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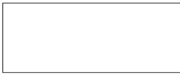
International Economic & Energy Weekly



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International Economic & Energy Weekly

25X1

10 November 1983

iii Synopsis

1 Perspective—LDC Import Cutbacks: Investment and the Private Sector 25X1 25X1

3 Briefs
Energy
International Finance
Global and Regional Developments
National Developments

11 International Financial Situation: Political Update 25X1
This article was prepared by analysts from ALA, OEA, NESA, and OGI

15 International Financial Situation: Imports of Manufactures Down Sharply in Key Debt-Troubled LDCs 25X1 25X1

17 South America: Import Contraction Hurts Growth 25X1 25X1

23 Saudi Arabian Military Programs: The Impact of Reduced Oil Revenues 25X1

27 Dominican Republic: Struggling To Revitalize Its Economy 25X1 25X1 25X1

25X1

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Synopsis

Perspective—*LDC Import Cutbacks: Investment and the Private Sector* 25X1

The current international financial situation has forced key Third World debtors to cut back dramatically on imports, particularly machinery and equipment. As these cuts work their way through LDC economies, current production and longer run economic potential will be lowered. In response Third World leaders could take two very different paths—greater import substitution or increased reliance on direct foreign investments. 25X1

International Financial Situation: Political Update 25X1

This article is part of a special series on the economic and political aspects of the international financial situation. It updates the political situation in several key LDCs. 25X1

International Financial Situation: Imports of Manufactures Down Sharply in Key Debt-Troubled LDCs 25X1

This is another in the special series on the economic and political aspects of the international financial situation. This article examines the sharp falloff since 1981 in imports of manufactures by major debt-troubled LDCs. 25X1

South America: Import Contraction Hurts Growth 25X1

The import contraction in many South American countries this year is likely to exceed IMF targets because of tighter exchange controls, the lack of trade financing, and recession. For the entire region, imports will most likely decline 27 percent below the $65 billion recorded in 1980. The United States is bearing the brunt of South America's import plunge. 25X1

Saudi Arabian Military Programs: The Impact of Reduced Oil Revenues 25X1

Saudi military spending for 1983 will be cut back 15 percent from 1982 to approximately $22 billion. Because of existing manpower and equipment problems, we do not believe the spending cutbacks will have a serious additional impact on Saudi military capabilities or readiness. 25X1

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Dominican Republic: Struggling To Revitalize Its Economy

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Despite the tough austerity measures taken last year, the Dominican Republic still is grappling with severe financial problems. We believe President Salvador Jorge Blanco will remain hard pressed by short-term financial woes and the challenge to make basic economic reforms needed to minimize longer term growth prospects and exploit the trade and investment incentives under the Caribbean Basin Initiative

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International Economic & Energy Weekly

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Perspective

LDC Import Cutbacks: Investment and the Private Sector

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The current international financial situation has forced key Third World debtors to cut back dramatically on imports. Manufactured goods, in particular machinery and equipment, have borne most of the burden. If the first-half trade statistics of the major industrial countries are an accurate guide, the investment component of key debtors' imports has been cut in half during the past two years.

The impact of the capital goods cutback goes well beyond the trade numbers. Most of the debt-troubled LDCs have relied on foreign machinery and equipment to build their industrial base. The importance of these purchases is underscored by the fact that capital goods accounted for 50 percent of the debt-troubled countries' imports in 1981. As the cutback in investment goods works its way through Third World economies, not only will current production be curtailed but, more important, longer run economic potential will be lowered.

We doubt that Third World leaders will sit idly by and watch their nations' economic base deteriorate. If nothing else, the political effects of declining living standards will force a response. Among the key questions then are what form will the response take and what will the side effects be.

There are at least two dramatically different paths Third World leaders could opt for:

- Import substitution has frequently been a Third World response to trade problems. While there is room for import substitution in consumer goods, much more could be done on the investment goods side. Even though budget deficit constraints are likely to rule out subsidies and rebates, numerous national restrictions could be woven together to develop large, albeit inefficient, domestic investment goods industries.

- Alternatively, greater reliance could be put on foreign direct investment. This could be done in a number of ways ranging from attracting traditional manufacturing investment to experimenting with a modified version of recent British and West German industrial policy—selling off nationalized industries to domestic and foreign investors in an attempt to strengthen the private sector, reduce budget deficits, and perhaps raise foreign exchange.

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Whichever investment path is chosen, difficulties will abound. Import substitution will entail more government intervention and control. Moreover, it typically widens trade deficits in the near term because of the imports needed simply to set up the domestic industries. If the direct investment option is chosen, many hurdles would have to be overcome. Increased private investment would most likely meet strenuous opposition from groups claiming that it is a sellout to foreign interests. In addition, it will be difficult to pursue because it hinges on Western investors' willingness to put money into risky foreign ventures just at the time when OECD recovery is picking up steam and domestic opportunities are growing. Moreover, the LDCs would have to assure foreign investors that foreign exchange will be available to repatriate their profits—assurances that are not bolstered by current policies that generally put the private sector at the end of the foreign exchange queue.

Despite its well-established shortcomings, the import substitution path has a strong nationalistic appeal for the LDCs and could become policy by default. While it would be easier to implement in the short run, the inefficiencies it would generate could easily sow the seeds for future financial crises.

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Briefs

Energy

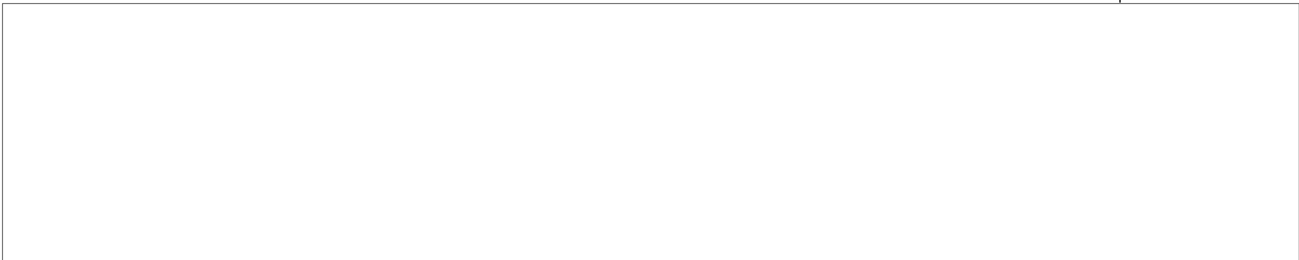
Mexico Sees Small Rise in Oil Output, Exports Next Year

Pemex—Mexico's state oil company—is projecting crude oil production to average 2.75 to 2.90 million b/d and exports of crude and products to average 1.65 to 1.70 million b/d in 1984, [ ] Crude production this year is running at about 2.75 million b/d—about the same level as 1982. A drop in domestic consumption to just over 1.10 million b/d, however, has enabled Mexico to raise exports to nearly 1.65 million b/d, including almost 100,000 b/d of refined products primarily sold to the United States. Mexico also produces about 260,000 b/d of gas liquids, all of which is consumed domestically. [ ] 25X1

Mexico claims that demand for its oil still exceeds its sales contracts, despite a total increase of $2 per barrel in the price of heavy Maya crude since April. Maya crude, now priced at $25 per barrel, accounts for about 55 percent of Mexican crude exports so far this year. The United States remains by far Mexico's largest customer, accounting for 54 percent of Mexico's crude exports—slightly above the maximum permitted by Mexican policy. Mexico still has about 250,000 b/d of shut-in capacity, mostly in newly developed offshore fields, which Mexican officials claim they are withholding from the market to support OPEC's effort to uphold oil prices. In fact, Pemex has allowed maintenance to lapse over the past few months, which could present problems in bringing this capacity back on line. The producing capacity of older onshore fields is continuing to erode as well. [ ] 25X1

Japan Increases Oil Stockpile

Tokyo has announced plans to buy an additional 7.86 million barrels for its government-owned stockpile by yearend. The addition would raise the stockpile to 87 million barrels, equal to 20 days of last year's net imports. Originally the Ministry of Trade and Industry (MITI) was seeking a 15.7-million-barrel increase, but in negotiations with the Finance Ministry gained approval for only half. We expect MITI will request approval to purchase the remaining 7.86 million barrels in early 1984. The goal of the stockpile program remains at 189 million barrels by 1988. [ ] 25X1



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Electric Utilities Reduce Oil and Gas Use

Total oil consumption by electric utilities in France, Italy, West Germany, the United Kingdom, and the United States in first-half 1983 averaged only about 700,000 b/d—down about 50 percent from 1979 levels, before the second oil shock. Gas consumption by the electric utilities in these countries dropped by 240,000 b/doe to 740,000 b/doe. Increased nuclear and coal-fired generation during the period offset the declines in oil and gas consumption. The United States and Italy remain the largest users of oil for electricity, burning 340,000 b/doe and 220,000 b/doe respectively. In Italy, oil accounts for about 50 percent of electricity generation. The United States, on the other hand, burns oil to produce only about 6 percent of its electricity. High utilization rates in nuclear, coal-fired, and hydroelectric generation leave little room for additional declines in oil- or gas-fired electricity generation in the near term.

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New Australian Uranium Development Policy

The Australian Labor Party's Parliamentary Caucus narrowly approved Prime Minister Hawke's new uranium policy this week. As a result, Australia—with the largest recoverable uranium reserves in the non-Communist world—will not permit the development of new uranium mines, except for the huge Roxby Downs mine in South Australia. In addition, no new export contracts will be permitted for Australia's two operating mines pending an inquiry into Australia's role in the nuclear fuel cycle—expected to be completed in mid-1984. Two contracts that were negotiated with US electric power utilities earlier this year, however, will be honored. The policy represents a compromise between Hawke's pro-uranium development faction and the Labor Party platform calling for a complete phaseout of uranium mining and exports. Opposition to the new policy remains widespread; unions are against uranium mining whereas local political leaders are disappointed over the loss of $500 million in investment for new mines.

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International Finance

Egyptian Negotiations With the IMF

Cairo may soon double subsidized bread prices to improve its chances for a $300 million IMF standby agreement. US Embassy sources in Cairo and Fund officials in Washington believe that the Mubarak government is likely to announce the price increase before the IMF team's scheduled arrival in Cairo on 15 November. Fund officials have indicated that without the increase, negotiations for the standby will be postponed.

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Even if Cairo takes this politically hazardous step, negotiations with the Fund are likely to be difficult. The IMF will probably demand austerity measures including reduced budget deficits and a 40-percent devaluation of the country's official exchange rates—one Egyptian pound (£E) equals $1.43—to the free market rate of £E 1 equals $0.87. The most contentious issue, however, is likely to be energy prices. Fund demands for domestic energy price hikes early next year are certain to clash with the government's desire to hold the line until the expected furor over higher bread prices has subsided and until after the People's Assembly elections in April. 25X1

Moroccan Debt Rescheduling Jeopardized

Paris Club members have tentatively agreed to provide Morocco with a $530 million aid package—$120 million short of meeting the IMF's projected balance-of-payments gap through the end of 1984. Representatives from the IMF have notified Paris Club members that, unless the gap is closed before the Fund's standby loan review in late November, the IMF program in Morocco will be canceled. Donors are reconsidering their pledges in light of the IMF warning because failure to continue the IMF program would leave Rabat's debt rescheduling and financial stabilization program in disarray. The US delegation has been urged by Paris Club members to offer additional support and will be watched closely by other Paris Club participants and the Moroccan delegation. 25X1

Trouble Brewing for Honduras-IMF Agreement

Continued heavy payments on publicly guaranteed private debt will probably push Honduras out of compliance with its IMF standby agreement, endangering disbursement of the Fund's final 1983 tranche of $16 million. Debt servicing has pushed Tegucigalpa's domestic borrowing $30 million above the IMF ceiling, [redacted] Moreover, the government's reluctance to cut spending and raise taxes will impede a new standby arrangement in 1984. Meanwhile, Honduras's net international reserves have slipped to a minus $110 million. Tegucigalpa probably will await the final word on US aid levels—and hope that Washington will press the Fund to disburse the final 1983 tranche despite the violation—before making politically difficult cuts at home. 25X1

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Global and Regional Developments

Bonn Dissatisfied With EC Steel Policy

West Germany is increasingly critical of the Community's steel program and is threatening to increase subsidies to its steel industry if the EC does not raise West German production quotas and curb imports from third countries. The steel industry is pressing the Kohl government to protect domestic markets from heavily subsidized steel imports from other EC countries. The industry argues that higher West German production quotas—and lower quotas for other EC countries—would help alleviate the problem. West German steelmakers also are complaining that their domestic market is absorbing an inordinately large share of total EC steel imports from third countries. In first-half 1983 West Germany accounted for 40 percent of EC steel imports from third countries compared with 34 percent in 1980. 25X1

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The EC is unlikely to provide any relief for the West German steel industry over the short term and Bonn probably will act on its own. Faced with surging imports, steel disputes with the United States, and the mounting financial problems of key steel companies, Bonn is committed to providing financial aid to help restructure the industry and reduce capacity. West German Economics Ministry spokesmen have threatened that any new steel subsidies would come at the expense of West German contributions to the EC budget, adding to Brussels's financial woes. The move also would reduce the likelihood that the EC Commission will be able to phase out EC and national subsidies by the end of 1985. 25X1

National Developments

Developed Countries

Israeli Tax Increases

The Israeli Cabinet agreed on Monday to a number of measures designed to increase government revenues, according to a press report. The measures include:

- A higher tax bracket for Israelis earning $32,000 a year or more—from 60 percent to 66 percent.
- An $80 annual education fee for each child in public schools.
- A doubling of the tax on foreign travel to $100.

The Cabinet also agreed to tax child allowances provided by the government, freeze government hiring, and cut overtime. Earlier press reports had indicated that Finance Minister Cohen-Orgad had agreed to these measures, particularly the higher tax bracket for wealthier Israelis, in order to get agreement on future budget cuts from TAMI, a coalition party that has a lower-income constituency. The government raised gasoline prices 15 percent last Friday, and similar increases on other items with government-controlled prices are expected soon. The new measures will make only a small dent in the budget deficit. They reflect Cohen-Orgad's cautious approach and desire to work out agreements with other Cabinet ministers whose continuing support is necessary if his austerity program is going to work. 25X1

Canada To Begin Manufacturing Helicopters

The Canadian federal government and the government of Quebec have joined a US firm to invest in Canada's first helicopter manufacturing plant. Three different helicopter models are to be manufactured with production beginning in 1985. In addition, Ottawa will provide a subsidy of $81 million to Pratt and Whitney Canada, Ltd., to expand production of helicopter engines for the new aircraft. The firms involved project more that $8 billion in helicopter and engine sales over the 20-year life of the project—a figure we believe is optimistic given the competitiveness in the helicopter market. 25X1

The Canadian move to jointly produce helicopters with a US firm underscores Ottawa's commitment to maintaining a broad-based aerospace industry despite last year's $1.1 billion loss by Canadair and a $200 million loss by

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DeHavilland. Because of a limited home market, Canadian aerospace firms have had difficulty reaching production break-even points. Canada is the world's second-largest market for civil helicopters, however, and Ottawa believes the new plant will significantly reduce imports as well as boost exports; the US firm involved expects to export 85 percent of production.

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South African Drought Eases But Impact Lingers

South Africa's wet season began on schedule in late September with normal rainfall bringing some immediate relief to areas hard hit by a year of severe drought. The rains enabled corn farmers—who have suffered most from the drought—to begin this season's planting and have caused official estimates of the wheat harvest to be revised sharply upward. Wheat supplies are now projected by Pretoria to be adequate for 1984—apparently without imports. There was little runoff from the rains, however, and dams remain well below normal levels. The dam that provides most of the water for households in the Pretoria-Johannesburg region is at only 22 percent of capacity and must reach 50 percent by late December to forestall additional rationing measures.

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Less Developed Countries

Saudi Arabia's Strategy for Its Next Five-Year Plan

Riyadh intends to institute austerity measures as part of its fourth Five-Year Plan (1985-90)

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The plan calls for lower government expenditures—particularly for consumer subsidies and the operation of public facilities—improved government efficiency, and a larger private-sector role, particularly in providing social services. The Saudis' new plan is based on expectations of at best a stabilization in their oil production and in the world oil price at a time when they will face rising costs for completed development projects. Subsidy reductions, however, will risk popular dissatisfaction among Saudis who expect improved economic well-being.

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Nicaragua Plans To Reactivate Oil Port

Managua is attempting to reactivate a mothballed oil offloading facility on Nicaragua's Pacific coast in order to counter insurgent attempts to destroy its other oil import facilities.

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In addition to opening another import route, the reopening could add a week to the country's 18 weeks' worth of storage capacity and reduce the economy's vulnerability to insurgent disruptions. In a related move, Managua has begun building a new road and rail causeway to help secure transportation between the mainland and Corinto, the country's principal port. Nicaraguan leaders have been concerned over insurgent attempts to knock out the existing road bridges to Corinto that carry about 85 percent of the country's foreign trade. Managua hopes to complete construction by February 1984.

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Cuban Economic Problems Continue

Data released recently by Havana indicate that Cuba's economic downturn and foreign exchange problems continued during the first half of 1983. Convertible currency export receipts fell by nearly 30 percent from the previous period because of:

- A 1-million-metric-ton drop in sugar production and foreign sales resulting from poor weather during the peak harvest season.
- The 25-percent decline in world sugar prices compared with the same period a year earlier.
- A decrease in the volume of nickel exports apparently because of smaller sales to Japan and some West European countries that were beginning to negotiate agreements with Washington to certify that no Cuban nickel is contained in their steel exports to the United States.

Lower foreign exchange earnings and the continued reluctance of Western bankers to provide credits forced Havana to keep hard currency imports during the first half of this year at the depressed 1982 level—40 percent below 1981 purchases. 25X1

Shortages of imported raw materials and spare parts from the West are causing economic activity to stagnate. Particularly affected are consumer goods and public transport. Production of fertilizers and textiles as well as repairs of sugar harvest machinery also are behind schedule. Although we expect some recovery in sugar production next year, projected increases in export earnings will not ease the shortage of convertible currency much. As a result, we expect Cuba in early January will seek a Paris Club rescheduling of debts due in 1984. 25X1

Chinese Failure To Honor US Grain Agreement

International grain traders say China will fail to meet its commitment to purchase 6 million metric tons of US grain this year under the Long-Term Grain Agreement. Purchases for delivery this year now stand at 3.8 million tons. This would be the first time China has failed to purchase the minimum called for in the agreement, which expires at the end of next year. The Chinese claim that US textile trade quotas forced them to cut purchases of US grain this year, but cheaper supplies from other exporters and record Chinese harvests also contributed to their decision. China already has signed long-term agreements that would cover its stated import plans for 1984, including 6 million tons of US grain. Traders suggest that during bilateral talks this month the Chinese will refuse to carry over any shortfall of purchases for 1983 into 1984. Furthermore, if the current countervailing duties case on textiles is not resolved to China's satisfaction, it could be offered as a reason for canceling purchases of US grain in 1984. 25X1

Good Start for Soviet Winter Grains

Prospects for the winter grain crop have been helped by good weather this fall. 25X1 press reports indicate that the sowing of winter grains was virtually complete by late last month and that good emergence was evident in most areas. The sown area is 6 to 7 percent larger than it was at the

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same time last year. Although soil moisture in the southern Ukraine, North Caucasus, and South Volga areas was deficient in September, most of the region received sufficient rainfall in October for germination. October's improvement in soil moisture is likely to result in a good winter grain crop as long as the winter weather remains normal.

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First-Half 1983 Soviet Trade Results

Recently released data show that the USSR recorded a substantial improvement in its trade balance during the first six months of 1983 compared with the same period in 1982. Almost all of the improvement occurred in the USSR's trade with its socialist trading partners. Higher oil prices accounted for most of the rise in Soviet exports to the CEMA countries; oil prices are calculated on a five-year moving average, so the price charged by Moscow increased about 20 percent while world oil prices dropped 10 percent. Trade with the West during first-half 1983 stagnated at about last year's level, and trade with the Third World showed small gains.

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Soviet Trade Results

Billion US $

	January-June 1982			January-June 1983		
	Exports	Imports	Balance	Exports	Imports	Balance
Total	**41.9**	**42.6**	**−0.7**	**45.3**	**43.8**	**1.5**
Socialist	23.0	22.9	0.1	25.9	24.1	1.8
Eastern Europe	17.8	17.1	0.7	20.0	18.9	1.1
Other	5.2	5.8	−0.6	5.9	5.2	0.7
Developed West	12.7	14.7	−2.0	12.5	14.5	−2.0
Less developed countries	6.2	5.0	1.2	6.9	5.2	1.7
Hard currency	15.6	15.7	−0.1	15.9	15.7	0.2

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Moscow's hard currency trade position remained close to last year's level during the first six months with exports increasing by $300 million to $15.9 billion while imports remained at $15.7 billion. Partial Western trade data indicate that Soviet imports of machinery and equipment were about 30 percent higher than in first-half 1982; the higher level probably represents goods for the export gas pipeline as well as a rebound to pre-1981 levels. The rise in machinery and equipment imports was balanced by a sharp drop in Soviet purchases of agricultural products. Soviet imports of US grain dropped by almost 50 percent during January-June compared with the same period in 1982. In Soviet trade with the less developed countries, Soviet deliveries of military equipment apparently were responsible for the rise in exports in first-half 1983. On the import side, an increase in Soviet oil purchases from Libya more than offset a decline in imports from other LDCs.

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Soviet Manganese Purchases

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Soviets have purchased as much as 500,000 metric tons of high-grade manganese ore during the first half of 1983—about 400,000 tons from Australia and the rest from Gabon. This purchase is the first evidence of Soviet manganese ore imports in over a decade. With about 30 percent of known world reserves, the Soviet Union is the largest producer of manganese ore, and production was about 10 million tons last year. The Soviets, however, have been plagued by declining quality of their ore. We believe the high-quality imported ore is needed to blend with Soviet ore for use in new Japanese-designed electric furnaces for the manufacture of high-grade ferro-manganese, a compound used to increase the hardness and wear resistance of steel.

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Austria Helps East Germany Through Trade Financing

Austria's willingness to provide large credits to financially strapped East Germany is helping East Berlin avoid a financial crisis. While East Germany has slashed imports from most Western countries, purchases from Austria surged to $183 million in January-July 1983 compared with $104 million in the same period last year. An Austrian loan of $180 million extended last December has facilitated this growth, and as a result Austria has become East Germany's second-largest Western trading partner after West Germany. A recently concluded $195 million trade pact promises further expansion of commercial and financial links between the two countries.

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Hungarian Capital Market Experiments

Budapest, increasingly supportive of a larger role for private enterprise, is pushing an unorthodox new tactic—the sale of government bonds to individuals. Bond sales would absorb large personal savings, curb consumer spending, and direct assets toward priority investment projects. Previously, consumers could earn at most 5 percent on long-term savings deposits. Following government decisions late last month, they now can earn up to 9 percent by investing in "development bonds" that will help finance a new natural gas pipeline. Individuals also can purchase development bonds in some local areas for projects ranging from expanding telephone service to setting up a winery. More venturesome investors can risk their savings to help capitalize private and semiprivate ventures in the newly authorized small enterprise program. While these new financial options only faintly resemble the full-fledged capital market that some Hungarian reformists have proposed, they demonstrate the regime's continuing resolve to experiment with schemes that elswhere in Eastern Europe are considered audacious and even heretical.

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International Financial Situation: Political Update

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This article is part of a special series focusing on the economic and political aspects of the international financial situation.

Political strains have intensified in some key LDC debtors over the past month. This is particularly the case in the Philippines, where the Marcos government is under steady attack. Recent disturbances in Pakistan have eroded President Zia's authority, but he still has the upper hand. In other countries the situation is in flux. In Argentina, the unexpected magnitude of Alfonsin's victory gives him some political leeway. The Brazilian administration has devised a less painful austerity law which is expected to gain Congressional approval. In Chile demonstrations have increased in frequency but diminished in strength. The situation in Mexico has been relatively quiet.

We believe the political ground rules have changed in the **Philippines.** Marcos's relations with key interest groups have been badly damaged, and the unity of the military and the ruling party apparatus is no longer assured. Some military personnel are meeting with business leaders and politicians to discuss alternatives to the Marcos government. We believe the shift in the loyalty of the business community away from Marcos is a pivotal development, and the need for financial austerity suggests it may be irreversible.

Several signs also suggest growing divisions within the Cabinet. Prime Minister Virata and Foreign Minister Romulo have recently demonstrated their independence from Marcos on key political issues.

The deteriorating financial situation is limiting Marcos's room for maneuver. The US Embassy reports that the banking system has stopped issuing new letters of credit for importers because of foreign exchange shortages. Manila has tightened import regulations, ordered banks to surrender all foreign exchange receipts at the official exchange rate, and has warned of additional layoffs and fuel rationing. These moves almost certainly will put the business community and labor groups more firmly in the opposition camp. In recent weeks labor strikes involving about 50,000 workers have added fuel to almost daily demonstrations calling for Marcos's resignation.

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Antigovernment demonstrations have flared up again in **Pakistan.** In the past month further violence occurred in Sind Province, lawyers held protest marches in nearly all major cities, and 5,000 trade unionists staged the largest antigovernment demonstration in Punjab in recent years. The Sindhis believe the Punjabi-dominated government has ignored their region's economic development and favored Punjabi settlers. They support opposition groups who are demanding that President Zia end martial law and call early national elections. So far, the protests have caused little disruption to economic activity, and Pakistan is making debt repayments on schedule—mainly to official creditors who hold 90 percent of the country's foreign debt.

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In **Argentina** the Radicals' decisive election victory should give President-elect Raul Alfonsin some time to initiate policy changes, but prospects for stability remain uncertain. After his inauguration

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in mid-December, we expect him to move on a variety of contentious issues, including military reforms. Alfonsin is strongly antimilitary, and he intends to reorganize the high command to subordinate the services to the civilian government. He says he will investigate the military regime's human rights abuses and corruption.

Alfonsin's political position over time could be further complicated by Argentina's economic problems. The economy is in a severe recession, and a wage-price spiral pushed inflation to an annual rate of 925 percent in September. On the foreign front, the President-elect has pledged to obtain more favorable terms in rescheduling the country's $40 billion foreign debt. Alfonsin probably will quickly begin discussions with foreign creditors and try to exploit his mandate to gain easier repayment terms. Foreign bankers say they are encouraged by his victory; if rescheduling efforts progress, they may be ready by the end of this month to make long-delayed disbursements of funds that are vital to avoid default and to maintain minimal import levels.

The **Brazilian** Government's introduction of a new and milder wage restraint law—central to the austerity program prescribed by the IMF—has temporarily calmed the stormy political situation in Brazil. The Embassy reports that ruling party leaders have enough votes to pass the new law because, unlike four previous efforts, they negotiated the law with the Congress. The new measure will permit wage hikes averaging 87 percent of the consumer price index, compared with an 80-percent ceiling stipulated in Brazil's revised IMF letter of intent.

The IMF probably will find the new wage law acceptable only if the government agrees to take other steps to reduce the public-sector deficit, including even deeper cuts in state enterprise budgets. Such actions undoubtedly would arouse substantial popular and congressional opposition. Until these questions are resolved, the government is maintaining the 60-day state of emergency declared for Brasilia in mid-October.

Even with a renewed IMF agreement, political trends in Brazil do not augur well for an effective stabilization program. Decisionmaking remains in the hands of five or six military and civilian advisers, with President Figueiredo on the sidelines. Without authoritative guidance, the administration is likely to continue floundering, further eroding public confidence.

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Confrontations in **Chile,** although increasingly frequent, have diminished in strength in the past few weeks. The government is taking a hard line, and the opposition has been unable to mobilize large numbers of protesters. This situation has reduced the prospects for renewal of talks between Interior Minister Jarpa and the opposition Democratic Alliance. Reduced turnout for protests is making the moderate opposition leaders increasingly desperate.

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This increased polarization, the lack of an effective channel for dialogue, and growing frustration of the opposition, if coupled with a harsh government crackdown on leaders of the national strike set for next month, could provoke widespread violence.

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Jarpa has recently urged President Pinochet to replace Finance Minister Caceres to clear the way for more expansionary economic policies. Opposition demands have become so focused on political change, however, that we doubt moves to revitalize the economy would significantly ease political pressures on the government.

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In **Mexico** President de la Madrid successfully juggled problems with labor and dissident groups over the past month, once again demonstrating his political skills:

- A leftist-sponsored nationwide protest against austerity in mid-October generated little popular support.

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- Labor disputes with workers for the National University and foreign and domestic airlines were settled with wage increases substantially below government guidelines.

- Price hikes for milk, eggs, and rice were announced, but so far public reaction has been muted.

- A dispute between farmers and PEMEX officials in the southeastern state of Tabasco, which had caused a number of producing wells to be shut in, was ended when police forcibly dispersed demonstrators.

- In Juchitan, Oaxaca, where a leftist mayor recently was removed from office, supporters are still occupying the city hall. Tensions are expected to mount as elections approach.

- Veteran labor leader Fidel Velazquez is repeating earlier statements that new wage hikes will not be sought this year, but organized labor is campaigning hard for large increases in January 1984.

Over the next month, Mexico City will be concerned about potential setbacks and possible outbreaks of violence in seven states where local elections are scheduled. While losses in some key municipalities could be embarrassing, the ruling party should prevail in most elections.

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International Financial Situation: Imports of Manufactures Down Sharply in Key Debt-Troubled LDCs

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This article is part of a special series focusing on the economic and political aspects of the international financial situation.

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The 15 key debt-troubled LDCs have sharply curtailed their purchases—largely manufactured goods—from the industrial West over the last year and a half.[1] Trade statistics for the major industrial countries indicate that during the first half of this year purchases of manufactured goods, excluding chemicals, were running only 50 percent of their 1981 level. The bulk of the falloff has been in machinery and transport equipment. The decline in imports of machinery in most cases reflects the drop in investment activity in these LDCs. While lower imports are reducing foreign payments pressures, cutbacks in capital spending will retard industrial growth. This in turn will limit the ability of these countries to provide domestic employment for rapidly growing work forces. At the same time, the reduction in purchases from the industrial West could feed back onto the debt-troubled countries to the extent it slows the pace of OECD recovery and thereby limits LDC export expansion.

Fifteen Key Debt-Troubled LDCs: Composition of Imports From the Major Industrial Countries [a]

Billion US $

	1981	1982	First Half	
			1982	1983
Total trade	**62.1**	**49.1**	**27.0**	**17.8**
Foodstuffs	6.9	4.8	2.7	2.5
Raw materials	2.0	1.3	0.7	0.6
Fuels	0.9	1.8	1.1	0.5
Manufactures	51.5	40.7	22.3	14.0
Chemicals	6.7	5.9	3.1	2.6
Semifinished goods	9.4	7.5	4.3	2.2
Machinery	20.7	17.1	9.2	5.6
Transport and equipment	10.5	6.9	4.1	2.6
Consumer goods	4.2	3.3	1.6	1.0
Other	0.8	0.5	0.2	0.2

[a] Data presented here are exports from the United States, Japan, and West Germany. These three countries account for about 40 percent of total purchases by this group of Third World countries.

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Extent of the Fall

Trade statistics for the United States, Japan, and West Germany—which together account for about two-thirds of OECD sales to the debt-troubled LDCs—show that reduced exports of manufactures accounted for 83 percent of the $13 billion drop in Big Three sales to these countries in 1982. Most of the remaining decline was in sales of foodstuffs and raw materials. In the first half of this year, 90 percent of the drop came in sales of manufactures.

Available data for other industrial nations show manufactured goods accounting for one-half to two-thirds of the sales reduction to these 15 debt-troubled LDCs. Most of the remaining decline in exports was in foodstuffs.

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Across the individual debt-troubled LDCs, the composition of the import reductions from the three major industrial countries has been fairly uniform:

- In **Brazil,** reduced imports of manufactures accounted for 85 percent of the falloff in purchases from the three countries in 1982 and 80 percent of the year-over-year decline in first-half 1983.

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[1] The 15 key debt-troubled LDCs are Argentina, Brazil, Chile, Costa Rica, Ecuador, Indonesia, Ivory Coast, Kenya, Mexico, Morocco, Nigeria, Peru, Philippines, Venezuela, and Zaire.

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Selected Debt-Troubled LDCs: Imports of Manufactures From the Major Industrial Countries [a]

Billion US $

	1981	1982	First Half	
			1982	1983
Brazil				
Total	**5.1**	**4.4**	**2.2**	**1.6**
Chemicals	1.1	0.9	0.4	0.3
Semifinished goods	0.5	0.4	0.2	0.1
Machinery	2.6	2.1	1.1	0.7
Transport and equipment	0.7	0.6	0.4	0.3
Consumer goods	0.2	0.3	0.1	0.1
Indonesia				
Total	**5.7**	**6.6**	**3.4**	**2.6**
Chemicals	0.8	0.8	0.4	0.4
Semifinished goods	1.3	1.5	0.8	0.5
Machinery	1.9	2.7	1.3	1.0
Transport and equipment	1.4	1.3	0.8	0.5
Consumer goods	0.3	0.3	0.1	0.1
Mexico				
Total	**17.0**	**10.9**	**6.6**	**3.5**
Chemicals	1.8	1.4	0.9	0.6
Semifinished goods	3.3	1.7	1.1	0.5
Machinery	7.0	4.8	2.8	1.5
Transport and equipment	3.3	1.7	1.2	0.6
Consumer goods	1.5	1.2	0.6	0.3
Venezuela				
Total	**5.7**	**6.0**	**3.0**	**1.3**
Chemicals	0.6	0.6	0.3	0.2
Semifinished goods	1.2	1.4	0.8	0.2
Machinery	2.4	2.5	1.2	0.5
Transport and equipment	1.0	0.9	0.4	0.3
Consumer goods	0.5	0.6	0.3	0.1

[a] Data presented here are exports of manufactures from the United States, Japan, and West Germany.

- For **Indonesia,** a dropoff in purchases of manufactures accounted for almost all of the first-half 1983 reduction.
- In the case of **Mexico,** the fall in imports of manufactures accounted for 85 percent of the decline last year and over 90 percent of the drop in the first six months of this year.
- Nearly all of **Venezuela's** first-half 1983 decline in imports was in manufactures.

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Composition of Reduction in Manufactures

Machinery and transport equipment have accounted for most of the drop in imports of manufactures. Export data for the three major industrial countries, for instance, show that these two categories accounted for two-thirds of the overall decline in manufactures sales to the key debt-troubled LDCs last year. In first-half 1983, reduced purchases of machinery accounted for over 40 percent of the drop in imports of manufactures while a falloff in sales of transport equipment comprised just under one-fifth. Declines of 50 percent or more in machinery imports have occurred this year in Ecuador, Ivory Coast, Kenya, Nigeria, and Venezuela. Mexican machinery imports from the major industrial countries were down 45 percent from the same period last year, following a 30-percent decline in 1982. In one of the few exceptions, Morocco increased imports of machinery, in the first half, probably because of the steady flow of funds for projects sponsored by Saudi Arabia.

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South America: Import Contraction Hurts Growth

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The import contraction in many South American countries this year will most likely exceed IMF targets because of tighter exchange controls, the lack of trade financing, and recession. For the region as a whole, imports are likely to decline 27 percent below the $65 billion recorded in 1980. We estimate import demand in South America will remain depressed thoughout 1984. The United States is bearing the brunt of South America's import plunge.

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Import cuts necessary to improve current account positions and reduce foreign borrowing requirements are contributing to the economic slowdown throughout the region and fueling inflation. Over the longer term, the current import cutbacks will adversely affect capital formation and export potential.

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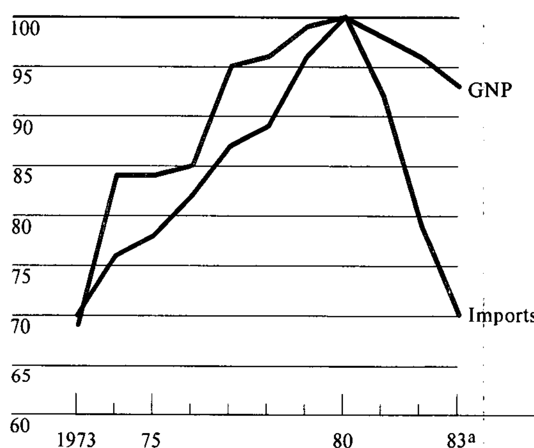
South America: Real Import and GNP Growth Trends



[a] Estimated.

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Import Performance

South America's imports rose from $6 billion in 1960 to $65 billion in 1980. The region's sustained development and industrialization have required growing imports of capital goods and raw materials, especially oil. The sevenfold increase in nonoil imports to $49 billion in 1980—mainly capital goods for development projects—has made possible increased manufacturing, agricultural modernization, and development of the natural resource base. Oil imports increased from a mere $40 million in 1960 to $16 billion in 1980.

South American economies since 1960 have diversified their imports away from the United States and Western Europe to other LDCs and Japan:

- South American purchases from the United States—the region's main supplier with $18 billion in sales in 1980—fell from 40 percent of total imports in 1960 to 28 percent in 1980.
- The EC's share of South American imports declined from 28 to 19 percent over the period.
- South American purchases from other developing countries soared from 19 to 36 percent over the 20-year period.
- Imports from Japan boosted its share from 2 to 7 percent. (C)

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Brazil, Venezuela, and Argentina have been the leading importers since 1960. Brazil—the region's

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largest purchaser—has sustained rapid industrialization and modernization through increased purchases of oil from the Middle East and capital goods and industrial inputs from developed countries. As a result, Brazilian imports increased from $1.5 billion in 1960 to $25 billion by 1980. Imports by Venezuela—the second-largest market—rose from about $1 billion in 1960 to $12 billion in 1980, driven by consumer goods and industrial equipment. Foreign purchases by Argentina soared in the late 1970s to $10.5 billion as the government attempted to use import competition to force industrial efficiency. Smaller South American economies also represented dynamic markets, particularly for manufactures and equipment needed for energy-related development projects.

Since 1980, the situation has changed dramatically. In 1981 imports grew only 3 percent to $67 billion. In 1982, the deteriorating financial position of South American countries caused imports to drop by 16 percent to $56 billion. The region's ability to import was squeezed further as the debt service burden rose to $49 billion—equal to 80 percent of sagging export revenues. By late 1982, worries about the solvency of many South American borrowers prompted international bankers to tighten credit lines.

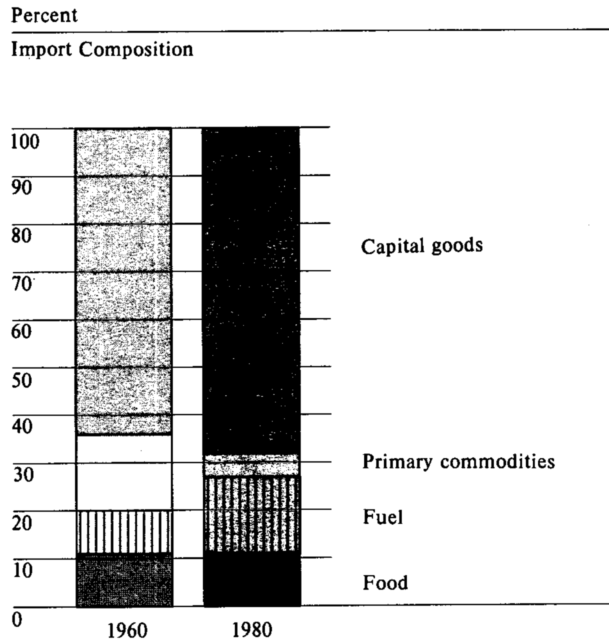
The Current Situation

Additional import cutbacks were planned this year as part of IMF-sponsored adjustment programs. With export revenues flat, South American countries were forced to slash imports to improve current account and debt servicing prospects so they can qualify for IMF support. To meet trade targets, countries such as Brazil and Ecuador have implemented large devaluations and tightened exchange controls. Throughout the region, the stiff IMF-mandated austerity measures—public spending cutbacks, tight monetary policies, and financial reforms—are slowing economic activity and import demand.

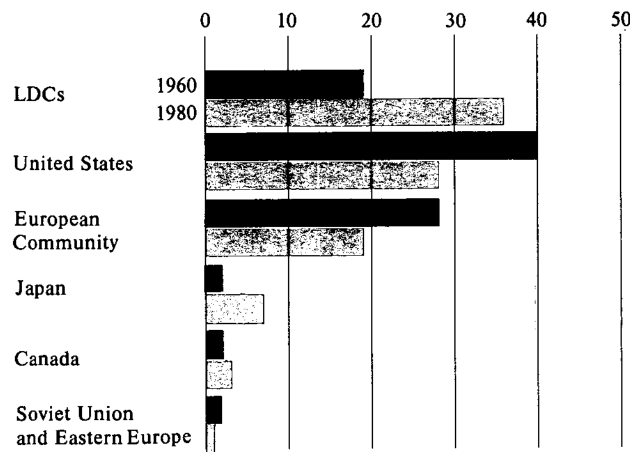
South America: Imports

Percent

Import Composition



Imports by Source



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Trade credit cutbacks are further limiting imports. [redacted] bankers are insisting that a greater share of trade transactions with South America be on a cash basis. Moreover, as importers fall behind in payments, foreign suppliers are requiring collateral, eliminating open accounts, and demanding advance payment for shipments. By placing a greater proportion of international trade on a cash basis, foreign suppliers could increase short-run liquidity pressures on cash-short South American countries, risking financial rescue packages in place throughout the region. [redacted]

South America: 1983 Imports *Billion US $* 25X1

	1982	1983	
		IMF Target	CIA Forecast
Argentina	5.3	5.6	5.1
Brazil	21.1	16.1	16.0
Chile	3.5	3.5	3.4
Ecuador	2.0	1.6	1.7
Peru	3.6	3.2	3.0
Uruguay	1.1	1.2	1.1

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Results to Date

South American import retrenchments, according to Embassy reports and available trade statistics, will likely exceed IMF targets in many countries this year. We estimate imports will decline 16 percent to $47 billion:

- Brazil cut imports 23 percent to $11 billion in the first nine months of this year, as compared with the same period in 1982. Nonoil imports declined about 30 percent while oil imports were down by some 20 percent.
- Venezuela slashed imports in half to $3.1 billion through June, as compared with the same period last year. The downturn in oil earnings and mounting debt difficulties have resulted in devaluation, foreign exchange controls, import prohibitions, and higher duties.
- Argentina's imports of $2.3 billion through June were 23 percent lower than the same period of 1982.
- Colombia's imports in January-June were 13 percent lower than the same period of 1982. To avoid debt rescheduling, Bogota is imposing licensing requirements on over 80 percent of its imports and stepping up its monthly devaluations.
- Paraguayan imports dropped 18 percent through July 1983 as a result of foreign exchange shortages and slack demand resulting from the slowdown of the Itaipu dam construction.
- Uruguay reduced imports 45 percent to $223 million during the January-May period. [redacted] 25X1

Economic stringencies, depressed export earnings, and borrowing difficulties are also causing the Andean importers to retrench. Peru, Chile, and Ecuador all reduced imports by about one-third during the first six to eight months of this year. Bolivia, which has banned the import of nonessential items to conserve foreign exchange, reduced imports by half during the first quarter. [redacted] 25X1

Economic Impacts

Despite lackluster export performance, we estimate import retrenchments will reduce South America's current account deficit by 30 percent this year to $17-18 billion, the same as 1980 levels. This improvement is having the intended effect of depressing foreign borrowing requirements. As expected, shortages of capital goods and industrial imports are slowing down production, contributing to the 2.5 percent decline in regional economic activity we foresee in 1983. At the same time, devaluations and import controls are pushing up prices throughout South America this year. [redacted] 25X1

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South America: Value of Imports *Index: 1980=100*

	1980	1981	1982	1983 [a]
Argentina	100	90	51	48
Bolivia	100	100	63	67
Brazil	100	97	84	64
Chile	100	124	69	67
Colombia	100	112	118	100
Ecuador	100	99	88	76
Paraguay	100	98	122	97
Peru	100	138	144	121
Uruguay	100	101	64	65
Venezuela	100	111	107	91

[a] Estimated.

South America: Decline in US Exports

	Peak Year	Exports at Peak Year (*Billion US $*)	Percent Decline from Peak Year to 1983 [a]
Argentina	1980	2.6	81
Bolivia	1981	0.2	60
Brazil	1980	4.4	71
Chile	1981	1.5	77
Colombia	1982	1.9	55
Ecuador	1980	0.9	70
Paraguay	1982	0.1	36
Peru	1982	1.5	73
Uruguay	1981	0.2	42
Venezuela	1981	5.4	68

[a] Estimated.

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The longer term cost of achieving trade surplus by cutting imports will be reduced capital formation. In Brazil, for example, import shortages are hindering the completion of investment programs, especially in the energy sector; US businesses report that import controls are restricting oil investment in Venezuela. Colombia's import squeeze, according to the US Embassy, is slowing resource development that ultimately could reduce the country's ability to earn its way out of its financial problems.

A Glance at 1984

We estimate—on the basis of projections of various forecasting services—that South American imports will most likely range between $45 billion and $50 billion in 1984, little change from this year. Import demand will remain sluggish throughout the region as a result of continued economic austerity programs under IMF auspices. Moreover, South American exports in 1984 will face uncertain markets, maintaining the squeeze on import capacity. Beyond this, bankers remain reluctant to increase lending to South America, and high debt servicing payments will continue to claim a large share of exchange earnings.

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Implications for the United States

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The United States is bearing the brunt of South America's import contraction. US sales to South America declined by 15 percent to $15 billion in 1982—possibly displacing as many as 60,000 workers in the United States.[1] In the first half of 1983 US sales fell a further 60 percent compared with the same period a year earlier. US capital goods producers, industrial suppliers, and farmers have been most affected.

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A continued squeeze on imports could prompt South American governments to shift to more nationalistic economic strategies. To meet debt payments and conserve foreign exchange reserves, they may tighten import restraints further. Additionally, most South American governments—in response to domestic recession and growing unemployment—are encouraging local production of goods previously imported. If import substitution again emerges as a primary pillar of South American development strategies, US suppliers will face a tough challenge regaining access to these markets.

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[1] The US Department of Commerce estimates that 25,000 jobs in the United States are lost for each $1 billion decline in exports.

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Saudi Arabian Military Programs: The Impact of Reduced Oil Revenues

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The decline in Saudi oil revenues has forced reductions and reevaluation of several military programs. Saudi military spending for 1983 will be approximately $22 billion, a 15-percent cutback from 1982,
Although the cuts are falling most heavily on Air Force and Navy programs, the Land Forces and National Guard also are affected. No major programs have been canceled, but funding delays have become common; scheduled Foreign Military Sales (FMS) contract payments to the United States are in arrears by about $1 billion. Because of existing manpower and equipment problems, we do not believe the spending cutbacks will have a serious additional impact on Saudi military capabilities or readiness.

Background

The drop in oil revenues has confronted Riyadh with difficult financial problems. We expect oil revenues for 1983 to be about $45 billion, down from $75 billion in 1982. To cope with lower revenues, the regime has instituted across-the-board budget cuts for the fiscal year ending in April 1984. Military spending, however, will remain the largest item in the Saudi budget—about 30 percent of total. The Saudi Government also has responded to reduced earnings by delaying payments to foreign contractors, drawing down its substantial foreign assets and curtailing foreign aid.

Budgeting in the Ministry of Defense and Aviation

Before the decline in Saudi oil revenues, the Ministry of Defense and Aviation "budget" was a collection of programs over which the Ministry exercised only loose control. Service programs with direct political backing from a royal family member or the Ministry of Finance often were funded without prior coordination with the Defense Ministry.

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Defense Ministry officials have recently begun placing greater emphasis on service accountability for programs. Within the Ministry, the Foreign Procurement Division has been charged with exercising increased oversight over the three services' budgetary requests, according to Embassy reporting. Moreover, the Ministry of Finance now has the power to deny funds to previously approved military programs. This has led to at least temporary arrearages on FMS contracts already signed by the Saudi Government.

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Royal Saudi Air Force

Several large, high-priority programs within the Royal Saudi Air Force are receiving reduced funding this year, The largest program affected is Peace Shield, a major improvement of the Saudi air defense network, which includes the purchase of AWACS aircraft and the upgrading of ground radar and communications facilities
funding will be spread over three years instead of one. Although the scale of the program has not been reduced, the delay in a program the Saudis view as critical suggests how seriously they regard their current budgetary problems. In addition, Air Force "wish list" items, such as additional fighter aircraft and the Patriot surface-to-air missile (SAM) have been temporarily shelved. Even without funding problems, however, chronic Saudi manpower shortages probably would have forced

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delays in the purchase of more fighter aircraft and the Patriot.

Saudi Arabian Land Forces

The Saudi Arabian Land Forces have had at least one major ongoing construction project affected by spending constraints, and some Army "wish list" projects have been quietly dropped. Construction of the King Khalid Military City, a division-size installation near the sensitive Kuwaiti-Iraqi border, has been scaled back. In April 1983, as fiscal problems became apparent, the Land Forces asked the US Corps of Engineers' supervisors of the project for an assessment of the impact of a $600 million cut this year. One brigade area has been eliminated, and construction on the supporting airfield may be delayed. Military manpower shortages probably combined with the financial considerations to force the changes.

The 10-year $6.4 billion army aviation program, now in the final planning stages, We believe that this ambitious program (plans call for up to 500 helicopters and 18 new airfields) probably will be cut back and delayed. Other army projects apparently experiencing funding problems are a $5 billion purchase of additional French Shahine mobile SAM batteries (for tactical air defense for Army units) and a multibillion dollar purchase of a replacement tank for the two Land Forces armored brigades. The Saudis are considering the US M-1 tank and the West German Leopard II tank. Spending concerns have become so acute that the Army objected to the cost of flying, rather than shipping, the demonstration model M-1 tank into Saudi Arabia.

So far as we know, other programs are on track. In June 1983 the Land Forces agreed to purchase the Stinger hand-held SAM system to replace the Redeye SAM already in use with Army field units. In addition, the Army decided in July 1983 to purchase an additional 100 US M-60 tanks. Neither sale, however, represents a new large program commitment by the army.

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Royal Saudi Naval Forces

The Royal Saudi Naval Forces have been hard hit by spending cuts, with payments for US-sponsored naval programs in arrears. These programs involve construction of several naval training centers capable of training thousands of personnel each year and a communications network. In addition to current arrearages totaling some $700 million, the Saudi Navy faces near-term obligations of $900 million. If the current arrearages are not paid off, some US contracts could be canceled.

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At the same time, payments for the $4 billion shipbuilding program with France, the Saudi Navy's largest project, are on schedule, The contract includes the purchase of four frigates, two support ships, 24 helicopters, antiship missiles, and an extensive personnel training program in France. Although delivery dates for the frigates have slipped six months, funding has not been delayed.

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Some of the funding delays for the US programs can be attributed to the new Defense Ministry and Ministry of Finance budgetary review processes. In our judgment, however, the Navy is hard pressed to justify a near-term need for the program. Its cost, manpower shortages, and existing naval training programs in France and Pakistan tend to diminish arguments by the Navy for the US program. It may, in fact, be allowed to lapse.

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Saudi Arabian National Guard

Virtually immune to fiscal constraints in the past, the Saudi Arabian National Guard has had to delay by two years the completion of the second

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phase of its ambitious modernization program. It calls for equipping two National Guard brigades with tanks and armored personnel carriers. The start of the third phase of the program, which involves equipping additional units with tanks and armored personnel carriers, probably will be delayed indefinitely. Moreover, Embassy reporting indicates that plans for upgrading the National Guard medical support program are being questioned by the Ministry of Finance.

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Future Impact

The decline in military spending presents advantages as well as problems for the Saudi military. On the positive side, the military will have more time to train personnel and absorb new equipment. We do not believe the fighting capabilities of the Saudi armed forces will be seriously diminished by stretching out major capital projects. Furthermore, continued budgetary constraints could foster useful competition for scarce funds between and within the services. This competition probably would center around funding for "pet" projects sponsored by various senior military officers, some of whom are royal princes. Such infighting, however, could reduce cooperation in planning and exercises to the detriment of Saudi readiness.

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Dominican Republic: Struggling To Revitalize Its Economy

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Despite the tough austerity measures taken last year, the Dominican Republic still is grappling with severe financial problems. In an attempt to comply with IMF targets, the government probably will take additional belt-tightening measures soon; these could weaken popular support and intensify rivalries within the ruling party. We believe President Salvador Jorge Blanco will remain hard pressed by short-term financial woes and by the challenge to make the basic economic reforms needed to improve longer term growth prospects and exploit the trade and investment incentives under the US-sponsored Caribbean Basin Initiative (CBI).

Dominican Republic: Economic Indicators *Percent*

	1978	1979	1980	1981	1982 [a]	1983 [b]
Real GDP growth	2.1	4.8	5.7	3.5	0	1.0
Change in consumer prices	3.5	9.2	16.7	7.5	7.6	7.5
Debt service ratio [c]	19	27	18	20	38	40

[a] Estimated.
[b] Projected.
[c] Debt servicing as a share of earnings from merchandise exports and services.

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Jorge Blanco Inherits an Economic Crisis

When Jorge Blanco took office in August 1982, the country was saddled with severe foreign payments problems, budget shortfalls, stagnating output, and unemployment approaching 30 percent. Weak world demand and domestic supply constraints since early 1981 have slashed sugar and mineral sales, which had contributed up to 70 percent of export earnings. To deal with rising world oil prices, Jorge Blanco's predecessor had slashed imports by banning vehicle purchases and by pushing many foreign exchange transactions onto the more costly parallel foreign exchange market. Despite these efforts, foreign payments pressures mounted through mid-1982 as bulging payments on largely short- and medium-term debts came due and as jitters prior to the May election slowed capital inflows. At the time of Jorge Blanco's inauguration, import-financing arrears had exceeded $300 million and foreign exchange reserves were only about three weeks' import coverage.

Public-sector fiscal performance in 1981 and the first half of 1982 mirrored the weakened trade position. Declining trade tax receipts—about half of government revenues—and overspending by inefficient public enterprises deepened the public-sector deficit despite cuts in central government capital spending. To finance the deficit, the government took a major share of expanded domestic credit, edging out the private sector.

Economic activity slowed to a standstill by mid-1982. This compares to real growth averaging 5 percent a year during 1976-80. Tight credit markets and up to one-year delays in obtaining official foreign exchange for imports crimped production across the board. Output in agriculture—17 percent of GDP and the source of almost half the jobs in the economy—barely grew because of price controls, export restrictions on certain foodstuffs, and an inefficient internal marketing network. Heavy rains and rust disease cut sugar production in 1981. Mining experienced severe setbacks as the world recession led to the suspension of ferronickel mining operations in early 1982, the closure of bauxite operations, and declining production of dore (a gold and silver alloy).

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Swift Response to the Crisis

The Jorge Blanco government quickly announced sweeping austerity measures to deal with the deteriorating economy:

- Measures to cut the trade deficit and maintain official foreign exchange reserves included a ban on some 150 consumer imports, the transfer of additional imports to the more expensive parallel market, and an import surcharge. Incentives were established for exports.
- Government expenditures were trimmed by cutting pay for civil servants and by slashing subsidies to public enterprises.
- Income taxes were increased and a value-added tax was imposed to raise revenue.

The new government's policies contributed to mixed results in 1982. The restrictive fiscal and monetary policies trimmed the budget deficit and helped keep inflation under 8 percent, one of the lowest rates in Latin America. Production stagnated, however, and the current account deficit grew slightly. Import cuts and increased tourist earnings were offset by the effects of depressed world prices for exports.

Beginning a Slow Recovery

In early 1983 Jorge Blanco won IMF approval of a three-year, $408 million Extended Fund Facility (EFF) program. By initiating a tough austerity program several months prior to formal negotiation with the IMF, Jorge Blanco managed to skillfully sidestep public opposition to IMF-directed austerity. The targets of the IMF's stabilization program include steady cuts in the public deficit, limits on foreign borrowing and reserve drawdowns, and the elimination of arrears by early 1986.

The tight rein on imports and public spending necessary to comply with IMF guidelines will result in real GDP growth of at best 1 to 2 percent in 1983 and 1984. Low world sugar prices are limiting sugar output despite the recent replantings of rust-resistant cane. Overhanging world inventories probably will delay recovery in mineral production until late 1984. The construction sector, however, is expected to rebound moderately because of new public investment for housing and roads.

Strengthened tax administration combined with current spending cuts should reduce the public deficit to less than 4 percent of GDP this year, meeting the IMF target. Smaller public borrowing requirements and continuing monetary restraints probably will keep inflation again near 8 percent this year.

OECD economic recovery, government import curbs, and reduced oil prices probably will halve the current account deficit in 1983 to $200 million. After lengthy negotiations, the Dominican Republic has reached agreement with foreign bankers to reschedule some $600 million in debt—mostly import financing arrears and other short-term trade credits—and the package is awaiting the approval of the Dominican Congress. Paris Club restructuring of the country's official debt, held primarily by the United States and Spain, is likely to be delayed until early 1984, pending a yearend IMF review and the formulation of second-year financial targets. In the absence of a Paris Club rescheduling this year, the government could push additional imports to the parallel market to ease payments problems.

Until now, the administration has been able to maintain popular support for austerity by containing inflation and cracking down on corruption and tax evasion. Labor and student unrest has been diffused; the military has been used to eject strikers from the publicly owned cement plant, ward off strikes in several financially troubled businesses, and quell student demonstrations for increased university funding. Nevertheless, additional government spending cuts under the IMF program are likely. As a result, oppositon to government policies is likely to mount, even from members of Jorge

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Dominican Republic: Balance of Payments *Million US $*

	1978	1979	1980	1981	1982 [a]	1983 [b]
Current account balance	−311	−331	−670	−406	−430	−200
Trade balance	−186	−269	−558	−264	−482	−275
Exports (f.o.b.)	676	869	962	1,188	768	825
Sugar	181	201	310	534	287	300
Imports (f.o.b.)	862	1,138	1,520	1,452	1,250	1,100
Net services and transfers	−125	−62	−112	−142	52	75
Debt amortization [c]	96	234	102	148	263	209
Financial gap	**−407**	**−565**	**−772**	**−554**	**−693**	**−409**
Capital account balance	397	678	760	563	582	
Net direct investment	64	17	93	80	−1	
Medium- and long-term loans	207	377	432	299	468	
Net short-term capital, including errors and omissions	126	284	235	184	115	
Change in gross reserves	−10	113	−12	9	−111	

[a] Estimated.
[b] Projected.
[c] Excludes debt rescheduling under negotiation.

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Blanco's own party. His party is divided after last year's bitter election contest and already the jockeying has begun in preparation for the 1986 elections.

Longer Term Economic Restructuring and the CBI

In order to sustain economic recovery, Jorge Blanco will have to go beyond the current austerity program and institute fundamental economic reforms. Diversifying production, for example, would help break the chain between world commodity price fluctuations and chronic Dominican balance-of-payments crises. The development of cost-competitive sugar substitutes abroad and growing competition from subsidized European sugar beet production clouds the long-term outlook for Dominican sugar, which is the country's largest source of foreign exchange earnings and the basis for one-fourth of total industrial production. The development of high-value, labor intensive export alternatives will require substantial investment and time. The expansion of fruit, vegetables, cut flowers, meat, and light assembly and agroindustries could show quick results.

The government has sought to encourage foreign investment in new export industries by amending the foreign investment law and establishing a high-profile investment promotion council to cut bureaucratic redtape. Nevertheless, pressing financial problems, powerful domestic business lobbies and Jorge Blanco's often fractious congressional support probably will delay necessary policy changes.

The Dominican Republic is particularly well suited to benefit from the CBI, which allows 12-year, tariff-free access for many Caribbean exports to the US market and provides long-term trade and investment incentives. The economy is the largest in the Caribbean area—excluding Cuba—and already directs 80 percent of its exports to the US

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market. Sugar constitutes the bulk of these exports and, although US sugar imports will remain under quota restrictions at least through most of next year, tariff-free entry of Caribbean sugar will support Dominican sugar earnings and provide revenues to support export diversification. The elimination of US tariffs under the CBI and the possible hardening of Generalized System of Preferences (GSP) terms for other LDCs after 1984 should attract investors to the Dominican Republic. Moreover, the US tax deduction for convention expenses under the CBI is likely to spark new interest in Dominican tourist facilities.

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