturity positions far beyond their original intentions.

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- They feel left out of key decisions on loan restructuring and report they are often informed of decisions by syndicate managers or bank advisory groups only after the fact.

Executives at major international banks generally respond that the smaller banks have been happy enough to enter profitable markets in a subsidiary role when the going was good and should now temper their complaints at a time of adversity. [redacted]

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The smaller banks' entry into international lending was often influenced by the desire to exploit the prestige of closer links with the money center banks. Now, however, the managers of the smaller banks are more concerned with the attitudes of their directors and shareholders than with their relationship with bigger banks in the colder climate of debt restructuring. Indeed, there is growing concern among smaller banks about shareholder law suits regarding high-risk loans, which would certainly reduce bank participation in any additional lending to LDCs, especially if banks' domestic business prospects improve with US economic recovery. [redacted]

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So far, most smaller banks have not fought the desires of the IMF, the Federal Reserve, or the large banks to go along with debt restructuring—probably because of coercion, powerlessness, or a sense of group responsibility. Most of the key LDC debtors are in “technical default” for violating their loan contracts. In order to force legal action, however, creditors must choose to declare the debtor in default. For syndicated loans, creditors holding usually a simple majority of the loan amount must vote to declare a default. Thus, most syndications are safe in that smaller banks do not carry enough votes on any one loan to force a default. [redacted]

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The smaller banks are now showing signs of greater restiveness. The Michigan National Bank of Detroit filed suit last month to recover from Citibank its \$5 million share of a \$45 million syndicated loan to Mexico. The Michigan bank claims that Citibank extended the repayment schedule on the loan without its agreement. While the suit will not come to court for some time, bankers were surprised at the break in ranks and are worried that the action could set a legal precedent for small banks that want to force large banks to either buy out their loans or call a debtor country in default. [redacted]

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More recently, Venezuela's failure to pay past-due interest on its private-sector foreign debt, despite over \$10 billion in reported foreign exchange reserves, is pushing banks closer to a tougher stance that could risk formal default. The US Embassy reports that a source on the bank advisory committee for Venezuela fears that regional banks will balk at further extensions of Venezuela's deferred payments on public-sector debt and will seek court authorization to attach Venezuelan assets abroad. The Venezuelan Government incorrectly assumes, said one banker, that the advisory committee can hold in check the more than 400 smaller banks with loans outstanding in

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Venezuela. An episode earlier this year involving Venezuela's failure to pay creditors on time was quietly resolved out of court; this time the danger of more severe legal action is greater because the banks' level of dissatisfaction is higher. Moreover, the smaller banks are joined in their frustration by Wells Fargo, the 12th-largest US bank, which manages some \$900 million in loans to Venezuela. While Venezuela's situation may be unique, bankers—large and small—will be watching the outcome carefully.

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## Briefs

### Energy

#### *OPEC Production Quotas Reaffirmed*

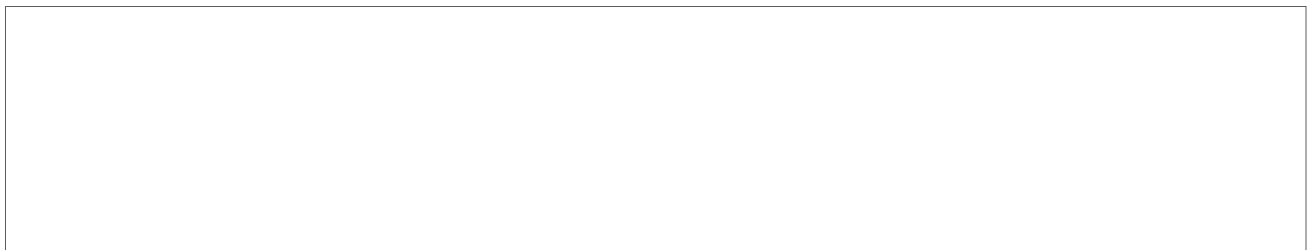
OPEC has decided to postpone until at least late next month any move to raise its ceiling on crude oil production of 17.5 million barrels per day, despite widespread cheating and requests from several members for larger quotas. The organization's market monitoring committee concluded at a meeting last week that the market is too weak to support an increase in production. Saudi Arabia's efforts to export more crude have particularly contributed to recent weakening of spot prices. The Saudi increase, combined with higher Iranian production, has pushed OPEC production above 18 million barrels per day since the beginning of July. [redacted] 25X1

The Saudis have no quota but are responsible for adjusting their production to keep overall OPEC production at 17.5 million barrels per day. Recent increases in Saudi production probably are intended to prevent other producers from increasing their output, to dampen price pressures in the spot market, and to earn additional revenues. Riyadh is concerned that an increase in OPEC quotas now would leave the cartel ill prepared for the seasonal drop in demand early next year. [redacted] 25X1

#### *Sabotage of Nicaraguan Oil Import Terminal*

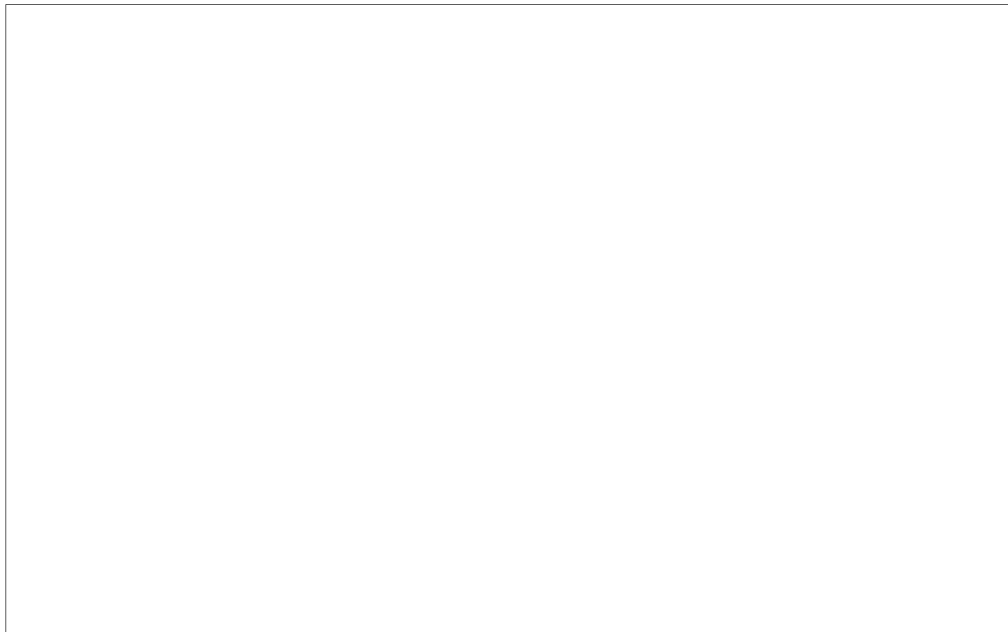
Managua admitted that last week anti-Sandinista insurgents sabotaged all five mooring buoys at Puerto Sandino, the country's only crude oil import terminal. Divers have already found two of the sunken buoys. Total repair costs are expected to exceed \$1 million. Meanwhile, some crude oil shipments have been postponed, and refinery operations have been reduced from 10,000 to 7,500 barrels per day to conserve the estimated 15-day supply of remaining crude. [redacted] 25X1

It will take at least four to six weeks to order, import, and install new buoys—and possibly longer if damage to piles or pipelines requires underwater welding and leasing of a pipelaying barge. The refinery in Managua could be forced to close temporarily if barges are unable to haul enough crude to shore to sustain refinery operations. Refined product, however, can still be offloaded at Corinto. Nicaragua already rations gas, but the government may have to institute additional restrictive measures. [redacted] 25X1





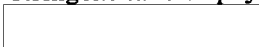
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*Transcanada Pipelines  
Renegotiates Gas  
Contract*

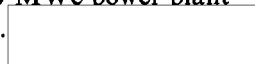
Transcanada Pipelines, a major gas transmission company, has tentatively agreed to reduce the required minimum volume in one of its seven contracts with US pipeline companies. As amended, the contract will require purchases of at least 1.8 billion cubic meters (bcm) annually, rather than the original requirement of 2.6 bcm. The firm is Canada's largest exporter of natural gas to the United States with contracts covering about 30 percent of Canadian gas exports. Given the current oversupply of gas in the United States, we expect other Canadian gas transmission companies to also consider relaxation of stringent take or pay provisions in gas supply contracts in coming months.



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*Possible West German  
Purchases of French  
Electricity*

The governor of Baden-Wuerttemberg has directed two West German utilities to begin negotiations with Electricite de France (EDF) toward concluding a long-term electricity supply agreement. In informal discussions with EDF, the German utilities have offered to purchase for a period of over 10 years electricity equivalent to the output produced by a 400-megawatt-electric (MWe) power plant. If an agreement can be reached, it would be the first long-term electricity supply agreement between the two countries. Faced with continuing sluggish demand for electricity, the West German utilities would use the imported electricity to replace scheduled output from the Wyhl nuclear plant—a 1,300-MWe plant, which the governor of Baden-Wuerttemberg proposes to postpone indefinitely. For its part, France has encouraged EDF to attempt to export up to 20 terawatt-hours of electricity per year—equivalent to electricity generated by a 3,800-MWe power plant—in an effort to more fully utilize French nuclear capacity.



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*Yugoslavs Raise  
Oil Prices*

Belgrade last week increased wholesale prices of petroleum products by an average of 35 percent and retail prices by 25 to 30 percent. Similar increases were implemented last April. Officials claim the increases are necessary to meet higher costs of imported oil that resulted from the 44-percent depreciation of the dinar in the first half of 1983. Oil prices will continue to rise as long as the regime—to ensure export competitiveness—follows a policy of gradually devaluing the dinar [redacted] 25X1

The price increases will fuel inflation both by raising the cost of oil products and of goods that use oil in production. Although the higher prices will curb oil demand somewhat, they will not eliminate present shortages—which are due to a rapid drop in crude imports resulting from an acute shortage of foreign exchange. The higher prices will, however, ease the financial burden on refineries, which are earmarked to receive 25 percent of the additional revenue generated by the price increase. [redacted] 25X1

*Esso Seeks Contract  
Revision From  
Pertamina*

According to Embassy reporting, Esso Natuna will seek agreement from Pertamina—Indonesia's state oil company—to amend its contract to postpone gas exploration and development at its offshore contract area near Natuna Island, without relinquishing its rights to the area. According to industry estimates, the Natuna Island area may have natural gas reserves of 2 trillion cubic meters (tcm), but disposal of the estimated 5 tcm of carbon dioxide found in the reservoir make exploitation costs extremely expensive. Esso has been engaged in a four-well drilling program to determine the commercial viability of the gasfield and reportedly believes that, given current gas market conditions, Japan would be the only market large enough to support the investment necessary to continue development. Based on present supply commitments, however, Japan faces a potential surplus of LNG of nearly 6 billion cubic meters in 1990—the year Esso must declare the field commercial or relinquish its concession to Pertamina under current contract terms. [redacted] 25X1

*Syria Closes Refinery*

[redacted] Syria's refinery at Baniyas—with an annual capacity of 120,000 barrels per day—was closed on 12 September 25X1 because of a shortage of Iranian light crude. The refinery needs Iranian Light to blend with its domestic low-gravity, high-sulfur crude to create a mix suitable for domestic use and export. Syria reportedly has been involved in a dispute over the last 18 months with the charter transport company Polyventor that delivers the Iranian oil. The Syrians claim the company has not fulfilled contract volumes and that the oil delivered contains salt that corrodes Syria's refineries. Damascus consequently has delayed payment to the company for the past several cargoes, causing Polyventor to renege on delivery of about 25X1 8,000 b/d of crude to Baniyas. Operations of Syria's other refinery at Homs have also been affected by the shortage of Iranian Light crude [redacted]

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**International Finance**

*Status of Polish Debt Rescheduling*

The US Embassy in Paris reports that Poland's Western government creditors reluctantly agreed last week only to reaffirm the decision made in July to move ahead in principle with rescheduling. They had expected to agree to open negotiations with the Poles by mid-October—a timetable that now has slipped at least a month. Austria, Switzerland, and Sweden are increasingly impatient with the delay. Meanwhile, the US Embassy in Warsaw reports that Austria has approved a \$30 million guarantee for grain financing, the first new government-guaranteed credit for Poland since martial law. [redacted]

The delay probably prevents substantial progress from being made on rescheduling government debt before the end of the year. Allied creditors generally have supported Washington's go-slow approach, and the neutrals have not been able to develop a strategy of their own. Brazil has even asked to join the Western creditors, after failing for two years to get some payments on its \$1.8 billion credit in bilateral negotiations with Warsaw. [redacted]

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*Continued Disagreement in EC Over Export Credits*

Because of the hard line taken by Paris, the EC so far has been unable to formulate a joint approach for the OECD negotiations next month on export credits. [redacted] West German Chancellor Helmut Kohl has rebuffed French President Francois Mitterrand's recent attempts to enlist help in forming a common EC front against the United States and other OECD participants who want to dismantle export credit subsidies. A French EC representative has told US officials that unless Finance Minister Jacques Delors is offered at least "face-saving" concessions, he cannot back away from the French position that calls for reductions of 1.5 percentage points in the OECD consensus interest rates. Although interest subsidies are a strain on the French budget, Paris believes they help assure French export competitiveness. Without a unified EC position, the OECD negotiations could be postponed, resulting in still another extension. [redacted]

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*Deteriorating Israeli Credit Rating*

US bankers, [redacted] are becoming increasingly cautious about their lending to Israel. Although the level of concern varies among the bankers, they appear to be worried about persistent triple-digit inflation, the growing trade deficit, and the possibility of a future debt rescheduling. [redacted]

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[redacted] Israeli officials, faced with a rapidly growing financial gap over the next few years, may not be able to borrow the commercial funds that would be required to avoid a drawdown of foreign exchange reserves and will probably look to the US Government for additional aid on better terms. [redacted]

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*Moroccan IMF Loan  
Approved*

The recently approved \$315 million IMF standby loan for Morocco will provide badly needed support and should expedite its debt rescheduling. Discussions between commercial creditors and the government over \$500 million of commercial debt payable through December 1984 are progressing more swiftly than earlier expected, according to Embassy reporting. In addition, the Paris Club will consider rescheduling Morocco's official debt at an upcoming meeting. Terms of the Paris Club rescheduling have not been revealed, but the total amount probably will exceed \$500 million. [redacted] 25X1

**Global and Regional Developments**

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*Soviet Purchase of  
Canadian Gas  
Equipment*

[redacted] The Canadians already have delivered \$10 million worth of workover rigs, valves, and other equipment, and preliminary negotiations for another \$3 million in equipment for the project reportedly have taken place. The Soviets have asked that all the equipment ordered so far be delivered before the end of the year. [redacted] 25X1

The Canadians have been anxious to broaden their participation in the Astrakhan project, hoping that contracts with the Soviets will help establish Canada as a leading international supplier of oil and gas technology. Canada already enjoys a favorable trade balance because of its agricultural exports to the USSR. Nonetheless, it would like to increase its sales of manufactured goods. The Astrakhan project could bring Western equipment suppliers as much as \$1.5 billion in Soviet orders. The Soviets plan to begin producing gas next year and hope—optimistically—to reach full capacity production of about 6 million cubic meters of gas and 3 million tons of sulfur annually by 1986. The Soviets have bought some equipment from the French—who are managing construction of the project—and from the West Germans, [redacted] 25X1

*Tokyo To Support a  
Second Steel Complex  
in South Korea*

Tokyo has reversed an earlier decision and now favors providing financial and technological support for a second Posco steel mill complex in South Korea. Although Japanese steel companies participated in the first steel mill, they had been reluctant to respond to Korean requests to assist the second project for fear of creating more competition that would cut further into their profits. The proposed \$2.3 billion steel mill, which is scheduled for completion in 1988, would have an initial capacity of 3 million metric tons per year. [redacted] 25X1

Following ministerial talks with the Koreans in August, Prime Minister Nakasone persuaded Japanese steel executives to participate. [redacted] Nakasone believes the project will help build better economic relations with South Korea over the long term. Nippon Steel has agreed to sell new technology for the proposed plant, [redacted] 25X1

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[redacted] Tokyo will likely offer some financial help. An additional factor in Tokyo's decision has been the lobbying efforts of Japanese construction firms and machinery manufacturers, who have been suffering from a worldwide economic slump and feared that contracts on the proposed plant might go to European competitors [redacted]

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*Soviet Soda Ash Production Problems*

[redacted] the USSR during the early part of 1983 experienced severe technical difficulties in the production of soda ash—a chemical commodity used primarily in the manufacture of glass, other chemical compounds, and soap. Because of domestic production shortfalls, the Soviets have turned to Eastern Europe—the world's major soda ash producing and exporting region—as well as the United States and have withheld soda ash shipments from a number of their own customers. Major purchasers of Soviet soda ash are Italy, Cuba, Finland, and Czechoslovakia. Recent shortages of soda ash contrast sharply to Soviet dumping in 1982, which led to the imposition of duties by the EC. Argentina and China, traditional East European customers, have turned to the United States and other sources for much of their soda ash. US companies recently have been faced with underutilized capacity because of declining worldwide demand for soda ash.

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*Indian-Soviet Trade*

The USSR agreed this month to sell India 20,000 b/d of crude oil in 1984 in addition to the 50,000 b/d it will supply under a long-term contract. This deal, similar to one signed last July for delivery in 1983, is intended to reduce the Indian bilateral payments surplus, which led Moscow to curtail purchases of Indian goods during the past year. The oil agreement reflects some concessions on both sides to help revive bilateral trade. The Soviet Union has been pushing India to diversify its imports, now about 80 percent petroleum, by buying more Soviet machinery and equipment, but New Delhi has continued to resist pressure to buy inferior capital goods. Although New Delhi could have obtained crude oil at a slightly lower price by avoiding Soviet intermediaries and negotiating directly with Middle Eastern suppliers, we believe India is willing to increase total purchases from the Soviet Union so that Moscow will have the rupee earnings to buy more from Indian exporters. [redacted]

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**National Developments**

*Developed Countries*

*Fujitsu First To Mass-Produce 256K RAMs*

Fujitsu has become the first Japanese firm to mass-produce the next-generation memory device, the 256K RAM. Fujitsu is several months ahead of its Japanese competitors such as Hitachi and Mitsubishi, who are still in the sampling stage. According to the Japanese press, Fujitsu produced 100,000 256K RAMs in July. [redacted] Fujitsu's July production rate and predicted Fujitsu would reach its goals of 300,000 units

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per month in October and 1 million per month by March 1984. Traditional US suppliers to the open market are further behind Fujitsu than are its Japanese rivals. Two US firms are about to deliver their initial samples for customer testing—a process that usually takes about six months—while most have yet to start sampling. A third major US maker, which has just initiated a policy of open-market sales and is capable of matching Fujitsu's current production level, is heavily committed to meeting internal requirements and is not expected to be a market competitor to Fujitsu before 1984. [redacted]

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### *Less Developed Countries*

#### *Mexico Announces New Guidelines for Automobile Industry*

With output of cars and trucks cut by nearly 50 percent this year because of the country's financial and economic problems, Mexico City has undertaken to streamline production and increase efficiency in its automobile industry as well as save foreign exchange. Under the new regulations, each manufacturer will be restricted to a single car line with no more than five models by 1987. In addition, eight-cylinder engines in cars and small trucks are banned, production of heavy trucks is reserved for majority Mexican-owned companies, and 25 percent of cars must be austere models without "superfluous accessories." The decree also tightens local content requirements and calls for balanced trade between both Mexican subsidiaries and their parent firms and domestic component producers and their foreign suppliers. [redacted]

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According to Embassy reporting, business and labor leaders have reacted negatively. Most manufacturers will have to extensively retool production and forfeit their most profitable lines, while labor leaders expect the new decree to eliminate jobs. US subsidiaries will be harder hit than their European and Japanese counterparts because they produce a greater variety of cars, including larger "luxury" models that are now discouraged. Subsidiaries that have established engine and automobile component plants, however, will be encouraged—because of cheaper pesos—to increase exports to parent companies and other affiliates. Moreover, the restrictions on model types may help local suppliers improve cost and quality by forcing concentration on a few standardized parts. The US Embassy reports that despite the new rules no manufacturer appears to be considering withdrawing from the Mexican market. [redacted]

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#### *Pakistani Disturbances*

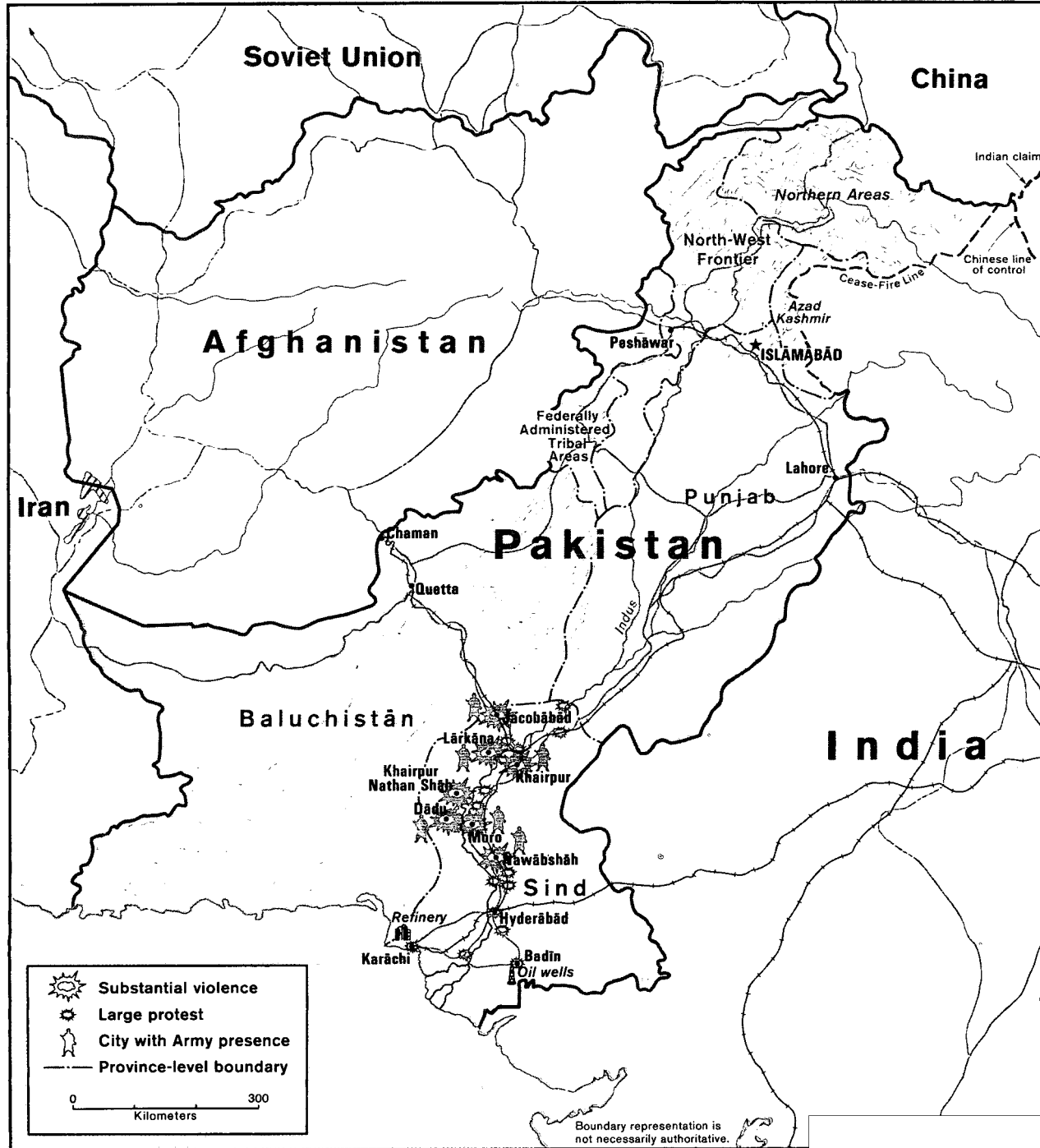
The antigovernment campaign begun last month by the Movement for the Restoration of Democracy (MRD) thus far has had only a small impact on Pakistan's economy and has been confined primarily to Sind Province. A Karachi newspaper reports that vegetable prices in the city have risen sharply because of the interruptions of highway traffic. [redacted] several trucks carrying crude oil from wells at Badin to the refinery in Karachi have been attacked and destroyed. Attacks on rail facilities have disrupted local service and resulted in some property damage. [redacted]

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Civil Disobedience



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Resentment by Sindhis, who believe that the Punjabi-dominated government in Islamabad has ignored their region's economic development and favored Punjabi settlers, has been a key issue in the protests in Sind. The relative prosperity of the country, however, due in large part to the record inflow of worker remittances, has made it difficult for the antigovernment forces to carry the demonstrations to other parts of the country. The anti-Zia campaign would get a boost, however, if imports of consumer goods and fuel were disrupted. Most imports enter the port of Karachi and are transported by road or rail through Sind to major population centers in the north including Islamabad and Lahore.

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*Suriname Unable To  
Secure Balance-of-  
Payments Assistance*

Suriname's recent attempt to secure \$200-300 million in loans from major British banks apparently has failed, in part due to the inexperience of the Surinamese negotiators and the need for detailed economic studies. This latest rejection follows similar rebuffs by a major US bank and the Inter-American Development Bank. Although Suriname's foreign reserve cushion remains relatively high, at three months' import coverage, the lack of significant austerity measures has contributed to more than a 30-percent drawdown in reserves so far this year. Prime Minister Alibux, already under pressure from the radical, pro-Cuban party, has claimed that his government would fall if it fails to unearth significant balance-of-payments support soon. Bouterse's confidence in Alibux's socialist party—reaffirmed last week—could weaken considerably should the suspension of Dutch aid continue through 1984—a prospect the regime unrealistically appears to ignore.

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*Argentine Meat  
Exporters Protest  
Government Policies*

In an attempt to pressure the government to change its tax and pricing policies, the Argentine Chamber of Regional Meat Packers last week suspended meat shipments to the Soviet Union, Argentina's largest export market. The exporters are demanding elimination of or a sharp reduction in the government's 20-percent "retention," a tax levied on earnings from farm-sector exports, and want subsidies to help them compete in international markets. The dispute will not, however, disrupt the world meat market in the near term because dampened demand has resulted in exportable surpluses and low prices. The action taken by the exporters also will have little impact on the USSR, which expects higher meat production this year and can readily make meat purchases elsewhere to make up for any lost Argentine shipments.

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*Ethiopian Austerity  
Measures*

Ethiopia has approved a severe austerity budget for FY 1984 and restrictive foreign exchange policies to counteract a deepening financial squeeze. The measures include a 10-percent reduction in the budgets of all ministries except Defense, a 40-percent reduction in development spending, a clampdown on luxury imports, and a 21-percent cut—\$40 million—in oil imports. We do not believe, however, these measures are sufficient to pull the country out of its economic nosedive. Growing apathy among peasants and civil servants, low agricultural producer prices, and the shortage of skilled manpower will further



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reduce economic growth during FY 1984. At the same time, Ethiopia's military expenditures continue to rise because of insurgent activities in the north. We believe these factors will force Mengistu to seek greater financial support from the Soviets and Libya, although relations with Tripoli are cool at this time. [redacted]

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**Communist****Soviet Grain Harvest  
Nearing Completion**

The grain harvesting campaign in the USSR is entering the final stages. The Central Statistical Administration reports that, as of 12 September, 101 million hectares—more than 80 percent of the total area—had been cut. Except for recent delays caused by rainfall in the northern parts of the grain region, the harvest has proceeded at an unusually quick pace. Moreover, the Soviet press indicates that the quality of grain harvested thus far is much better than last year. [redacted]

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Grain quality in the wet areas still to be harvested probably will be somewhat poorer. Even so, unless the rains continue unabated for the next few weeks, Soviet farmers should be able to complete the harvest with little loss in quantity. The amount of post-harvest straw residue [redacted] corroborates previous evidence that Moscow will harvest about 210 million tons of grain this year. Although a crop of this size would fall far short of the target of 238 million tons, it would be the fourth largest in history and the most since the record crop of 237 million tons in 1978. [redacted]

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**Moscow Cuts Retail  
Prices**

Effective 1 September, Moscow cut retail prices on a variety of consumer goods sold in state and cooperative outlets. Prices were reduced from 30 to 60 percent on selected models of black and white televisions, refrigerators, and mopeds, as well as on carpets, jewelry, and clothing. If these goods are sold at the lower prices, the price cuts, according to a Moscow radio report, will result in a savings to consumers of 3 billion rubles—about 1 percent of total retail sales in 1982, in current prices. [redacted]

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The price reductions probably are designed to reduce inventories of poor-quality items and goods that have saturated the market. Although data on inventory accumulation for 1982 are not yet available, the stagnation in growth of retail trade last year may in part be an indication that an abnormally large buildup occurred. The price cuts underscore a continuation of established retail price policies by the new leadership. Soviet industry for years has failed to produce a product mix to meet consumer demand, leading to accumulation of large stocks of unsold goods followed by periodic price cuts to reduce inventories. [redacted]

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*Romanian Miners'  
Strike*

More than 600 miners in the northern part of the country staged a one-day strike earlier this month to protest wage reductions resulting from failure to meet production quotas. The miners complained about inadequate food supplies, long working hours, and the requirement to perform agricultural tasks. Similar disturbances recently affected the Jiu Valley, the country's main coal mining area. President Ceausescu is insisting that his tough wage policy remain in force. [redacted]

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These are the largest confirmed worker disturbances since the rash of protests that occurred in 1980 and 1981. Discontent is widespread and could erupt into spontaneous protests. Ceausescu's effort to increase coal output by nearly 40 percent over last year to alleviate the energy shortage appears to be backfiring. The additional pressure on miners has already reduced their productivity.

[redacted]  
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*Hungary Hikes  
Food Prices*

Blaming "very serious" drought this summer, Budapest this week ordered an immediate increase of 16 to 23 percent in retail prices of sugar, cooking oil, bread, and other basic foodstuffs. Government spokesmen acknowledged that the austerity program for 1983 had forecast no further boosts in centrally fixed consumer prices, but stressed that they were now needed to help adjust for poor harvests. The new price hikes could push Hungary's rate of inflation into double digits; the overall consumer price index was already rising at an annual rate of 8.5 percent by midyear, compared with 6.9 percent in 1982 and 4.6 percent in 1981. [redacted]

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The abruptness of the announcement is out of character for the Kadar regime, which in the past has generally warned consumers well ahead of time of impending price increases. Indeed, when state purchase prices of foodstuffs were raised last January, Budapest reported its intention to keep the lid on retail prices. Since then, industrial production has slowed even further than planned, while domestic demand has remained higher than anticipated, complicating Hungary's ability to keep pace with the stabilization program worked out with the IMF. The price hikes, therefore, were probably motivated not only by supply problems but also by desires to reduce consumer subsidies, curb purchasing power, and safeguard food exports. We expect that the strongest resentment is likely to be felt by workers and pensioners who have not found a way to supplement their incomes in Hungary's large second economy. [redacted]

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*Higher Soviet Freight  
Rates*

Increases over the past year in Soviet rail freight rates on East-West container traffic over the Siberian land bridge—the Soviet-established rail artery across Siberia for international container traffic—may cost the Soviets much-needed hard currency. Container traffic earnings amounted to \$210 million in 1979, and the Soviets hope they will reach \$1.3 billion in 1985 when expansion of container facilities at the port of Vostochny are completed. The increased

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### Major Cities Served by Soviet Land Bridge



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charges consisted of the recission of a longstanding 10-percent discount rate for Japanese shippers and the addition of a 20-percent surcharge on Iran-bound containers. The USSR justified the rate hikes by a need to recover expenses incurred in expanding the container ship fleet operating on the Sea of Japan, adding storage space for stranded Iran-bound containers, and providing additional freight cars for swiftly expanding container traffic to Iran.

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The rate increases have evoked strong Japanese protests and demands for rectification. Tokyo trade firms place little value in Soviet claims that the surcharge would be lifted by early October when congestion problems at Vostochnyy are supposed to be resolved. Japanese shippers, who provide the bulk of the land bridge trade, have also been critical of Soviet information services that fail to keep them up to date on the precise location and status of their cargo. Japanese disenchantment with land bridge use comes at a time when independent Taiwanese nonconference sea-transport companies are undercutting both the land bridge rates and the rates set by sea freight conferences.

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**IMF/IBRD Annual Meeting:  
Key Issues**

The backdrop for the annual meetings of the International Monetary Fund (IMF) and the World Bank (IBRD) next week is one of increased tensions between creditor and debtor nations, concerns about the liquidity of the IMF itself, and pessimistic forecasts about the pace of LDC economic development. Although we do not expect any substantially new policy directions to emerge from the IMF/IBRD meetings that would ease international financial pressures, these sessions will set the tone for financial relationships over the next year.

**The Agenda**

Three themes are likely to dominate discussion at this year's annual meetings:

- LDCs and industrial countries alike will watch for any indication that the IMF is about to depart from its rigorous austerity demands imposed on borrowing countries. About 35 countries are currently undertaking IMF-mandated economic adjustment programs, often at the cost of rising political and social pressures.
- The IMF's own liquidity is an increasingly important issue. Demands on IMF funds by financially strapped LDCs are high, while several major contributors to the Fund have not met the quota increase authorized earlier this year.
- The third topic certain to surface at the annual meeting is the expansion of the IMF's reserve assets, the Special Drawing Rights (SDRs). Industrial countries have been concerned that expanding the supply of SDRs, which member countries can convert into hard currency, may rekindle global inflation.

**Top 20 LDC Debtors, 1982**

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	External Debt (billion US \$)	IMF Program
Brazil	85.4	Yes
Mexico	83.2	Yes
South Korea	37.2	Yes
Argentina	36.7	Yes
Venezuela	33.7	
Indonesia	23.5	
India	21.5	Yes
Egypt	21.5	
Chile	18.3	Yes
Algeria	17.2	
Philippines	16.2	Yes
Peru	11.7	Yes
Thailand	11.1	Yes
Pakistan	10.3	Yes
Morocco	10.1	Yes
Nigeria	10.0	Imminent
Malaysia	9.9	
Taiwan	9.7	
Colombia	9.3	
Ecuador	6.6	Yes

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**IMF Conditionality**

Members' traditional demands for easier access to Fund resources are taking on additional emphasis this year because of the unprecedented magnitude of LDC debt problems and the profound economic and political impact of IMF-mandated austerity on such key members as Brazil and Mexico. Of the top 20 LDC debtors, 12 are operating under austerity programs as conditions for obtaining IMF loans,

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and one other is likely to join this group. These austerity programs usually require painful economic adjustments:

- IMF-prescribed current account targets and devaluation criteria imply large import reductions. Brazil, for example, has been forced to devalue the cruzeiro by 70 percent this year, resulting in a 25-percent cutback in imports from 1982 levels; Mexico has devalued the peso by more than 20 percent.
- Countries are required to bring inflation under control by substantially reducing government deficits and monetary expansion. The fund has asked Mexico to cut last year's record 100-percent inflation rate to 55 percent this year; Brazil's 1984 inflation target is 90 percent, as compared with this year's rate of 160 percent.
- Economic efficiency must be increased by reducing or eliminating subsidies and returning prices and interest rates to free market levels. For example, Mexico allowed petroleum prices to rise sharply and removed subsidies on many basic foodstuffs.

Several financially troubled LDCs—among them Brazil, Venezuela, Argentina, and India—have publicly expressed concern that the industrialized countries will pressure the IMF to apply austerity conditions even more rigorously. They are worried that the fragile political structure in their countries will make it impossible to reach strict trade, inflation, and government deficit targets. Already Brazilian Central Bank President Langoni has resigned because he views the Fund austerity program as unworkable and new inflation and public-sector spending targets as unattainable. We believe the Fund is unwilling to risk its reputation as a sound financial adviser by imposing unobtainable performance criteria; yet it must come down strongly in favor of effective conditions because LDCs need more rational economic policies: (a) to avoid a repeat of the current financial crisis, (b) to restore development progress, and (c) to encourage commercial banks to resume lending. The Fund has

been reasonably successful at balancing these demands, and we believe it is unlikely to alter its existing policies toward conditionality

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### IMF Liquidity

The Fund already has outstanding loan commitments of almost \$42 billion, while its total loanable resources currently available are about \$36 billion. Quotas, or members' subscriptions, account for about two-thirds of the IMF's resources; the remainder is borrowed. Quotas, which also represent individual members' voting strength in the organization, are reviewed at least once every five years and revised if necessary. Earlier this year the Fund decided to boost members' subscriptions about 48 percent, anticipating increased demand for Fund resources through the remainder of the 1980s. The US quota was raised from \$13.2 billion to \$18.8 billion. As of mid-September, only 48 countries accounting for only one-fourth of total quotas had formally accepted the new assessments.

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Major European nations, angered by the delay in Congress of legislation to increase the US contribution to the IMF, last week rejected a request from IMF Managing Director Jacques de Larosiere for a temporary advance of \$3 billion, which would have been matched by a like amount from Saudi Arabia. Comments in the financial press suggest that the decision to delay making the advance available to the IMF reflects a European belief that the Fund does not face as severe a liquidity crisis as it has sought to depict. France and West Germany, in particular, have begun to question whether the \$6 billion "commitment" gap estimated by the IMF is accurate. While the Fund does not face an immediate liquidity bind, it sought the loan to match disbursements expected next year.

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A side issue to the quota increase will be whether members should have more or less access to IMF lending facilities in the future. The IMF's executive

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**Major Debtors:** *Billion US \$*  
**1983 IMF Commitments  
 and Associated New Commercial  
 Bank Lending**

	IMF Funds	Associated Commercial Bank Funds <sup>a</sup>
Brazil	4.2	4.4
Mexico	3.4	5.0
Argentina	1.5	1.5
Yugoslavia	1.7	1.6
Chile	0.5	1.3

<sup>a</sup> New publicized medium- and long-term private bank credits.

board has agreed in principle that after the current quota increase takes effect some time next year the Fund's recent policy of "enlarged access" will have to be trimmed back. Unless access to the IMF's pool of money is limited, several of the executive directors from major industrialized countries have said they fear the institution will soon exhaust the cushion provided by the quota increase. The IMF executive board last month approved a plan recommending that the current enlarged access policy—under which a member may draw resources equivalent to 150 percent of quota in a single year or 450 percent of quota over three years—be phased down by 1986. Some industrial countries, including the United States, West Germany, Japan, and Australia, which represent 33 percent of Fund voting power, believe that the annual access ceiling should be revised downward to nearer 100 percent. The net effect of this proposal coupled with the quota increase is that the amount a member could draw annually is basically unchanged. [redacted]

Embassy reports indicate representatives of the LDCs are likely to insist on more generous access limits. Ten executive directors representing roughly

34 percent of voting power have advocated maintaining the present limits after the new quota increase becomes effective. Reports in the financial press anticipate, and we tend to agree, that a compromise will probably be reached scaling back the enlarged access limits but still allowing for an increase in the absolute level of funds available to borrowers. [redacted]

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The World Bank's soft loan affiliate—the International Development Association (IDA)—is similarly mired in funding problems. The 1981 decision of the United States to stretch its contributions to IDA-6—the sixth replenishment of IDA covering the three fiscal years 1981-83—over a four-year period had a strong adverse effect on other donors. Several donors at that time indicated they were considering making their level of contributions to IDA-7, currently under discussion, conditional on maintenance by the United States of what they regarded as its proper share. While funds committed under IDA-6 have not been fully collected, the World Bank will attempt to establish the replenishment level for IDA-7 at the upcoming meeting. [redacted]

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The question of burden sharing—particularly contentious after the experiences with IDA-6—seems likely to become acute at this year's meeting. It seems likely that the United States' decision to scale back its commitment to IDA-7 to \$750 million annually from \$1.1 billion under IDA-6 will be met by a like response from other donors. Such a replenishment cutback will force a precipitous decline in soft loan disbursements between now and 1987. Any decline in disbursements is almost certain to give rise to allocation problems, exacerbated by the difficulty of accommodating both China's borrowing request and existing IDA commitments to Sub-Saharan Africa. [redacted]

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Aside from the funding difficulties experienced by the IDA, the IBRD itself is encountering difficulties increasing its capital. Traditionally, any change in the relative position of member countries in the

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**IMF: Impatient With Contributors**

*On 19 September the IMF announced, for the first time in its history, that it has suspended all negotiations on new credit programs. Press sources said the negotiations will remain suspended at least until the next IMF executive board meeting on 3 October. The Fund move is apparently an attempt to put pressure on industrial country central banks to provide the IMF with \$3 billion in short-term bridging finance, to be matched by a like contribution from Saudi Arabia. The IMF Managing Director is also distressed that only 48 of the 146 members of the Fund have ratified the proposed general quota increase.*

global liquidity and help ease debt repayment and development financing problems. Opponents from several industrialized countries believe a clear case for greater liquidity has not been made and that an allocation at this time would risk re-igniting global inflation. We believe the chances are less than even that the G-10, the controlling industrial country group, will recommend a new issue.

[Redacted]

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IMF—such as just occurred under the eighth quota increase—is followed by a similar adjustment by the World Bank. An exact match in IMF subscriptions would require an increase in IBRD capital of \$20 billion. West Germany and the United States, however, would like to see an increase of only \$3 billion—the amount needed to adjust the position of Japan and a few other countries. Preliminary indications are that the Bank's management will seek to work out a compromise of approximately \$8 billion. A final resolution may not come until the IMF/IBRD interim committee meeting next spring.

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**Special Drawing Rights**

Fund documents indicate the IMF staff has been studying the feasibility of a new issue of SDRs for distribution to member nations. The Managing Director is required to recommend to the annual meeting whether an issue of SDRs is justified. Since 1967 about \$22 billion in SDRs have been allocated to Fund members; the last issue occurred in early 1981. Proponents—nearly all the LDCs—argue that an issue of SDRs would contribute to

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## Eastern Europe: Facing Up to the Debt Crisis

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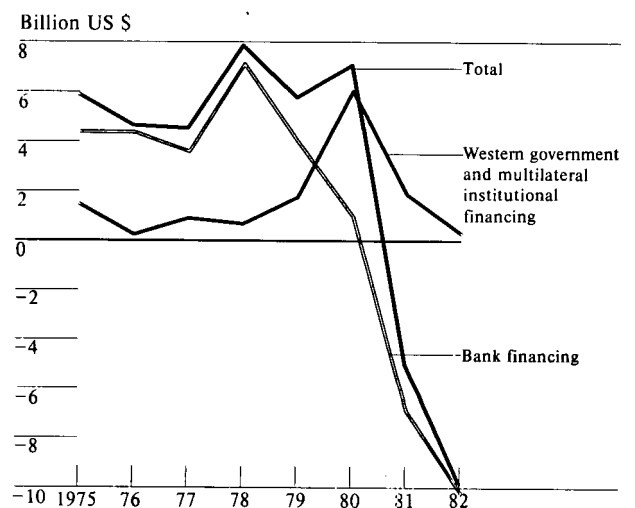
Most of Eastern Europe has withstood the severe credit crunch that began in 1980, but the region remains financially vulnerable. The peak of the crisis occurred in the first part of 1982, when it seemed that several countries were on the brink of default. The regimes responded by imposing austerity, mostly in the form of severe import reductions. With the incipient economic recovery in the West and signs of some easing in creditors' attitudes, the worst of the crisis is probably over. Some countries may yet have to reschedule their debts, however, and most will continue to look to the West for financial assistance. For the longer run, all will need to rely more on their own resources, which will increase pressure for more systemic solutions to economic problems. The adjustment process almost certainly will increase the risk of internal instability and will present problems and opportunities for the USSR and the West.

### The Credit Crunch

While Western bankers showed some unease about Eastern Europe as early as 1980, the credit crunch intensified the following year when Poland's inability to service its debts gave bankers second thoughts about continuing to lend to other East European countries. Banks initially refused to provide more medium-term loans. As a result, the East Europeans had to resort to more official financing, activate undisbursed credit lines, seek costly short-term borrowing, and draw down their reserves. By yearend, all the East European countries faced liquidity problems. The crunch thus hit Eastern Europe well before Latin America and other developing countries.

The squeeze grew particularly severe in the first half of 1982. The imposition of martial law in Poland and difficult rescheduling talks with Poland

### Net Resource Transfer to Eastern Europe From Western Financing<sup>a</sup>



<sup>a</sup> New credits minus repayments of principal and interest.

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and Romania led bankers to withdraw short-term credits from the entire region in addition to refusing to roll over maturing medium-term loans. For the year as a whole, Western banks reduced their short-term exposure by 30 percent and rolled over only \$3.6 billion of \$9.1 billion in maturing medium- and long-term obligations. Western government-backed credits did not offset the loss of private loans; the region as a whole contracted new government-backed loans in roughly the same amount that it owed in repayments.

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Net Financing Flows From Western Banks <sup>a</sup>

Million US \$

	1975	1976	1977	1978	1979	1980	1981	1982	1983 1st Qtr
<b>Eastern Europe</b>	<b>5,877</b>	<b>6,048</b>	<b>5,824</b>	<b>10,715</b>	<b>11,252</b>	<b>5,342</b>	<b>-1,513</b>	<b>-6,685</b>	<b>-2,122</b>
Bulgaria	628	407	428	556	-86	-495	-489	-320	-170
Czechoslovakia	5	609	510	485	950	541	-224	-473	71
East Germany	1,164	1,170	715	1,494	1,760	1,375	805	-1,874	-389
Hungary	892	892	1,413	1,747	1,058	64	-305	-940	-457
Poland	2,427	2,550	1,327	3,167	3,393	339	-890	-1,373	-720
Romania	133	-163	470	1,406	1,552	1,362	-707	-826	-206
Yugoslavia	628	583	961	1,860	2,625	2,156	297	-879	-251

<sup>a</sup> Net financing flows equal changes in the stock of bank claims as reported in the Bank for International Settlements (BIS) statistics. This reflects new credits less repayments.

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## Adjusting to the Credit Squeeze

Lack of credits and inability to expand exports because of Western recession forced the East Europeans to slash imports by 30 percent in 1981-82. Planners focused the cuts on those items that would have the least immediate impact on their economies and populations. Purchases of capital equipment were generally denied because the loss of these items would not jeopardize current production. For political reasons, most regimes have been cautious about reducing purchases of consumer goods and foodstuffs although last year's good harvest permitted cutbacks in grain imports. Despite attempts at insulation, the reduction in Western imports has been a key factor in the decline of GNP which fell by 0.5 percent annually in 1980-82 for the six CEMA countries compared with an annual average growth of 2.5 percent in 1976-79. For Yugoslavia, growth slowed from a peak of 7.0 percent in 1979 to only 0.3 percent last year.

The East European countries reacted to their financial problems in varying ways. Poland, after Western governments refused to reschedule its 1982 debt or extend new credits, secured de facto debt relief simply by not making repayments. Warsaw

was able to negotiate debt relief from commercial banks, and Western bankers report that Warsaw met the repayment schedule. Altogether, Poland managed to cover less than half of its \$11 billion financing requirement last year. The need to deal with the resulting arrearages continues to delay and complicate Warsaw's economic recovery.

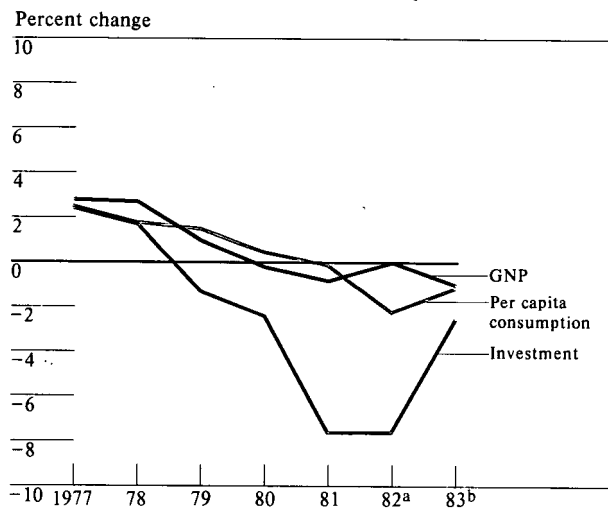
Doubts about Bucharest's creditworthiness brought the credit crunch to Romania in early 1981. After arrears reached \$1.1 billion at the end of the year, Bucharest gained breathing room through agreements with Western banks and governments to reschedule 1981 arrears and principal payments due in 1982. By mid-1982 there were signs that Bucharest was addressing its financial problems. By the end of the year, it had cut imports by one-third, enough to earn a current account surplus of \$655 million, but was still left with arrears of nearly \$400 million. The import cuts intensified shortages of food, gasoline, and other consumer goods. Data presented to the IMF show that consumption fell for the first time since World War II and that the rate of growth of industrial production fell to a new low.

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**Eastern Europe: Domestic Economic Indicators**<sup>a</sup> Preliminary.<sup>b</sup> Projected.

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The problems of Poland and Romania had a spill-over impact on Hungary, East Germany, and Yugoslavia—countries also dependent on new credits to meet debt obligations. In Hungary, the withdrawal of \$1.3 billion in short-term credits by Western, OPEC, and CEMA banks and inability to roll over medium-term credits brought Budapest to the brink of a liquidity crisis in early 1982. The Hungarians parlayed their good relations with the West and reputation as sound managers into enough emergency support from Western governments, the Bank for International Settlements (BIS), and the International Monetary Fund (IMF) to avert rescheduling. After temporizing for some months, Budapest imposed import controls and tougher austerity on consumers. Hungary consequently was able to slash its current account deficit by more than \$600 million and stabilize its financial position.

East Germany, despite suffering the region's largest cutback in credits—\$1.9 billion, was the only heavily indebted country in the region that did not require debt relief or emergency loans in 1982. The East Germans apparently managed last year's credit crunch through tough adjustment measures and skillful cash management. Trade adjustments offset about 80 percent of the cutback in bank credits, but the measures exacted a stiff price from the domestic economy. We estimate that GNP growth fell from 2.4 percent in 1981 to 0.5 percent last year.

Yugoslavia did not suffer as severe a reduction in Western bank lending as Hungary or East Germany, but the impact on its financial position proved more damaging. The country's financial crisis stemmed as much from failure to reduce the current account deficit and poor cash management in the banking system as from fewer credits. Belgrade's current account deficit reached \$1.4 billion in 1982 instead of the planned \$500 million, and emergency measures to strengthen the Yugoslav National Bank's liquidity position failed. IMF credits of \$600 million could not offset the shortfall in current earnings and capital flows, and Yugoslavia had to draw down its reserves by \$1 billion. By yearend, with arrears of \$500-600 million, the country technically was bankrupt.

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Because of their conservative trade and borrowing policies, Czechoslovakia and Bulgaria did not face as severe financial problems in 1982 as the other East European countries. The Czechoslovaks nonetheless slashed hard currency imports by 19 percent. The import curbs flowed from President Husak's pronouncement in 1981 that Czechoslovakia would not live on "credit." With shrinking export earnings, Prague's planners had to make deep cuts in purchases to meet the leadership's goal of reducing external indebtedness.

Bulgaria's low debt and comfortable maturity schedule freed it from onerous repayment obligations. Its conservative trade policy yielded surpluses

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**East European Debt***Million US \$*

	1971	1975	1980	1981	1982
<b>Eastern Europe</b>	<b>9,510</b>	<b>30,659</b>	<b>83,598</b>	<b>84,842</b>	<b>80,503</b>
Commercial	5,396	23,721	61,793	59,692	53,383
Official <sup>a</sup>	3,765	6,002	18,506	20,267	20,223
IMF/World Bank	349	936	3,299	4,883	6,897
<b>Bulgaria</b>	<b>743</b>	<b>2,640</b>	<b>3,562</b>	<b>3,065</b>	<b>2,782</b>
Commercial	442	2,453	3,128	2,575	2,187
Official <sup>a</sup>	301	187	434	490	595
<b>Czechoslovakia</b>	<b>485</b>	<b>1,132</b>	<b>4,756</b>	<b>4,400</b>	<b>3,998</b>
Commercial	284	926	4,013	3,610	3,158
Official <sup>a</sup>	201	206	743	790	840
<b>East Germany</b>	<b>1,408</b>	<b>5,388</b>	<b>14,089</b>	<b>14,680</b>	<b>13,077</b>
Commercial	693	4,423	11,411	11,535	9,642
Official <sup>a</sup>	715	965	2,678	3,145	3,435
<b>Hungary</b>	<b>1,071</b>	<b>3,135</b>	<b>9,276</b>	<b>8,700</b>	<b>7,800</b>
Commercial	968	3,081	9,053	8,380	6,748
Official <sup>a</sup>	103	54	223	320	415
BIS/IMF	0	0	0	0	637
<b>Poland</b>	<b>1,399</b>	<b>8,879</b>	<b>24,840</b>	<b>25,500</b>	<b>24,800</b>
Commercial	420	6,547	14,740	15,045	14,340
Official <sup>a</sup>	979	2,332	10,100	10,455	10,460
<b>Romania</b>	<b>1,227</b>	<b>2,924</b>	<b>9,467</b>	<b>10,160</b>	<b>9,766</b>
Commercial	585	2,024	6,537	6,167	5,408
Official <sup>a</sup>	642	706	1,750	1,845	1,428
IMF/World Bank/CEMA banks	0	194	1,180	2,148	2,930
<b>Yugoslavia</b>	<b>3,177</b>	<b>6,561</b>	<b>17,608</b>	<b>18,337</b>	<b>18,280</b>
Commercial	2,004	4,267	12,911	12,380	11,900
Official <sup>a</sup>	824	1,552	2,578	3,222	3,050
IMF/World Bank	349	742	2,119	2,735	3,330

<sup>a</sup> Includes Western government-guaranteed credits and direct official loans.

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on the hard currency trade account. Although some firms reported problems with payments from Sofia last year, we believe these were not the result of any serious financial deterioration.

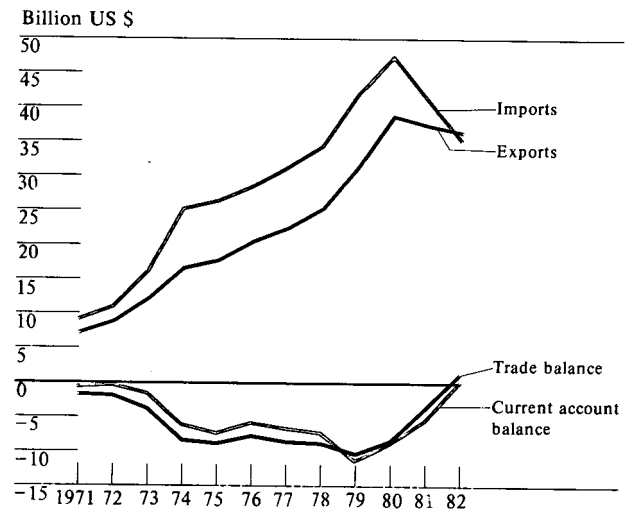
### Lender Attitudes

Lender attitudes toward Eastern Europe have eased slightly since last year's rush to reduce exposure, in part because their worst fears proved exaggerated. Poland did not default and Romania has improved its relations with banks. BIS and IMF involvement in Hungary's and Yugoslavia's crises has encouraged, and to some extent compelled, continuing banker involvement in these countries.

Continuing wariness among bankers and closer governmental supervision of commercial bank exposure will restrain the pace and extent of new loans. Major Eurodollar syndications will be much rarer than in the late 1970s; a far greater share of lending will be short term and trade related. The cost of credit will be higher, and the debt maturity structure will remain unfavorable for most countries. Commercial banks, furthermore, are likely to insist on more Western government backing for their loans or demand security from the borrowers, including gold collateral and offsetting deposits.

As a prerequisite for increasing lending, bankers are looking for evidence that the East Europeans are addressing their payments imbalance through structural changes to improve export performance. Creditors regard the draconian import reductions of the past two years as a short-run expedient with little positive impact on long-term creditworthiness. Some bankers remain skeptical that the East Europeans will or can do as much as the financially troubled LDCs to correct their fundamental problems. To assure long-term economic discipline, they are putting more weight on IMF membership, while urging the East Europeans to provide more complete economic and financial data.

### Eastern Europe: Trade and Current Account Balance



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### Outlook for 1983-85

In 1983 we estimate the region (excluding Poland, because of the uncertainties regarding rescheduling terms) will experience another large outflow on the capital account of more than \$2.4 billion. Yugoslavia will probably be the only net gainer, thanks to the Western financial rescue package. An expected slight improvement in borrowing conditions and a pickup in Western demand for East European exports should enable a few East European countries to ease the import cuts of the past two years, but we still anticipate a 1- to 2-percent decrease in Eastern Europe's (excluding Poland's) hard currency imports this year. Import gains seem likely in 1984-85, assuming continued growth in the West and continuing improvement in creditor attitudes.

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Only under the most favorable lending assumptions, however, would the absolute level of imports in 1985 exceed the level reached in 1980. With a modest revival of lending, imports in 1985 would be about 4 percent below the 1980 peak, while continued lending shortfalls would keep 1985 import levels some 8 percent below 1980 levels.

Even if lending revives, some countries—notably Bulgaria, Czechoslovakia, and Romania—may be unwilling to expand imports at the rates our projections suggest, opting instead to continue reducing hard currency debt or building up reserves. Most regimes will give preference to goods needed for consumption and current production. Some economists and planners, however, are arguing more strongly that their economies need a revival of investment, using Western resources to lay the foundation for long-term growth. This may have some greater impact down the road.

The prospect of slow export growth and at best small credit inflows means that financial problems will continue to beset nearly all the East European countries. In the near term, Poland—and very likely Yugoslavia—simply cannot generate enough debt servicing capacity on their own to meet obligations. Most regimes will have to restrain consumption and investment in order to lower demand for imports and free goods for export. Pressure will build to produce more output with fewer inputs. This will highlight the necessity of attacking the systemic flaws that contribute to low productivity.

Poland and Yugoslavia, caught in a medium- to long-term financial crisis, seem least able to impose effective adjustment measures and to attack structural problems. Poland's insolvency and lack of progress in dealing with debt problems have locked it into a continuing economic crisis. Merely to stem the increase in its debt, Poland must generate net exports equal to annual interest payments, an effort requiring large current account surpluses and, thereby, a commitment by the regime to revive economic growth and by the populace to make large sacrifices.

Even with completion of this year's financial rescue package, we believe that Belgrade will need more help in 1984. Yugoslavia's position entering 1984 will be very similar to that at the beginning of this year—stocks of imported goods and foreign exchange reserves will be at minimal levels and few credits will be in the pipeline to bridge the seasonal financing gap in the first half of the year. Adjustment policies and structural reforms needed for recovery may impose a higher price than regional politicians and the population are willing to accept.

Romania, East Germany, and Hungary show signs of financial recovery, but their positions remain fragile. East Berlin and Bucharest have squeezed their economies much harder than Budapest, while the latter seems further along in addressing structural problems. Bucharest has passed the peak in its debt maturity structure, but is having problems in satisfying IMF targets and in obtaining credits. Even if it meets its goal of avoiding rescheduling next year, another test of its external adjustment efforts will come in 1985 when Bucharest must begin to repay obligations rescheduled in 1982. Next year's expiration of the current IMF standby arrangement also will add to pressures for large current account surpluses.

East Germany probably can avoid a rescheduling, but the country continues to face a serious liquidity problem. The recent decision of the West German Government to guarantee a \$400 million five-year credit from West German commercial banks should improve prospects for covering this year's borrowing requirement. East Berlin can also draw on new government-guaranteed trade credits from France, Canada, and Austria. Over the medium term, the country will have to live more within its means, implement measures that improve export competitiveness, and promote economic growth without heavy reliance on Western imports and credit.

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Hungary is still on a financial tightrope despite some successes in raising credits in the first half of 1983. Budapest faces a rising level of debt repayments through 1985 and has requested a second IMF standby credit. The Hungarians must tighten adjustment policies, as well as continue to forge ahead with measures to improve efficiency and competitiveness. Fortunately for Budapest, many Western bankers believe they should support Hungary's reform program as an example for other East European countries.

Due to their small debts and generally good standing with Western banks, Czechoslovakia and Bulgaria enjoy the luxury of choosing whether to continue paying off their debt or to lift self-imposed restraints on imports from the West.

### **The Greater Implications**

Our forecast of continuing serious financial problems for some countries (Poland and Yugoslavia) and, at best, slow improvement for the rest implies that the leaderships will face difficult decisions in the next few years. The problems are not new ones, but are now more severe than in the past. Muddling through—tinkering, temporizing, and relying on help from the USSR and the West—has become less of an option. More than ever, the East European countries will be forced to rely on their own resources and on the ability of their economic managers and systems to adjust. Continuing financial and related problems will influence East European policy on a wide range of issues:

- Relations with the USSR, the West, and each other.
- Allocation of resources to investment, consumption, and defense.
- Economic reform—along with its political and ideological implications.

The East European regimes are likely to draw some sobering conclusions from the financial crisis of the past two years and from the past decade of expanded economic ties with the West. While the Polish situation is abhorred by the rest of the region, most of the countries made some of the same mistakes,

albeit to a lesser degree. In retrospect, the regimes overborrowed—at first to purchase Western capital goods with which to modernize their economies and later to buy grain and other supplies to support consumption.

Although East European officials instinctively blame the West for their problems, they must also recognize that their own shortcomings made them more vulnerable to the credit cutoff. At a minimum, they probably will try to be more certain that they can repay loans and will build more caution into their forecasts of the potential impact of Western economic performance on their external accounts. At the same time, the East Europeans probably will conclude that they now need the West more than ever. The problems that led them to seek Western trade and credits a decade ago are now even more pressing.

Economic relations with the USSR will still figure heavily in their decisionmaking; and Bulgaria's relative economic success in recent years will stand as an example of the advantages of less dependence on the West and strong Soviet ties as well as, perhaps, increased CEMA integration. The leaderships realize that one of their chief assets is their borderline position between the USSR and the West, and they will try to play off East against West.

The long-talked-about CEMA summit, if and when it is held, should provide some clues as to which of these conflicting pulls is predominant. The USSR has been pressing for more balanced and possibly less subsidized trade, as well as for increased integration. The East Europeans have seen these aims as burdening their economies still more and threatening their relations with the West and have delayed the convening of the summit.

The increased need for efficiency and the priority of boosting sales in hard currency markets is likely to give fresh impetus to reform advocacy in most countries. The problem is that reforms take a long time to implement and can be politically unsettling,

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threatening the privileges of the bureaucracies and challenging the ideological underpinnings of these regimes. The prospect of greater Soviet economic demands, continued stringency in economic relations with the West, and sharp domestic adjustments to the credit squeeze are likely to heighten tensions within the leaderships and between the leaderships and the led.

Although the populations have accepted recent austerity reasonably placidly, their patience may not survive the period of austerity ahead. The regimes will have to decide whether to use more repression (as in Romania) or to explain the problem and enlist public support (as in Hungary).

The Soviets will want to provide the minimum sustenance necessary to assure stability in Eastern Europe. With economic constraints of their own, the Soviets will want to avoid doing much more than is necessary.

Eastern Europe's economic difficulties may also persuade Western governments that they have new opportunities to weaken Moscow's influence in the region. To pursue these opportunities, however, would require a revival of willingness to take financial risks and to use new policy tools, such as including more East European states in the IMF, pursuing agreements between them and the EC, or assuming politically motivated aid burdens of indefinite duration and return.

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**LDCs: Worst Economic Performance  
in Three Decades**

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After three decades of strong economic performance, LDC growth has come to a near standstill in the past few years.<sup>1</sup> Real GNP growth in 1981 and 1982 was the lowest of the past 30 years, and we expect little or no improvement this year. By the end of this year real per capita income will have been on a downward slide for three years in a row.

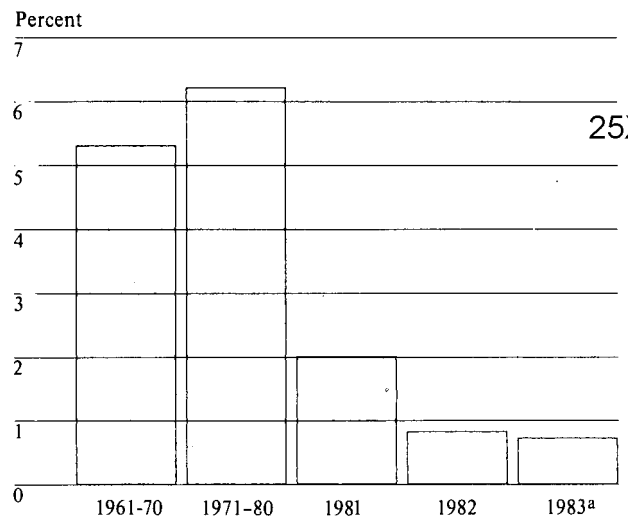
**Growth of Only 1 Percent a Year Since 1980**

According to data from the World Bank, the IMF, and our estimates, the LDCs as a group have recorded real GNP growth of only 1.2 percent a year since 1980. Moreover, overall LDC growth has steadily worsened over the past three years—from 2.0 percent in 1981 to 0.8 percent in 1982 and an estimated 0.7 percent this year. In contrast, those countries' GNPs expanded at a 6.2 percent annual rate in the 1970s. Even after the oil price shocks of 1973/74 and 1979/80, they achieved strong economic expansion—5.7 percent a year real growth in 1974-80—in part by offsetting the impact of higher oil prices by rapid increases in international borrowing.

Fifteen key financially troubled LDCs have suffered the severest growth reversals. After growing 7.3 percent a year in the 1970s, their economies contracted in 1982 and probably will do so again

<sup>1</sup> In this article, we have included 93 countries in our examination of LDC growth. Data for those countries for 1961 to 1980 are from *The Planetary Product in 1980: A Creative Pause?* Those for 1981-83 are CIA data and estimates. The source for the historical data was chosen because of its comprehensive coverage of LDC and developed country real growth performances. In some cases, particularly the OPEC countries where substantial shifts in external terms of trade occurred, there are discrepancies between *The Planetary Product* growth rate estimates and those derivable from other sources. We do not believe, however, that these discrepancies distort historical LDC growth performances.

**LDCs: Average Annual Real GNP  
Growth**



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<sup>a</sup> Estimated.

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this year. Argentina, Brazil, and Costa Rica have experienced particularly sharp downturns. We estimate that real GNP in each this year will be about 10 percent lower than it was in 1980.

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Real GNP growth in 10 other financially troubled LDCs has remained relatively strong, holding close to the 1970s pace in 1981-82. Indeed, average growth in these countries may even accelerate somewhat this year. The favorable group performance, however, masks a marked slowdown in growth in several of these countries, notably

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**LDCs: Average Annual Growth of Real GNP** *Percent*

	1961-70	1971-80	1981	1982	1983 <sup>a</sup>
<b>Total LDCs</b>	<b>5.3</b>	<b>6.2</b>	<b>2.0</b>	<b>0.8</b>	<b>0.7</b>
Key financially troubled <sup>b</sup>	5.9	7.3	1.2	-1.1	-2.3
Other financially troubled <sup>c</sup>	4.7	4.2	5.7	2.5	4.4
Other East Asian NICs <sup>d</sup>	9.3	8.4	7.3	3.8	5.7
Other Africa	4.0	3.1	2.7	2.1	2.0
Other Asia	3.7	3.4	5.7	2.6	3.3
Other Middle East	6.1	11.2	-6.0	3.6	0.2
Other Latin America	5.0	4.0	0.4	-2.1	-1.7

<sup>a</sup> Estimated.

<sup>b</sup> Argentina, Brazil, Chile, Costa Rica, Ecuador, Ivory Coast, Indonesia, Kenya, Mexico, Morocco, Nigeria, Peru, the Philippines, Venezuela, and Zaire.

<sup>c</sup> Colombia, Egypt, India, Malaysia, Pakistan, Paraguay, South Korea, Sudan, Thailand, and Uruguay.

<sup>d</sup> Hong Kong, Singapore, and Taiwan.

Colombia, Paraguay, and Uruguay. At the other extreme, South Korea, Malaysia, and India have done rather well in 1981-83.

The remaining newly industrializing countries (NICs) of East Asia—Hong Kong, Singapore, and Taiwan—also have done well, averaging 6-percent a year real GNP increases in 1981-83. Although growth in all of these countries slowed in 1982, as the industrial country recession depressed their exports, we believe it will rebound this year, except in Singapore.

Among the other 65 LDCs that we presently classify as nonfinancially troubled, those in two regions—the Middle East and Latin America—suffered major growth slowdowns. The declines in Latin America were caused by the impact of the world recession and import cuts by the larger, financially troubled Latin American LDCs; in Central America domestic security problems also played a major role. In the Middle East, the sharp

overall real GNP decline since 1980 was caused by the economic dislocation in Iran and Iraq and the drop in incomes stemming from the soft world oil market.

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The areas that have experienced the mildest slowdowns in growth in 1981-83 have been nonfinancially troubled African and Asian countries. Nonetheless, because growth in the African countries was below average throughout the 1970s, their real GNP gain for 1981-83 slipped below population growth. In the Asian countries, growth in 1981-83 has averaged 3.9 percent, an acceleration from the 1970s pace. Improved performances in Sri Lanka and Burma accounted for much of the increase.

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**Shifts in Underlying Factors**

We believe key causes of the dismal post-1980 LDC growth performance are global factors: high oil prices, record interest rates, and worldwide recession. While these forces are continuing to constrain growth, for the most part they are exerting much less of a negative influence than earlier. World short-term interest rates are down more than 7 percentage points from 1981 peaks, OECD real imports are again rising, and oil prices are down. While lower oil prices cut both ways, on balance they are probably beneficial to LDC economic prospects.

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Despite the slightly more favorable external economic environment, however, many LDCs are unable to boost growth because of their precarious debt positions. Some 34 LDCs, for example, are under IMF-mandated domestic austerity programs and many others have instituted their own domestic cutbacks. As a result, we project the key financially troubled LDCs to experience a 2.3-percent real GNP decline in 1983.

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**Outlook**

In terms of real growth performances, the worst is probably over for the LDCs. The outlook should brighten in 1984 as OECD growth picks up and

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LDCs: Average Annual Growth  
of Real GNP

Percent

	1961-70	1971-80	1981	1982	1983 <sup>a</sup>		1961-70	1971-80	1981	1982	1983 <sup>a</sup>
Algeria	3.5	7.6	4.1	3.1	3.0	Madagascar	3.3	0.4	1.0	3.0	3.0
Angola	3.9	-0.2	1.0	-1.0	-1.0	Malawi	4.5	7.8	0.5	1.0	2.5
Argentina	4.4	2.5	-6.0	-5.7	1.0	Malaysia	6.1	7.3	6.5	4.6	5.0
Bahamas	5.5	0.3	0	2.0	2.0	Mali	4.3	5.0	0.7	2.0	2.0
Bahrain	6.9	4.4	7.0	8.0	3.5	Mauritania	7.3	3.1	8.5	4.0	4.0
Bangladesh	4.1	2.9	6.0	0	4.5	Mauritius	3.1	6.0	2.0	6.5	6.5
Barbados	6.1	1.7	-2.7	-4.4	0.1	Mexico	6.9	5.6	8.0	-0.2	-5.0
Benin	0.7	5.0	4.7	5.0	5.0	Morocco	3.9	4.3	-1.6	4.5	2.0
Bolivia	5.1	4.3	-5.0	-10.0	-5.0	Mozambique	4.7	-1.2	0	-5.0	-1.0
Botswana	10.3	10.2	8.6	-5.3	0	Nepal	2.5	2.8	5.6	3.8	-5.5
Brazil	6.1	8.8	-3.5	0	-5.0	Nicaragua	6.5	2.6	8.7	-3.0	-1.0
Burma	2.9	4.7	8.0	6.0	6.0	Niger	4.3	3.4	5.0	5.0	5.0
Burundi	3.2	3.4	4.0	3.0	3.0	Nigeria	4.0	11.0	-2.4	-11.0	-1.0
Cameroons	5.0	4.4	6.5	6.5	6.0	Pakistan	6.7	4.5	7.3	6.1	6.2
Central African Republic	2.6	2.4	2.0	3.0	3.0	Panama	8.0	4.9	3.6	1.0	1.0
Chad	0.4	-1.5	0	-2.0	1.0	Peru	5.6	3.6	3.9	0.2	-5.0
Chile	4.5	2.6	6.3	-14.1	0	Philippines	5.1	6.4	3.8	2.6	2.0
Colombia	5.2	6.3	2.5	1.1	1.0	Qatar	9.6	10.9	3.0	3.0	1.0
Congo	5.0	2.6	8.0	3.0	3.0	Rwanda	5.1	4.4	4.0	3.0	2.0
Costa Rica	4.7	5.6	-3.6	-8.8	-2.0	Saudi Arabia	8.7	21.5	8.1	7.0	-4.0
Dominican Republic	5.2	7.1	3.4	1.6	1.0	Senegal	1.1	-1.4	-5.2	9.0	2.0
Ecuador	5.6	8.9	4.3	2.0	1.5	Sierra Leone	4.6	1.2	2.0	0	0
Egypt	6.1	4.5	8.0	6.0	5.0	Singapore	9.3	9.0	10.0	6.3	6.0
El Salvador	5.7	2.7	-9.5	-5.5	-5.0	Somalia	2.5	0.1	1.0	1.0	1.0
Ethiopia	4.4	2.5	3.0	3.5	3.0	South Korea	8.4	8.2	6.4	5.4	7.5
Gabon	7.6	13.4	5.0	5.0	5.0	Sri Lanka	4.6	4.1	5.8	5.1	2.0
Gambia, The	5.3	4.4	-0.4	-1.0	-1.0	Sudan	1.4	3.2	5.5	6.0	3.5
Ghana	2.6	0.1	0	0	0	Suriname	7.3	2.0	0.8	0	-1.0
Guatemala	5.5	6.2	1.0	-3.5	-4.0	Swaziland	9.6	5.1	5.0	3.7	5.0
Guinea	3.3	0.2	2.0	3.0	3.0	Syria	6.6	8.3	8.8	5.0	5.0
Guyana	3.6	2.0	-6.0	-10.0	-10.0	Taiwan	9.1	8.5	5.0	3.8	6.0
Haiti	0.8	4.0	0	-1.3	0	Tanzania	5.6	3.8	-3.6	-3.6	-3.0
Honduras	4.7	4.2	0.3	-1.2	-1.0	Thailand	8.0	7.1	7.6	4.2	5.0
Hong Kong	10.0	7.9	10.9	2.4	5.0	Togo	7.9	3.4	-5.9	-4.0	-5.0
India	3.8	2.8	5.2	0.5	4.0	Trinidad and Tobago	3.5	4.3	1.5	0.5	-1.0
Indonesia	10.6	12.9	7.6	3.0	2.0	Tunisia	7.4	8.6	5.0	0.8	2.0
Iran	5.6	6.1	-27.0	-2.5	5.0	Uganda	4.3	-0.1	1.0	10.0	7.0
Iraq	5.4	13.9	-30.0	-2.1	-2.0	United Arab Emirates	17.6	8.8	16.3	10.0	5.0
Ivory Coast	7.2	6.2	1.5	1.5	2.0	Upper Volta	2.9	3.6	2.0	1.6	3.3
Jamaica	5.0	-1.3	1.5	0.5	-1.0	Uruguay	1.6	2.2	-1.0	-10.0	-5.0
Jordan	6.5	8.0	14.0	4.9	3.0	Venezuela	4.5	7.3	1.0	-2.2	-4.0
Kenya	5.5	3.6	2.0	3.5	3.0	Yemen, North	2.5	6.9	7.0	6.5	6.5
Kuwait	3.1	10.2	5.0	5.0	5.0	Yemen, South	2.4	2.9	3.0	3.5	3.5
Lebanon	4.9	-2.5	3.0	-10.0	-8.0	Zaire	5.4	0.6	2.4	-2.0	-1.0
Lesotho	6.1	4.8	3.0	-1.0	0	Zambia	4.5	-0.1	-1.8	-2.0	-2.0
Liberia	4.5	2.6	2.0	-5.0	-5.0	Zimbabwe	5.8	2.3	12.2	2.0	0
Libya	29.3	11.2	-20.5	-3.9	6.0						

<sup>a</sup> Estimated.

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**LDCs: Average Annual Growth of Selected Determinants of Economic Growth**

*Percent*  
(except where noted)

	1971-80	1981	1982	1983 <sup>a</sup>
OECD real imports	5.0	-1.8	-0.5	0.8
Oil prices	31.5	11.8	-2.5	-14.5
Interest rates	7.8	16.4	12.5	8.8
Countries with IMF mandate (number)	13 <sup>b</sup>	25	30	34

<sup>a</sup> Estimated.

<sup>b</sup> Data for 1980 only.

The political impact of slower improvement in living standards is uncertain. At a minimum, we believe less favorable LDC economic performances and prospects will increase strains on those countries and their governments. In particular, the risks of political instability could rise in those countries experiencing the greatest continued growth slow-downs. On the other hand, countries that respond to domestic economic hardship by attempting to boost economic activity run the risk of destabilizing precarious debt repayment schemes.

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commodity prices recover. Nevertheless, more rapid long-term growth is by no means assured. Most observers believe that the international indebtedness of the LDCs and the reluctance of private banks to extend new credit will keep LDC economic growth depressed well past the middle of this decade. Wharton Econometrics Forecasting Associates (WEFA), for example, projects LDC real GNP growth at only 3.2 percent a year through 1988, a pace barely half that of the 1970s.

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The slowdown in LDC economic growth during the past three years has reversed gains in living standards that characterized the previous three decades. Overall LDC real per capita GNP rose at an average annual rate of 3.0 percent a year in 1951-80; during 1981-83 it has declined at a 1.1 percent a year pace. For the future, it seems probable that the decline will be reversed, but gains are likely to be substantial only in East Asian countries. According to WEFA, Latin American real GNP will rise 2.6 percent a year in 1983-88; during that period, population will rise at a 2.4-percent rate. Similarly, African population growth of 3 percent a year in the 1980s seems almost certain to outstrip that region's real growth, put by WEFA at only 1 percent a year.

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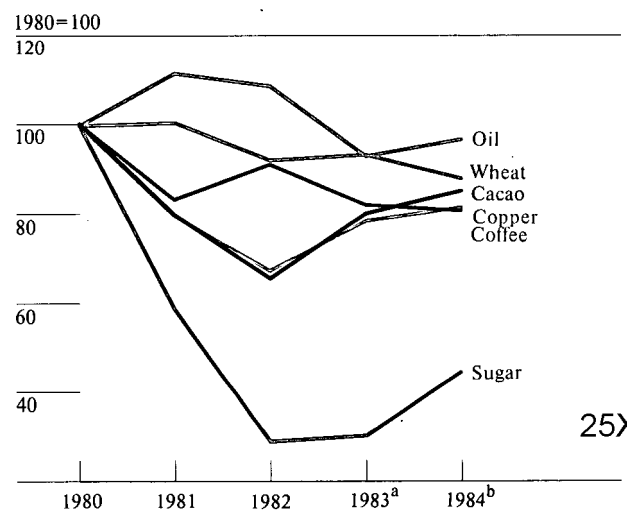
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**South America:  
The Export Challenge**

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For the third successive year, faltering export growth is impeding South American economic growth and eroding debt servicing capabilities. In the past, these countries relied on rapid export increases to drive their industrialization and growth strategies. Starting in 1980, however, the global recession severely set back export momentum. More recently, IMF stabilization programs have contributed to a weakening of exports within the region; as most countries have slashed imports to alleviate foreign exchange pressures, export markets for neighboring countries have contracted. In 1983, we estimate that only four South American countries will succeed in boosting exports over the previous year. Moreover, the likely failure by South America to increase export earnings in 1984 will seriously aggravate debt servicing difficulties and endanger rescheduling agreements and IMF programs.

**South America: Price Fluctuations of Key Exports**



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<sup>a</sup> First quarter data.  
<sup>b</sup> Projected first quarter prices.

**Export Performance**

South American exports grew from \$6 billion in 1960 to \$65 billion in 1980—an average annual growth rate of about 12.5 percent. Although the bulk of South American exports have been primary products, manufactures have played an increasingly important role driving the region's export boom over the past two decades. Between 1960 and 1980, the manufactures share of exports rose from 5 to 18 percent. Exports of manufactures have been especially important for Brazil, Argentina, Chile, and Peru.

At the same time, South American countries have diversified their export markets away from the United States and Western Europe:

- South American sales to the United States declined from 39 percent of total exports in 1960 to 21 percent in 1980.

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- The share of South American exports to the EC fell from 31 to 23 percent between 1960 and 1980.
- South American sales to Japan expanded from 1 to 6 percent of the total.
- The share of intraregional exports climbed from 9 to 15 percent in the past two decades.
- The value of South American goods absorbed by non-South American developing countries jumped as a share of total exports from 15 percent in 1960 to 21 percent in 1980.
- Soviet Bloc countries more than tripled their share of South American exports—from 2 percent in 1960 to 7 percent in 1980.

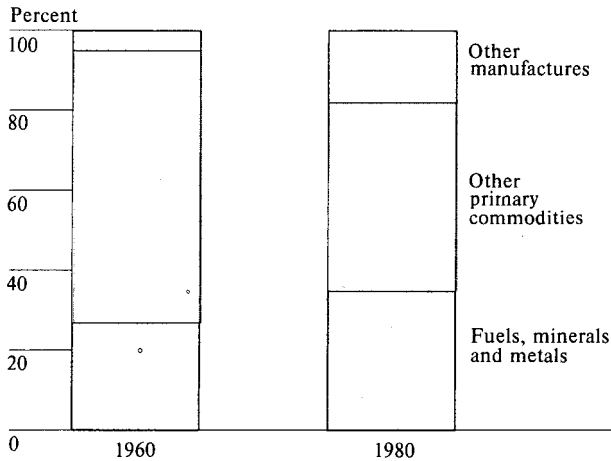
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**South America: Export Composition and Direction of Export Flows**

**Export Composition**



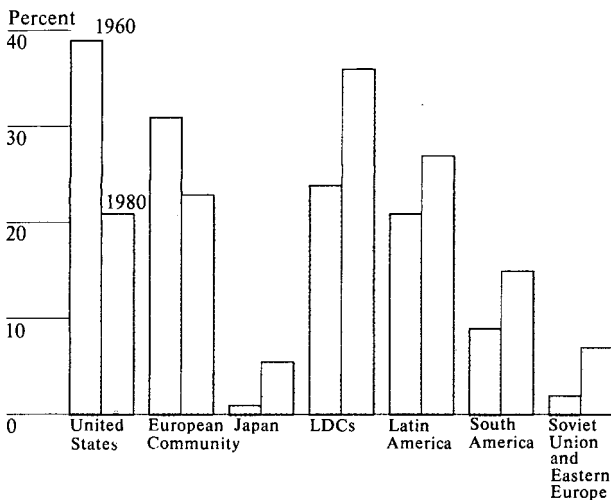
The star export performers over the past two decades have been Brazil, Argentina, and Venezuela, although a number of other countries also achieved significant gains. Rapid industrialization and an array of export promotion policies have permitted Brazil, the region's leading exporter, to increase sharply its manufactures sales to industrialized and Latin American customers while continuing to take advantage of its large agricultural and mineral export capability. Argentina also has succeeded in boosting both agricultural and manufactured exports, especially to the Soviet Union and Latin America. The export impetus for Venezuela derived from rapidly rising petroleum sales to developed nations.

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Hard hit by the global recession, South American exports slumped badly in the early 1980s. Exports grew only 5 percent in 1981 and dropped by 10 percent in 1982 as both volume and prices sagged. Real earnings from primary products exports dropped to a 30-year low by 1982. In 1982, South America's export receipts shrank 10 percent to \$61 billion, and regional debt service ratios rose dramatically. Argentina and Brazil, for example, had to allocate over 75 percent of their export earnings to service 1982 debts.

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**Direction of Export Flows**



**IMF Programs**

The foreign exchange strains brought about by deteriorating current accounts and a diminishing ability to obtain foreign bank loans made South American countries, excluding Colombia and Paraguay, turn to the IMF for assistance. Among the conditions for its financial support, the IMF is requiring South American countries to meet balance-of-payments and foreign exchange reserve criteria. To achieve these goals, the IMF has set trade targets and specified policies to boost earnings and control foreign exchange expenditures. As a result, most governments are pushing for increases in export earnings through currency devaluations, export incentives, and larger credit allocations. Furthermore, they are seeking greater

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**South America: Comparative  
Export Trends**

Index 1980=100

	1980	1981	1982	1983 <sup>a</sup>
<b>Argentina</b>				
Value	100	114	95	99
Volume	100	139	99	NA
<b>Bolivia</b>				
Value	100	96	88	85
Volume	100	108	102	NA
<b>Brazil</b>				
Value	100	116	100	106
Volume	100	120	108	NA
<b>Chile</b>				
Value	100	84	82	91
Volume				
Copper	100	99	116	NA
Iron ore	100	88	73	NA
<b>Colombia</b>				
Value	100	74	77	63
Volume	100	82	80	NA
<b>Ecuador</b>				
Value	100	101	85	80
Volume	100	113	94	NA
<b>Paraguay</b>				
Value	100	98	125	99
Volume	100	95	125	NA
<b>Peru</b>				
Value	100	112	111	75
Volume	100	95	125	NA
<b>Uruguay</b>				
Value	100	115	97	104
Volume				
Wool	100	116	90	NA
Meat	100	150	126	NA
<b>Venezuela</b>				
Value	100	105	93	74
Volume	100	95	80	NA

<sup>a</sup> Estimated.

diversification of export markets and products and are attempting to strengthen regional trade integration. 25X1

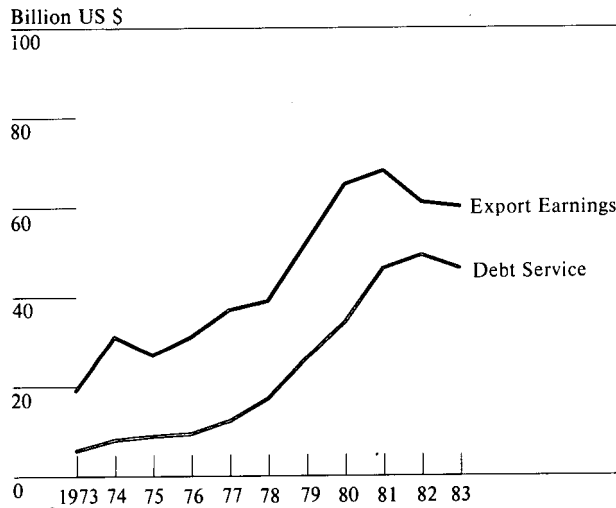
Because of the growing inability of South American countries to generate sufficient foreign exchange to cover their import needs, many are turning increasingly to alternative trade schemes. Accordingly, more trade is being transacted under countertrade agreements, bilateral credit lines, and barter arrangements. The recent agreement between Brazil and Mexico, which includes \$3 billion in barter trade, and Brazil's efforts to reach similar agreements with other Latin American countries are examples of this new trade track. 25X1

**Results to Date**

According to Embassy reports and available export statistics, only four South American countries are improving export performance this year. Brazil boosted exports 7 percent to \$14.4 billion in the first seven months of this year compared with the same period in 1982 mainly through large devaluations and export credits. Nevertheless, 1983 earnings probably will fall short of the \$22 billion targeted by the IMF because of the effect of a still overvalued cruzeiro on manufactures sales to Western Europe and substantially reduced exports to cash-short Venezuela, Argentina, Chile, and Mexico—countries that together absorb 15 percent of Brazil's total sales abroad and represent its fastest growing export markets. 25X1

Argentina's \$2.6 billion of exports in January-April were 16 percent lower than the same period of 1982, intensifying Buenos Aires's difficulties in trying to meet the \$9.5 billion IMF annual export goal. While Argentina has a record wheat harvest,

**South America: Debt Servicing Obligations and Export Earnings Trends**



[Redacted]

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the production of corn—the second-largest agricultural foreign exchange earner—is down because of drought. The government's elimination, under IMF pressure, of a 5-percent tax incentive for exporting to new markets has further depressed exports. [Redacted]

Venezuela pushed up exports during January-March, but lower oil prices since March are likely to cause 1983 annual exports to fall at least 10 percent short of last year's \$16 billion. Petroleum products account for about 90 percent of Venezuela's export earnings. [Redacted]

Colombian, Uruguayan, and Paraguayan exports have been adversely affected by significant devaluations in their principal export markets. For example, Colombian exports declined 22 percent to \$1 billion in the first half of 1983 compared with the first half of 1982, as sales to Venezuela and Ecuador fell sharply. Although Uruguayan first-half 1983 sales have risen 13 percent to \$531 million, as compared with the same period of last

**South America: IMF Export Goals Compared With Likely Results, 1983**

*Billion US \$*

	IMF Target	CIA Forecast	Forecast Deviation From IMF Target
Argentina	9.500	8.000	1.500
Brazil	22.000	21.500	0.500
Chile	4.500	4.255	0.245
Ecuador	2.336	2.000	0.336
Peru	3.030	2.915	0.115
Uruguay	1.135	1.100	0.035

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year, the US Embassy in Montevideo reports that weak global economic conditions may not permit annual Uruguayan sales to reach the \$1.1 billion 1983 IMF export target. [Redacted]

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Ecuador and Peru also have had difficulties increasing exports this year despite their incentive programs. Ecuadorean export earnings this year totaled \$1.2 billion through June, a 5-percent increase over the same period in 1982, as a result of increases in oil, shrimp, and coffee exports. It is unlikely, however, that exports will do as well in the second half of the year because of the one-third agricultural production decline. Continued depressed demand for mineral exports, weak copper prices, and weather-induced declines in petroleum production kept Peruvian export earnings at \$1.3 billion through June, 10 percent below the same period last year, providing little optimism that Lima will meet the \$3 billion IMF export target. [Redacted]

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Bolivia and Chile are also heavily dependent on minerals sales. In Bolivia, declines in mineral production—mainly resulting from labor stoppages and lack of spare parts—resulted in a \$24 million

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drop in first-quarter 1983 exports. Chile's plan to increase export earnings through the financing of export industries and continuing peso devaluations has not succeeded because of weak global economic conditions. Chilean January-July sales dropped to \$1.9 billion, 12 percent below comparable period 1982 levels, rendering the \$4.5 billion IMF annual export goal almost unattainable. [redacted]

### An Early Look Ahead

South American exports in 1984 probably will continue to face shaky markets and, consequently, are unlikely to register major gains. For oil-exporting Venezuela and Ecuador, earnings may firm in 1984, but at lower levels than in recent years. Markets for Brazilian and Argentine manufactures will remain soft pending a strong worldwide economic recovery and improved financial health throughout the region. Although most forecasters expect increased industrial country economic activity next year, few are predicting a major surge in growth. Moreover, sustained commodity price rises tend to lag industrial country recovery some six months. Labor and management pressures for increased industry protection in developed countries may restrict a rapid expansion of imports from South America. Intraregional trade also will continue to be constrained by austerity programs throughout the region. [redacted]

### Implications for the United States

Failures on the part of South American countries to increase their export earnings will jeopardize IMF stabilization programs and heighten debt servicing difficulties. Foreign bank rescheduling agreements and IMF programs may not survive without tougher austerity and additional foreign government assistance. The unraveling of a few financial packages—such as those of Brazil and Argentina—would have widespread repercussions throughout the rest of South America. A further drop in financial support to South America would deepen recessions in the region, reduce world trade, and slow the global economic recovery. [redacted]

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