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International Economic & Energy Weekly

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Synopsis

Perspective—*International Oil Market: Tough Time Ahead for OPEC?* 25X1

Divergent producer interests are straining OPEC's eight-month-old production accord, and prospects for a weak recovery in oil demand will add to the cartel's problems in the months ahead. OPEC's problem of dividing its shrunken market could be eliminated quickly, however, if Iran and Iraq carry out threats against oil-related targets in the Persian Gulf. 25X1

International Financial Situation: Drop in Key Debtor Reserves 25X1

This article is part of a special series on the economic and political aspects of the international financial situation. The article examines the foreign exchange reserves of 10 key debtor countries, which fell by $3.2 billion during the first 10 months of 1983. 25X1

International Financial Situation: Banking Regulatory Policies 25X1

This is another article in the special series on the economic and political aspects of the international financial situation. It examines the mixed signals banks have received from regulatory agencies over the past year. 25X1

Near-Term Oil Market Outlook 25X1

The oil market has softened in recent months in response to overproduction and continued weak consumption. Even if consumption rebounds in response to a sustained economic recovery in the OECD, we expect soft market conditions to persist at least through mid-1984 unless OPEC members adhere to present production ceilings. 25X1

Oil Stocks and Government Policies of Industrial Countries 25X1

Falling consumption, high interest rates, declining oil prices, and prospects for ample supplies have triggered a sizable reduction in industrial country oil stocks. Although oil inventories remain adequate for projected consumption needs, the erosion of the commercial stock cushion over the past few years and uncertainties regarding the disposal of government-owned stocks have increased the market's vulnerability to a major supply cutoff. 25X1

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Prospects for Cuts in Soviet Large-Diameter Pipe Imports 25X1

Imports of Western 1,420-mm-diameter pipe by the USSR could drop from an annual average of 2.2 million metric tons during 1981-85 to as little as 500,000 tons a year during 1986-90 as a result of a slowdown in oil and gas pipeline construction and increased domestic production of pipe in the Soviet Union. A substantial drop in Soviet imports of 1,420-mm pipe would most affect Japan and West Germany. 25X1

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International Economic & Energy Weekly

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2 December 1983

Perspective

International Oil Market: Tough Time Ahead for OPEC?

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Divergent producer interests are straining OPEC's eight-month-old production accord, and prospects for a weak recovery in oil demand will add to the cartel's problems in the months ahead. Spot oil prices have come under downward pressure in recent weeks because most OPEC states have been producing above their assigned quotas despite repeated calls for compliance from OPEC's monitoring committee. Moreover, Iran, Iraq, Nigeria, and Venezuela reportedly intend to ask for higher allocations at the ministerial conference on 7 December, even though present market conditions do not justify higher production. OPEC's problem of dividing its shrunken market could be eliminated quickly, however, if Iran and Iraq carry out threatened actions against oil-related targets in the Persian Gulf. 25X1

Despite a modest resurgence in oil consumption in the United States and Japan, oil demand remains sluggish in other non-Communist countries where economic activity has yet to rebound. The strength of the dollar is depriving other major consumers of the benefits of the oil price drop because oil prices are denominated in dollars. Most industry analysts now anticipate only a slight increase in demand next year, with a good chance that a seasonal dropoff in oil use in early 1984 will put OPEC in a bind similar to the previous two years. OPEC's own market assessments developed this fall for the cartel's monitoring and long-term strategy committees reached similarly pessimistic conclusions. Indeed, Saudi Oil Minister Yamani has commented that demand for OPEC crude in second-quarter 1984 will be about 1 million b/d below OPEC's existing 17.5 million b/d ceiling. Production drops in Saudi Arabia and Nigeria in early November combined with further softening of spot prices suggest that OPEC output may already be receding from its recent peak of 19.2 million b/d in September. 25X1

OPEC's awareness of its market problems has not paved the way toward a solution. Instead, competing interests have divided the cartel on the best means to confront the soft market. The sparsely populated Arab nations on the Persian Gulf, led by Saudi Arabia, are principally concerned with maintaining a long-term market for their enormous oil reserves. These states are more disturbed by a loss of market share than recent price erosion, which they consider temporary. This group is wary of price hikes that tend to lessen demand for their crude, and is firmly against any price increase in the next year or so. Most other OPEC countries have large populations relative to their oil reserves and face pressing revenue needs. These nations want to maximize short-term earnings by pressuring the wealthier Gulf producers such as Saudi

Arabia to absorb a larger share of the slack in the market. Some have been openly critical of Saudi Arabia's aggressive marketing tactics in recent months. We believe the Saudi actions have been aimed at keeping prices soft. [redacted] 25X1

Political rivalries are further contributing to tensions in OPEC, especially those arising from the Iran-Iraq war. Iraq recently responded to an Iranian demand for a higher production quota with a similar request. Iran, which wants to limit the revenues of Iraq's Persian Gulf supporters, is arguing for a price increase that would require further curbs on production by the Arab states in the region. [redacted] 25X1

OPEC's next chance to resolve its conflicts will be the ministers' conference next Wednesday in Geneva. Members will probably consider a variety of self-serving proposals; none currently has enough support to win approval. The need for OPEC to adopt new production and pricing measures in the months ahead will depend largely on consumption trends. We believe continued production restraint will be needed even if a small increase in consumption occurs. Unless OPEC reaches an effective production-sharing agreement, the cartel could be confronted with another price drop early next year. [redacted] 25X1

As OPEC struggles to cope with the soft oil market, rising tensions between Iran and Iraq threaten oil market stability. Baghdad continues to brandish recently arrived French Super Etendard jets and other weapons against Iranian oil targets, including Iran's crude export facilities on Khark Island. The sinking of a Greek freighter north of Khark last week may signal that Baghdad is closer to such attacks. Tehran claims it would counter a disruption of its own exports by halting all oil flows from the Gulf and has threatened to retaliate against Iraq's Arab financial backers. [redacted] 25X1

Any action that disrupts the flow of Persian Gulf oil or results in damage to oil facilities in the region could quickly tighten supplies. How fast and how high prices would be bid up during a disruption would depend in large part on market perceptions about the size and duration of the supply loss. While about 8 million b/d of oil surplus production capacity is available worldwide, only 3 million b/d of this total is outside the Gulf. Commercial oil stocks are adequate to meet expected consumption needs; destocking over the past two years, however, has eliminated most of the cushion previously available to offset a supply disruption. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

Australians Pushing Coal Exports

The Hawke government recently established a Coal Council with representatives from federal and state governments, mining companies, and unions that will examine export marketing problems stemming from weak demand that could last until the end of the decade. The Council is considering establishing a national coal marketing board to negotiate coal contracts for individual mines. It may also undertake a mission abroad to identify potential markets in order to diversify exports away from Japan; that country will most likely remain Australia's largest customer. 25X1

Despite the slack world coal market, Australia—which already accounts for one-fourth of the world's seaborne coal trade—is continuing to increase coal export capacity. By 1990 export potential could nearly triple to 220 million metric tons, according to a survey of mining companies recently published by the government. Nearly 85 percent of the increase would be steam coal for electric power generation. 25X1

Australia: Coal Export Potential *Million metric tons*

	1983	1985	1990
Total	**81**	**127**	**220**
Steam coal	29	63	144
Coking coal	52	64	76

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Dutch Gas Sales Rebound

Dutch gas sales during the first nine months of 1983 are up 4 percent compared with year-earlier levels—reversing a downward trend begun in 1979. Declining gas sales and a worsening domestic fiscal situation prompted The Hague early this year to reverse policies aimed at conserving domestic resources and to authorize additional gas exports. Export sales are up 1 percent, with a 10-percent jump in third-quarter exports offsetting a decline in sales during the first half of the year. West Germany, the largest Dutch customer, recorded an 8-percent increase in gas use during the third quarter. On the domestic front, gas sales are up 8 percent because of increased industrial use and a near doubling of gas use in electric utilities following a government decision to supply power stations with extra gas at coal parity prices. 25X1

Oil Problems in Lebanon

Extensive damage to Lebanon's main oil installation at Tripoli has severely limited Lebanon's oil storage capacity and may result in gasoline rationing north of the Awwali River. Parts of the installation have been burning since the onset of heavy fighting between Palestinian groups in early November. Twenty-seven of the facility's 36 tanks and about 35 million gallons of fuel have been destroyed, according to the US Embassy. The Medreco oil facility—located at Sidon—is currently operating, but its location behind Israeli lines renders shipments to central Lebanon, including Beirut, spotty at best. The remaining storage depot, located at Dura and close to Beirut, has a capacity of only 10 days of products at present consumption levels, according to Lebanese Government officials, making the timely receipt of fuel shipments essential. With little room for building reserves and the likelihood that repairs to the Tripoli facility will take up to one year, fuel rationing in the Beirut area is a strong possibility. 25X1

Caltex Production-Sharing Terms With Indonesia

Indonesia's largest oil producer, Caltex, has acceded to Pertamina's demand for new production-sharing terms, including a government share of 88 percent of Caltex's output. This compares to the 85-percent share in force for all other contracts. According to Minister of Mining and Energy Subroto, negotiations are continuing on other aspects of the Caltex agreement, but he expects to sign the contract shortly. Under its former concession-type contract, Caltex retained management authority and split profits with Pertamina. Now output will be split and Pertamina will exercise decisionmaking authority. Pertamina had long made known its intent to seek a larger share of Caltex's output when the 20-year-old contract expired on 27 November; so far the Indonesians have not indicated they will seek larger shares from other contractors. 25X1

Lagging Gas Production Threatens Thailand's Industrial Expansion

Despite the inauguration of Thailand's second natural gasfield in late October, gas shortfalls are hindering efforts to replace imported oil and threatening industrial expansion. Initial production of 400,000 cubic meters per day from the new field is projected to rise at most to 1.1 million cubic meters per day (mcmd). This will not make up the shortfall from Thailand's larger gasfield, which is producing 4.5 mcmd, far short of the 7.1 mcmd originally expected. Although other small fields are expected to come on line in the next few years, total gas production is likely to fall far short of the 21 mcmd Bangkok had hoped would fuel a heavy industry complex. Thailand already has put some projects on hold, and foreigners are reluctant to participate in the remaining petrochemical and fertilizer investments. 25X1

Norwegian Oilfield Development Plans Finalized

Norsk Hydro—operator of the Oseberg oilfield—has won the support of the Norwegian Petroleum Directorate (NPD) for its plan to develop Oseberg using two platforms. Statoil, a member of the field's operating committee, had argued for a less-expensive single-platform option, but the NPD supported Norsk's development proposal because this will allow initial oil production to be accelerated by one year to 1989. Oseberg's recoverable oil and gas reserves are estimated at 900 million barrels and 70 billion cubic meters, respectively, and oil production is expected to peak at about 200,000 b/d in the early 1990s. Gas will be reinjected in the initial production phase in order to maximize oil output and later is expected to be exported through the new Statpipe system. [redacted] 25X1

International Finance

Philippines Commercial Loan Rescheduling

The Philippines' largest commercial creditors apparently have settled on a debt rescheduling formula that may be unacceptable to Manila's 370 to 400 smaller commercial creditors. [redacted] the proposed arrangement would extend payments falling due through the end of 1984 on medium- and long-term foreign debt over a seven- or eight-year period, while providing up to $1.5 billion in new commercial loans. The agreement also would seek to maintain short-term credit lines at the levels of October 1983 for 12 to 18 months—a move that the smaller banks reportedly would resist. Resolution of the short-term loan issue is crucial for Manila, because its short-term foreign debt is almost $11 billion. If smaller banks resist maintaining short-term credit lines at the October level, formal rescheduling of the short-term debt will be required for Manila to avoid another liquidity crisis in 12 to 18 months. [redacted] 25X1

Egypt's IMF Talks on Hold

A decision by the Egyptian Government to postpone an increase in subsidized bread prices has prompted the IMF to cancel a scheduled negotiating trip to Cairo. Doubling the price of bread is a Fund prerequisite for a $300 million standby agreement. Egyptian Prime Minister Muhi al-Din has indicated to US officials that the price rises will probably be postponed until after the People's Assembly elections in April of next year. [redacted] 25X1

Bread price subsidies are symbolic of Egyptian Government policies that the IMF and foreign donors find objectionable. The current retail price of bread—equivalent to less than a penny per loaf—represents only 12 percent of the cost of production. Similarly, large subsidies exist in the energy sector and for other basic staples. Failure to come to agreement with the Fund will dim chances that Egypt can secure an accommodation with Paris Club members on debt rescheduling and may cause aid donors to take a harder look at future aid requests. [redacted] 25X1

Taiwan Preparing To Allow Offshore Banking

Taiwan's effort initially will consist of 49 banks, about one-tenth the number in Hong Kong and one-third the number in Singapore. Taiwan's Ministry of Finance and Central Bank expect the offshore banks will help reduce Taiwan's costs of acquiring foreign capital for investment projects and will enhance Taiwan's status in the international financial community. In addition, Taiwan hopes to exploit the uncertain status of Hong Kong to attract business. Although Taiwan has strict foreign exchange controls for domestic banks, they will not apply to the offshore banks. [redacted] 25X1

Global and Regional Developments

East Germany and West Germany Sign Communications Accord

Bonn and East Berlin agreed in mid-November to renew their accord on postal and telecommunications services that lasts through 1990. East Germany will receive 200 million marks (DM) annually (about $75 million) to maintain and improve mail and telephone service as well as an advance on future payments of DM 100 million toward the cost of equipment improvements. The money will be paid before the end of the year. The previous agreement, which expired at the beginning of this year, brought East Berlin DM 85 million annually. The two sides also agreed to construct a fiber optic telecommunications cable between West Germany and West Berlin at an additional cost to Bonn of DM 15-20 million. 25X1

Bonn probably hopes momentum created by this agreement and other recent contracts will sustain overall intra-German relations during the period of INF deployment. East Berlin, still having trouble lining up trade credits, is concerned about safeguarding future inflows of hard currency from Bonn before it has to join in any Warsaw Pact political countermeasures to the INF deployment. The East Germans may also hope to use the new communications agreement to spur negotiations on other economic issues such as the status of their money-losing rail system in West Berlin. 25X1

France Seeks Improved Trade Balance With the USSR

In late November, French Foreign Trade Minister Edith Cresson claimed she had won assurances from the Soviets to step up orders for French goods. Soviet officials failed to give the specific assurances Cresson had sought, however, and the details of the proposed contracts remain to be negotiated. Soviet exports to France in 1982 (almost all energy) totaled about $3 billion, while France sold only half that amount. Despite some improvement in the 1983 trade balance, Paris is becoming increasingly concerned about the sudden fall in Soviet capital goods contracts—$125 million this year as opposed to $625 million in 1982. Meanwhile, with Soviet gas exports due to begin next year through the new Siberian pipeline, Paris fears the current trade gap will worsen. France will continue to press the Soviets for new orders but probably will find it difficult to obtain substantial increases in capital goods contracts because Soviet trade demands have been largely fixed under the current five-year plan. 25X1

EC High-Tech Program

The EC Research Council recently agreed, in principle, to implement an R&D program aimed at strengthening the competitiveness of West European information technology in an attempt to catch up with the United States and Japan. Final agreement to fund the program, however, could be delayed for several months because of EC budget disputes. The ESPRIT program— the European Strategic R&D Program on Information Technology—is the Community's principal cooperative research effort to support basic research activities of business and academic institutions. It is intended to improve the EC's technological base in advanced microelectronics, computer software, advanced data processing, computer integrated manufacturing, and office systems. The plan, however, will not fund product-oriented research efforts. The program is scheduled to cost $1.3 billion over the next five years with an equal share of the funding provided by the EC budget and the private sector. All countries support the research plan and none has raised objections to the amount of funding. Adoption of the ESPRIT program probably will be delayed, however, until the overall EC budget problem is solved. The budget issue is on the agenda for the EC summit in Athens on 4-6 December but probably will not be resolved for several months. [redacted] 25X1

Australia Moves To Sell Bumper Wheat Crop

Australia, with a record wheat crop expected this winter, is courting Middle East and Communist country markets using aggressive sales tactics. The Australians expect to harvest about 20 million metric tons of wheat, almost triple last year's drought-blighted crop and 2 million tons above the previous record. A high-level trade delegation is currently visiting the Middle East and is emphasizing Australia's agricultural exports, particularly wheat. The Australian Wheat Board (AWB) has offered grain storage technology and pest control systems to the USSR, has undertaken the construction of wheat silo complexes in Egypt, is helping Iraq set up a cereal testing laboratory, and has offered India free grain storage in return for purchase of 1.5 million tons of wheat. [redacted] 25X1

These tactics are paying off. The AWB announced a sale of 1.25 million tons to Iraq in early November and 2 million tons to Egypt. In mid-November, Australia sold 1.5 million tons of wheat to the Soviet Union, the largest contract ever signed between the two countries; Australia hopes to sign a long-term wheat supply agreement within the next year. Total Australian wheat exports are expected to reach 11.5 million tons this marketing year (July/June), up by 26 percent over last year. US wheat exports, on the other hand, are expected to fall to about 38 million tons, 5 percent below last year's already reduced levels. [redacted] 25X1

National Developments

Developed Countries

Forecasters Optimistic About Japanese Growth Prospects

In contrast to pessimism earlier this year, private economic research institutes in Tokyo are now confident that Japan's real GDP will meet the government's growth target of 3.4 percent during the fiscal year ending 31 March 1984. Export demand in recent months has been stronger than expected, forcing upward revisions in forecasts. We believe the institutes' optimism will help keep economic performance from becoming a political issue in the forthcoming lower house election campaign. [redacted] 25X1

Looking ahead to fiscal year 1984, the private forecasters are predicting real GDP growth of between 3.7 percent and 4.4 percent. Domestic demand is expected to revive somewhat next year without harming export performance. The institutes disagree, however, over the current account balance. Nomura Securities is projecting a $1 billion decline in the surplus, while Daiwa Securities foresees a $7 billion increase—to $29 billion. [redacted] 25X1

West German Economics Minister To Be Indicted

The state prosecutor's plans for bringing corruption charges against Economics Minister Lambsdorff may force Chancellor Kohl into an early and unwelcome cabinet change. The prosecutor's announcement Tuesday follows a lengthy investigation of Lambsdorff—the main architect of the government's free market policies—for bribery associated with campaign contributions. [redacted] 25X1 25X1 Although Kohl would prefer to postpone a decision on this issue, he will come under attack from the opposition and media if Lambsdorff does not quit. Lambsdorff's departure probably would not bring major changes in economic policies. Uncertainty about the economics portfolio, however, will dampen steadily improving business confidence. A minister of less stature than Lambsdorff might have greater difficulties promoting the government's free market policies with domestic and EC interest groups. [redacted] 25X1

Major Layoffs Continue in Western Europe

Despite modest economic recovery in most West European countries, traditional industries such as steel, shipbuilding, and autos continue to lay off workers. In recent months, manufacturers in West Germany, France, and Italy have announced planned layoffs totaling an additional 22,000 workers. West Germany's largest steel manufacturer, Thyssen, plans to reduce its work force by 8,000 workers by 1985. The Italian shipbuilding firm Fincantieri plans to reduce its work force by 7,000, and the French automobile manufacturer Peugeot intends to cut more than 7,000 assembly line workers, technicians, and managers. These layoffs continue the declining trend in manufacturing employment that began in the early 1970s. Manufacturing employment in Western Europe has dropped 15 percent since 1970—a loss of 6.2 million jobs. Although economic recovery should slow the decline in manufacturing employment, traditional industries in Western Europe will still face high labor costs and intense competition from abroad. [redacted] 25X1

Portugal Revises Labor Laws

President Eanes has signed a decree law that will make it easier for firms to obtain government permission to lay off workers temporarily and to shorten working hours. Since the 1974 revolution, the required government authorization to take these actions rarely had been granted. The new measure will provide relief to private-sector companies that cannot meet payrolls and in some cases will prevent bankruptcy. The new law, however, could have an even greater impact on public-sector enterprises. The Soares government now has a green light to trim excess labor from bloated public-sector payrolls. Portuguese trade unions oppose the new law, but they lack sufficient power to dissuade Lisbon from pushing ahead. Ministry of Labor officials have indicated to the US Embassy that additional revisions are in the works that will ease other restrictive labor laws. [redacted] 25X1

Greece's Credit Rating Jeopardized as Economy Worsens

Some international bankers have recently downgraded Greece's credit rating, according to the US Embassy in Athens, and a few lending institutions have begun to reduce their exposure in Greece. The bankers are questioning Greece's ability to finance its ballooning foreign debt. The debt—which has grown by $1.6 billion this year to $11.6 billion, including an estimated $1 billion in short-term credits—is expected to rise in 1984 to $13.2 billion. The debt service ratio, at present 23 percent of earnings from exports of goods and services, most likely will reach 25 percent next year. Adding to Athens's difficulties are its domestic economic problems; inflation and unemployment rates are running at 20 and 10 percent, respectively, while real GNP is expected to decline 0.2 percent this year. [redacted] 25X1

The latest OECD draft survey of the Greek economy concludes that Athens must reduce consumption and substantially increase productive investment and exports if it is to avoid serious debt servicing problems. The Papandreou government is not likely to take the OECD's advice, however, because it wants to avoid real reductions in personal income and public-sector spending. Barring new policies, Greece could be forced in the coming years to seek official financial assistance. This would be an embarrassment for a government that has pledged to reduce Greece's dependence on the West. [redacted] 25X1

Less Developed Countries

Mexico To Release Nationalized Companies

Treasury Minister Silva Herzog has announced that firms acquired when the banks were nationalized last year will be returned to private ownership soon, according to press reports. The minister made the statement in response to questions from opposition party members during a presentation to congress last week. Stiff opposition from labor groups, who wanted to assume control of the firms, and from leftist parties is probably responsible for the long-delayed decision on the companies' future. We believe attempts to return these firms will have mixed results because the financially strapped private sector may not have sufficient cash to buy them. The move, however, would reassure private business that de la Madrid's pledge of no further nationalizations is sincere. [redacted] 25X1

Mexico Announces New Price Measures for Food Producers

Mexico City recently boosted farmgate price guarantees and announced new direct subsidies for food processors as part of its effort to help hard-hit farmers while shielding urban workers. Guaranteed prices for 13 agricultural products were increased an average of 120 percent over October 1982 prices, according to press reporting. Processors of basic foodstuffs, including tortillas, bread, and cooking oil, will receive new subsidies totaling over $1 billion in the next year. Commerce Secretary Hernandez said that the additional income from recent gasoline and diesel price hikes would be used to partially fund these subsidies. In most cases, Mexico City did not pass price increases through to the consumer, although retail prices of milk and eggs were boosted in part to alleviate chronic shortages. The government reiterated that consumer prices for basic foods would be linked to minimum wage increases. [redacted] 25X1

These subsidy and price support measures are a part of the administration's National Food Program announced in mid-October. The program aims to increase production and improve distribution of basic foodstuffs. We believe Mexico will have difficulty meeting its targets, however, because farmgate price hikes during the past two years have been substantially below inflation, foreign exchange shortages have cut imports needed by agricultural and food processing firms, and budget restrictions and administrative problems have prohibited credit expansion. At current inflation rates, the recent price hikes will be eroded quickly, and we believe Mexico City most likely will be more concerned with holding the line on consumer prices than with boosting domestic agricultural production. [redacted] 25X1

New Economic Program Prompts Jamaican Elections

Prime Minister Seaga has scheduled parliamentary elections for 15 December—nearly two years early—in response to the opposition party's uproar over economic measures taken last week. Kingston announced a 40-percent devaluation of the Jamaican dollar in conjunction with its decision to abandon its IMF Extended Fund Facility (EFF). Jamaica has reached preliminary agreement with the Fund to replace the EFF with an $80 million, 15-month standby loan and a $70 million Compensatory Financing Facility. For the most part, private investors have welcomed the measures, which include the dismantling of import controls on essential goods and allow interest-bearing foreign currency accounts. The inflationary impact on consumers will be cushioned by temporary subsidies on basic food imports. Although Seaga's election is assured because of an opposition boycott, strikes and civil disturbances may be fomented in protest. If unrest occurs, it would undercut the short-term impact of the new economic policies by stimulating investor uncertainty, discouraging peak season tourist reservations, and disrupting the important bauxite and shipping industries. [redacted] 25X1

Sudanese Development Projects Threatened

The future of two major development projects in southern Sudan is threatened by recent dissident activity. In two separate incidents in mid-November, rebel groups kidnaped 11 foreign workers. The rebels demanded that Chevron stop oil exploration and cease construction of an oil export pipeline and that Compagnie de Construction Internationale (CCI) curtail work on the Jonglei canal. Although Chevron and CCI did not agree to the rebel demands and the hostages were released, dissident operations against the pipeline and canal could easily delay the projects and raise construction costs. Many of the companies' skilled employees are refusing to work because the rebels have threatened further attacks. Both projects are slated for completion in 1986. The pipeline will provide critical foreign exchange earnings for Sudan, and the canal will increase Nile water flows to both Sudan and Egypt. [redacted] 25X1

Libyan Consumer Price Increases

Tripoli's cost-trimming fiscal policies are cutting deep into the Libyan consumer's pocketbook, [redacted] Over the past 12 25X1
months consumer food subsidies have been reduced an average of 25 percent, [redacted] Salary increases have also 25X1
been postponed for the year. We believe the regime has adopted these steps to constrain disposable income to forestall further discontent over reduced consumer imports. Qadhafi's pervasive security service and a politically timid population weigh against discontent over prices and shortages reaching a regime-threatening level. [redacted] 25X1

Communist

Yugoslavia's Appeal for Financial Aid

The Yugoslavs, in a meeting last week with major Western government creditors, informally requested $500 million in new funds and an equal amount for debt relief in 1984. The participants tentatively agreed to form two working groups to begin discussions in January. One group, headed by the French, will handle debt refinancing. The second, chaired by the IMF, will deal with Yugoslavia's more general economic difficulties. The tentative format accommodates Yugoslavia's desire to avoid a formal meeting of the Paris Club, but official creditors are likely to follow Club guidelines for debt rescheduling. Some governments are unwilling to repeat the special financial rescue package for this year, and Belgrade's request for new funds seems certain to meet stiff resistance from these governments. [redacted] 25X1

Yugoslavia's Energy Situation

Electricity shortages of 15 to 25 percent are disrupting industrial production and threatening to become a political issue. The shortfall results from drought that has reduced reservoirs to their lowest levels in 60 years—hydroelectric power accounts for 40 percent of electricity—and from fuel oil shortages at thermal plants. Conditions could worsen if overtaxed coal-fired plants and the Krsko nuclear power plant experience breakdowns. In addition, the Winter Olympics in February could cause a temporary crunch in some areas when power is diverted to the Sarajevo area. Belgrade has tried to improve the situation by using scarce hard currency to import additional fuel oil, by drawing down federal fuel reserves, and by importing electricity on long-term swap arrangements. In addition, Belgrade increased electricity prices by 16 percent in early November. A major improvement is unlikely, however, until next spring when snow runoff fills reservoirs. [redacted] 25X1

Romania's Economic Problems

Bucharest is taking steps that will cause living standards for workers to become worse and could lead to widespread unrest during the coming winter. President Ceausescu announced last Friday that the government has approved measures to cut by 50 percent all domestic energy consumption not directly tied to production. The power problems are caused by a fall in hydroelectric generation because of drought, a drop in natural gas output, and reduced oil imports to save hard currency. Many regions are starting to experience severe electrical power shortages that have closed factories and idled workers. Western press reports from Bucharest say the leadership has urged consumers to stop using vacuum cleaners, washing machines, and refrigerators in an energy-saving campaign unprecedented in postwar Romania. In addition, the regime reportedly will close all schools for the month of January. [redacted] 25X1

The government also intends to impose—sector by sector during the next several months—a complex wage system tying salaries more closely to plan fulfillment. Strikes by miners—one of the first groups affected—took place at one or more mines in September in reaction to pay cuts resulting from production shortfalls. [redacted] 25X1

Ceausescu is shifting the burden to consumers in an attempt to protect Romania's shaky industrial sector and to repay hard currency debt as quickly as possible. Consumers, however, already are beleaguered by falling living standards, the worst food shortages since World War II, and earlier energy cutbacks and price hikes. The new energy measures will bring hardship to many Romanians, and the new wage program could result in take-home pay cuts for many as new groups of workers are added on the first of each month through the winter. The security forces have thus far been able to intimidate the disgruntled populace. Nevertheless, the new measures—particularly if they lead to severe dislocations—could provoke spontaneous protests that might be difficult to control. [redacted] 25X1

Soviets Demand Better Quality Goods From Eastern Europe

The Soviet Union has mounted a major effort to enforce quality standards on the goods it imports from Eastern Europe. According to the Hungarians, the Soviets are now using Western quality standards. Moscow reportedly has threatened to halt shipments of Soviet raw materials and stop paying for meat purchases with hard currency if Hungary does not fulfill its obligations to provide high quality goods. [redacted] the Soviets have often pressured foreign trade organizations and monitored quality control on goods intended for the USSR. Bulgarian computer components and foodstuffs that did not meet quality standards have been returned. [redacted] 25X1

For their part, the East Europeans have long complained about the quality of Soviet goods they receive, and the most financially pressed argue that exports to the West are critical to their hard currency position. [redacted] 25X1
[redacted] Sofia normally gives first priority to Western countries, which receive the highest quality goods in exchange for hard currency or trade credits. Bulgarian state enterprises have been accustomed to sending the Soviets second-quality goods that are not sold domestically. The Hungarian official said Budapest has not fulfilled agreements with the Soviets, because it has sold higher quality goods—originally intended for the USSR—to the West for hard currency. While an increase in such practices in the wake of greater East European hard currency requirements probably prompted the Soviet crackdown, it is doubtful how long Moscow can sustain its quality control effort. The USSR has traditionally accepted inferior goods from its East European allies and previous efforts to change the situation have not had lasting success. 25X1
[redacted] 25X1

Battle Brewing Over China's MFA Status

The GATT textiles committee later this month will consider China's request to join the Multi-Fiber Arrangement, the GATT forum that establishes guidelines for bilateral textile trade agreements. In its petition, China claims entitlement to "treatment equivalent to that accorded to other participating developing countries with similar levels of economic development." This statement suggests that Beijing wants to be accepted into MFA as a "small supplier," a category that would permit China during future bilateral negotiations to demand a minimum 6-percent annual growth rate for its textile exports. Many developed nations that have had textile trade difficulties with China are likely to oppose the Chinese claim and instead recommend giving China "large supplier" status, which carries no minimum growth rate. Beijing likely will press its claim and stimulate yet another textile controversy. [redacted]

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Shortfall in Kampuchean Rice Crop

Recent reporting from Phnom Penh, the UN, and the US Embassy in Bangkok confirms that Kampuchea's 1983 main rice crop will be smaller than last year's 1.7 million metric tons, but there is disagreement on the size of the shortfall and the impact on the 1984 food supply. Phnom Penh claims that planted acreage as of 30 September was slightly greater than at the same time in 1982, offsetting somewhat the impact of this year's floods and drought. Furthermore, the government claims that reserves of corn will mitigate any rice shortage. The US Embassy in Thailand believes that food shortages,if at all, will develop in the second half of 1984. On the other hand, UN officials, including Commissioner for Kampuchean relief Sir Robert Jackson and Food and Agriculture Organization representatives, predict that Kampuchea will need at least 100,000 tons of relief aid to avoid starvation next year. As long as Phnom Penh remains relatively positive, however, Jackson's appeals to potential food donors most likely will go unmet. [redacted] 25X1

International Financial Situation: Drop in Key Debtor Reserves 25X1

This article is part of a special series focusing on the economic and political aspects of the international financial situation. 25X1

The foreign exchange reserves of 10 key debtor countries fell by $3.2 billion during the first 10 months of 1983. We estimate that reserves for these countries in October stood at $22.6 billion, continuing a downward trend since 1980 when reserves totaled $47.9 billion. Although the ratio of reserves to average monthly imports—an important measure of a country's liquidity—has remained at about three and a half months since late 1982, the stability of this indicator results primarily from sharply lower imports caused by import restrictions and other austerity measures. 25X1

The major debtors have undertaken IMF programs or other policies to slow the reserves drain, but only Mexico has been able to sharply build reserves while remaining within IMF guidelines. Venezuela and Nigeria, hoping to avoid IMF-imposed austerity measures, have relied on foreign exchange controls and accumulation of arrearages to commercial creditors to reduce their reserve drawdowns. 25X1

Among the key LDC debtors:

- Brazil's official foreign exchange reserves probably totaled $3 billion in October, although we believe liquid reserves are substantially below this amount. Reserves fell sharply early in 1983 as foreign banks withheld promised financing and the IMF suspended its support when Brasilia went out of compliance with the IMF-approved economic austerity program. The decline continued until late summer when Brazil instituted centralized foreign exchange controls. The recent IMF agreement will encourage bankers and governments to provide $9 billion in new money and export credits. It is hoped that these new funds coupled with a large trade surplus will permit Brazil to meet its debt service obligations and ease pressures on reserves.

- The $400 million rise in Venezuela's foreign exchange reserves to $7 billion in October, in our judgment, gives a false impression of the financial health of that country. As an alternative to an IMF austerity program, Caracas on its own has slashed imports, imposed exchange controls, and chosen not to meet principal payments on public foreign debt. Arrearages on private-sector debt grew to $700 million by early November, according to Embassy reporting. We doubt these policies can be sustained for long, and it is likely that after the December elections Caracas will come under increased economic pressure to seek debt relief and an IMF austerity program.

- We estimate that Argentina's liquid foreign exchange reserves fell to about $200 million in October, a drop of more than $2 billion since the beginning of the year. Nearly one-half of the decrease occurred in September and October, largely because the government paid $700 million against arrearages in September, according to press reporting. Argentina currently is in a de facto payments moratorium and is using strict exchange controls to rebuild reserves. In our assessment, the liquidity crunch is unlikely to ease until the IMF and the new government of President-elect Raul Alfonsin agree on a new standby program.

- Mexico's reserves, which were nearly depleted in February, now total about $3.5 billion primarily because of the sharp decline in imports and the strong austerity measures undertaken this year.

Key Debtors: Foreign Exchange Reserves [a]

Billion US $

	1978	1979	1980	1981	1982	1983 [b]
Total	**37.2**	**45.9**	**47.9**	**40.7**	**25.8**	**22.6**
Argentina	5.0	9.4	6.7	3.3	2.5	0.2
Brazil	11.8	9.0	5.8	6.6	3.9	3.0
Chile	1.1	1.9	3.1	3.2	1.8	1.4
Indonesia	2.6	4.1	5.4	5.0	3.1	3.5
Mexico	1.8	2.1	3.0	4.1	1.0	3.5
Nigeria	1.9	5.5	10.2	3.9	1.6	1.0
Philippines	1.8	2.3	2.8	2.2	1.7	0.3
South Korea	2.8	3.0	2.9	2.6	2.8	2.0
Venezuela	6.0	7.3	6.6	8.2	6.6	7.0
Yugoslavia	2.4	1.3	1.4	1.6	0.8	0.7

[a] Total reserves less gold.
[b] Estimated through October.

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So far in 1983, imports have run at about one-half the 1982 level. The current account surplus is expected to reach a record $3.6 billion this year, according to our estimates. The international financial community is regaining confidence in Mexico and this should help the Mexican Government secure the $3.5 billion in new financing from commercial banks it is seeking for 1984.

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International Financial Situation: Banking Regulatory Policies 25X1

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

Banks lending to debt-troubled countries have received mixed signals from regulatory agencies over the past year. While regulatory agencies in OECD countries are trying to encourage continued private capital flows to debtor LDCs, they have a legal duty to monitor bank soundness and safeguard investor and depositor interests. Bankers have complained about being pulled in different directions whenever regulators have supported rescue efforts while at the same time stressing concerns about exposure.

Recent Regulatory Actions

Measures that commercial bank regulators have undertaken at least partly in response to the 1982-83 international debt crisis fall into three areas:

- Improving the quality of information regulators receive on worldwide activities of banks.
- Increasing bad debt reserves.
- Lowering the ratio of loans to bank capital.

Information. Regulators have devoted most of their effort to improving the flow of information so they can more effectively monitor the exposure and soundness of individual banks and better coordinate their own activities with bank regulators in other countries. The major push for improved information has come from banking supervisors of the major OECD countries working in the Bank for International Settlements' Committee on Banking Regulations and Supervisory Practices. Last June the group reformulated its international bank supervisory guidelines in an attempt to eliminate gaps in reporting that have developed as a result of the rapid internationalization of banking. In particular, the committee focused on the need for supervisory authorities to monitor a consolidated balance sheet incorporating both the parent and its offshore operations. 25X1

The EC has moved to improve information on lending. A directive, approved by member states in June, proposes that credit institutions be required to report on a consolidated basis. The directive obliges member states to introduce national legislation on this issue within two years. The directive also proposes to eliminate legal obstacles to the exchange of information on banking operations among EC member states. The West German Finance Ministry has responded by proposing legislation that would require banks to report consolidated balances and would make it easier for West German regulators to share information with bank supervisors in other countries. According to Embassy reporting, the West German proposals are expected to come into force by 1985. 25X1

Bad Debt Reserves. General bad debt reserves based on debtor performance are required in most countries, and sometimes specific reserves are required for individual loans or problem debtors. So far this year Switzerland and Japan have altered policies in this area. In October the Swiss Federal Banking Commission asked Swiss banks to set aside bad debt reserves voluntarily for problem debtor countries amounting to 20 percent of outstanding loans. The financial press has reported that the action stems from the Commission's belief that a number of Swiss affiliates of foreign banks have inadequate provisions against sovereign risk. Managers of some of these foreign banking operations in Switzerland have objected to the new guideline, which is stricter than those of parent countries. Nonetheless, virtually all banks in Switzerland will probably treat the recommendation on bad debt reserves as binding. 25X1

The US Embassy in Tokyo reports that since March the Ministry of Finance has encouraged banks to establish larger bad debt reserves against overseas lending. Banks are permitted to place in the new reserves between 1 and 5 percent of outstanding loans to problem debtor countries. At present, banks may deduct from taxable income 0.3 percent of all lending as a bad debt reserve. The new reserves can be applied to debtors that fall one month behind in principal or interest payments or have arranged or requested rescheduling.

Capital Ratios. Among the OECD countries, only West Germany has recently moved to lower the ratio of loans to bank capital. Legislation proposed by the Finance Ministry would limit by 1988 a bank's consolidated lending to 18 times capital—the ratio now required for unconsolidated reporting. Leading bankers have criticized the capital ratio proposal, noting that current consolidated ratios can be as high as 24 to 1. They have suggested a ratio of 20 to 1 as less likely to restrict domestic or international lending.

Outlook

Concerned that overreaction could threaten lending to debtor LDCs, most OECD banking regulators in 1983 have acted cautiously while reviewing policies and improving the quality of information available to them. Some have taken measured regulatory actions while others are only now evaluating banking policies:

- The Bank of England is reviewing the adequacy of information on bank exposure as well as supervisory practice and country risk analysis.
- Canada's Inspector General of Banks has said that guidelines on capital requirements will be issued.

As long as concerns over bank soundness stemming from global debt problems remain, slow and cautious implementation of additional controls is likely. While it is still too early to assess the effects of tighter regulatory practices, some bankers predict difficulties in maintaining adequate levels of international lending.

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Near-Term Oil Market Outlook 25X1

The oil market has softened in recent months in response to overproduction and continued weak consumption. Even if consumption rebounds in response to a sustained economic recovery in the OECD, we expect soft market conditions to persist at least through mid-1984 unless OPEC members adhere to present production ceilings. A seasonal drop in demand for OPEC crude oil next spring—perhaps to as low as 15-16 million b/d—will force the cartel to develop an acceptable allocation scheme among members or risk further price declines. Nonetheless, conditions in the Middle East remain unsettled, and market conditions could change quickly if Iran and Iraq follow through on recent threats to escalate attacks against oil targets. 25X1

OECD Consumption Patterns [a]

Percent changes over year earlier

	I	II	III	IV	Year
1979	3.0	0.9	0	−2.6	0.3
1980	−8.7	−6.8	−8.6	−8.1	−8.0
1981	−6.5	−7.5	−4.0	−5.6	−6.0
1982	−6.7	−2.6	−4.3	−7.6	−5.4
1983	−6.5	−3.3	−0.9		

[a] Inland sales.

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Recent Consumption Trends

Oil consumption continues to fall, albeit at a declining rate. Preliminary data indicate non-Communist oil consumption in the third quarter declined by about 1 percent from year-earlier levels. This marks the smallest quarterly decline since consumption turned down in late 1979. Consumption trends among major regions, however, vary widely. Oil consumption in the third quarter in Japan and the United States rose by 2 percent and 1 percent, respectively. In contrast, sales in Western Europe declined by 5 percent. Depressed demand in Western Europe reflects sluggish economic growth and strength in the US dollar, which has increased fuel prices in local currencies.

Partial data for the fourth quarter indicate that the consumption decline may be bottoming out. Oil use in the United States was about 2 percent above year-earlier levels during the October-November period. October sales in West Germany and Italy rose 6 percent and 2 percent, respectively, although oil use in France declined by 7 percent. Based on data supplied by major oil companies to the International Energy Agency (IEA), oil sales in member countries are expected to show a 2-percent rise over year-earlier levels during the fourth quarter. 25X1

Inventory Destocking Slows

Industry efforts to pare excess inventories continued in the third quarter. Although non-Communist inventories rose by about 1 million b/d in the third quarter, the rate of buildup was less than half the normal seasonal rate. We estimate that non-Communist oil stocks on land at the end of September approximated 4.1 billion barrels, or about 91 days of forward consumption. Nearly 500 million barrels 25X1

Non-Communist Primary Oil Stocks on Land, End of Period [a]

	Billion Barrels				Days of Forward Consumption			
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
1978	3.6	3.7	3.9	3.9	74	76	74	69
1979	3.5	3.8	4.2	4.3	72	78	81	82
1980	4.3	4.6	4.8	4.6	91	99	97	93
1981	4.5	4.6	4.7	4.6	101	104	100	96
1982	4.3	4.2	4.3	4.3	97	98	97	96
1983	4.0	4.0	4.1		93	93 [b]	91 [b]	

[a] Estimates include government-owned stocks in Japan, West Germany, and the United States that have increased from 62 million barrels in first-quarter 1978 to about 495 million barrels at end of third-quarter 1983. The increase amounts to about 10 days of forward consumption.
[b] Estimated.

[redacted] 25X1

of this total—11 days of supply—represent government-owned stockpiles. The commercial stock portion measured in days of supply has declined to a more normal operating range. Nonetheless, some industry sources believe there is room for further inventory drawdowns early next year. [redacted]

Production Trends

Preliminary figures indicating production drops of 200,000 to 300,000 b/d in both Saudi Arabia and Nigeria in early November suggest that OPEC crude production may have peaked in September at 19.2 million b/d, 1.7 million b/d above the cartel's self-imposed ceiling. OPEC production had climbed by more than 2 million b/d since the second quarter, reflecting in large part the slowdown in company efforts to pare excess inventories. Saudi production rose most sharply—output in October was 1 million b/d above its implicit quota of 5 million b/d—as Riyadh continued its war relief assistance to Iraq in the form of crude sales to Baghdad's customers. [redacted] Some industry analysts believe high Saudi production reflects a strategy to preclude a premature lifting of OPEC quotas by keeping spot prices soft. [redacted] 25X1

Bad weather reportedly forced Iran's main crude export terminal at Khark Island to close for several days, causing a cutback in production in October. 25X1
Qatar, on the other hand, reportedly raised its output 100,000 b/d above September levels, joining several other OPEC members in producing over its quota. Non-OPEC production also continues to rise, largely because UK production set a new high in September of almost 2.5 million b/d, roughly 200,000 b/d above second-quarter levels. [redacted] 25X1
[redacted] 25X1

Downward Price Pressures

Market conditions have put downward pressure on spot prices in recent months. With the exception of a short-lived upturn in October in response to Middle East war rumors, spot prices have trended downward since late August, and most spot prices 25X1

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OPEC: Crude Oil Production, 1983 *Million b/d*

	Quota	2nd Qtr	September [a]	3rd Qtr [a]	October [a]
Total	**17.5**	**16.8**	**19.2**	**18.7**	**19.0**
Algeria	0.725	0.6	0.6	0.6	0.6
Ecuador	0.2	0.2	0.2	0.2	0.2
Gabon	0.15	0.2	0.2	0.2	0.2
Indonesia	1.3	1.4	1.4	1.4	1.4
Iran	2.4	2.3	2.6	2.5	2.4
Iraq	1.2	0.9	0.9	1.0	1.0
Kuwait	1.05	0.7	0.9	1.0	1.1
Libya	1.1	1.1	1.1	1.1	1.1
Neutral Zone	[b]	0.4	0.5	0.5	0.5
Nigeria	1.3	1.4	1.2	1.4	1.3
Qatar	0.3	0.3	0.3	0.3	0.4
Saudi Arabia	5.0 [c]	4.4	6.2	5.6	6.0
United Arab Emirates	1.1	1.2	1.2	1.2	1.2
Venezuela	1.675	1.7	1.7	1.7	1.7

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

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are now below their official levels. Arab Light crude in late November approximated $28.05 per barrel. African Light crudes have declined from $31.00 in late August to $28.90 per barrel, or about $1.10 per barrel below official prices. Only a few heavy crudes have remained at or above official prices. In response to the weak market, the Soviet Union recently lowered the contract price of its crude oil by 50 cents per barrel to $29.00.

OPEC efforts to stem the slide in spot prices have been ineffective. Following an October meeting in Vienna, the OPEC Monitoring Committee sent telegrams to eight OPEC members admonishing them for exceeding their production quotas. The message had little effect since most violators continued to exceed their quotas through mid-November. The Committee also agreed to defer any decision to adjust the crude oil production ceiling of 17.5 million b/d until the OPEC ministerial meeting next week in Geneva.

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Oil Market Outlook Through Mid-1984

The near-term demand outlook will depend principally on the pace of the economic recovery in OECD countries, inventory patterns, and seasonal weather factors. In our base case scenario, we forecast a modest increase in oil consumption beginning in the fourth quarter in response to the continued economic recovery and further erosion in real oil prices. As a result, we expect non-Communist oil consumption to record a 1- to 2-percent gain

1983 Price Trends [a]

US $ per barrel

	May	June	July	August	September	October	22 November
Arab Light							
Spot	28.35	28.90	29.00	28.80	28.55	28.65	28.05
Official	29.00	29.00	29.00	29.00	29.00	29.00	29.00
Yield	27.85	28.80	29.21	29.95	28.67	29.23	28.26
Nigerian Bonny Light							
Spot	29.75	30.20	30.75	31.00	30.30	29.90	28.90
Official	30.00	30.00	30.00	30.00	30.00	30.00	30.00
Yield	29.41	31.03	31.05	32.00	30.38	30.89	29.95
Kuwait Medium							
Spot	26.85	27.10	28.60	27.40	27.30	27.50	27.40
Official	27.30	27.30	27.30	27.30	27.30	27.30	27.30
Yield	26.96	27.56	29.81	28.80	27.67	28.25	27.27
Ekofisk							
Spot	29.60	30.65	30.85	31.25	30.10	29.90	28.75
Official	30.25	30.25	30.25	30.25	30.25	30.25	30.25
Yield	28.67	30.24	30.45	31.25	29.65	30.14	29.23

[a] End of month prices.

[redacted] 25X1

Non-Communist Oil Supply and Demand, Base Case

Million b/d

	1983				1984	
	I	II	III	IV	I	II
Consumption [a]	44.6	42.7	42.7	45.3	46.0	43.0
Inventory change	−3.8	−0.9	1.4	−1.0	−1.9	0.4
Production [b]	40.8	41.8	44.1	44.3	44.1	43.4
Non-OPEC	24.1	24.2	24.7	24.7	24.7	24.8
OPEC	16.7	17.5	19.4	19.6	19.4	18.6

[a] Excluding refinery gain.
[b] Includes natural gas liquids.

[redacted] 25X1

over year-earlier levels through mid-1984. Our consumption forecast is in agreement with most recent industry projections of the near-term outlook. [redacted] 25X1

The existence of ample surplus capacity worldwide and prospects for continued price weakness have caused oil companies to reduce the amount of oil held as stocks to meet seasonal consumption needs. As a result, we have adjusted upward by about 1 million b/d our estimate of oil production requirements to fill consumption needs during the winter months to offset the lower stock drawdowns that we anticipate. [redacted] 25X1

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Weather patterns also have a significant impact on oil use in the Northern Hemisphere. The extremely mild weather last winter, for example, reduced oil use by roughly 500,000 b/d, according to some industry estimates. Our base case scenario assumes normal winter weather; if a very cold winter should occur, oil use could be about 500,000 b/d above our base case estimate. [redacted]

Under our base case conditions, we expect oil consumption to approximate 45.3 million b/d in the fourth quarter, rising to about 46 million b/d in first-quarter 1984. We estimate that demand for OPEC oil, including about 1 million b/d of natural gas liquids, will approximate 19-20 million b/d. With the expected seasonal decline in consumption to about 43 million b/d in the spring, we estimate demand for OPEC oil at about 18.5 million b/d during second-quarter 1984. [redacted]

Although a rebound in oil consumption would help underpin oil prices, the availability of some 8 million b/d of spare productive capacity should keep oil prices soft. Even at these higher levels, demand is insufficient to allow most OPEC countries to produce at desired levels. As a result, we believe continued production restraint will be needed to maintain the current price structure. [redacted]

Price Weakness Scenario

Should the expected rebound in oil consumption fail to materialize, oil producers will have a difficult time preventing further oil price declines. If oil use continues to fall at recent rates, companies would be saddled with excess inventories next spring, potentially reducing demand for OPEC crude oil to about 15.5 million b/d—about 2 million b/d below the current production ceiling. Given the growing financial pressures on several producing countries and the political animosity between some members, OPEC could be hard pressed to accommodate such a sharp drop in demand. Should OPEC fail to reach an effective production sharing agreement, a further cut in nominal prices early next year would probably be required. Under these conditions, we believe the possibility of a downward price movement would be considerable. [redacted]

Producer Cooperation

Barring a stronger-than-expected rebound in oil demand, the key to the near-term price outlook will be producer cooperation. Given recent experiences, we believe OPEC will have difficulty establishing an effective production sharing scheme at the upcoming OPEC ministerial meeting. Indeed, several members, including Iran, Iraq, Nigeria, and Venezuela, have already indicated that they will seek higher individual production quotas, according to press reports. [redacted]

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Saudi Arabia must play a major role in establishing an effective quota. [redacted] the Saudis are annoyed with criticism of their recent output increase and dissatisfied with their role as a swing producer. [redacted] several Saudi officials have expressed concern about the slow recovery in oil demand and have hinted that further price cuts might be advisable. Unless Riyadh is willing to assume a major share of the burden in cutting back output next spring when demand weakens, we believe OPEC will be unable to reach an effective production allocation scheme and avoid downward price pressures. [redacted]

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Any meaningful cooperation on production sharing from non-OPEC producers is unlikely until OPEC members themselves exhibit more discipline. British National Oil Company's general manager recently denied industry speculation that the British Government would soon implement plans to reduce crude production from North Sea fields. The UK Minister of State for Energy in a written reply to parliamentary questions said the United Kingdom will not take steps to restrain North Sea oil production until the end of next year at the earliest. Despite some formal exchanges on cooperation with OPEC, Moscow continues to demonstrate market flexibility as evidenced by its recent price cuts. Mexico is the only major non-OPEC producer now restraining output. [redacted]

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Market Vulnerabilities

Although our forecast and those of most industry experts point to continued weakness in the oil market over the coming months, the volatile situation in the Middle East could cause a rapid turnabout in the market. Iraq's deteriorating economic situation, coupled with the recent acquisition of French Super Etendard aircraft with Exocet missiles, could prompt Baghdad to initiate attacks against oil shipping in the Persian Gulf in an effort to bring an end to the conflict with Iran. Such action might induce Iran to carry out its oft repeated threat to retaliate by closing the Gulf to shipping or striking out against the oil facilities of Iraq and its Persian Gulf allies.

Should disruptions in the Persian Gulf occur, the world oil market could tighten quickly and cause at least a temporary runup in spot prices for several reasons:

- Uncertainty regarding the extent of damage to the oil industry in the Gulf and the length of any supply disruption, including the possibility of further attacks on oil facilities.
- A minimum of available surplus capacity in non-Communist countries is outside the Gulf; only about 3 million b/d of the present surplus of 8 million b/d is located outside the region.
- Commercial stocks have been drawn down to near normal levels and there is little surplus to offset a disruption; government-held stockpiles might not be used initially to prevent price runups.

While sizable runups in oil prices are likely during a major disruption of Persian Gulf oil supplies, we cannot predict how high prices would rise or how long such increases would be sustainable. We believe the key factors under any circumstances are industry and public perceptions of the disruption and the timing of such an event. Based on our analysis of previous disruptions, any supply curtailment that occurs during the early winter months is likely to have a much greater impact on prices than one that occurs late in the winter heating season.

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Oil Stocks and Government Policies of Industrial Countries [redacted] 25X1

Falling consumption, high interest rates, declining oil prices, and prospects for ample supplies have triggered a sizable reduction in industrial country oil stocks.[1] Since 1980 total oil stocks in the industrialized countries have declined by about 500 million barrels as increases in government-owned stockpiles have only partly offset the decline in commercial stocks. Measured in days of forward consumption, commercial inventories at the end of third-quarter 1983 have dropped to near the levels recorded in the 1978-79 period. Moreover, world market conditions and budgetary constraints have slowed purchases for government stockpiles and relaxed the level of compulsory stockpiles in some countries. Although oil inventories remain adequate for projected consumption needs, the erosion of the commercial stock cushion over the past few years and uncertainties regarding the disposal of government-owned stocks have increased the market's vulnerability to a major supply cutoff. [redacted]

The Role of Oil Stocks

Oil consumers hold stocks for two primary reasons:
- To meet expected operating requirements, including the need to balance seasonal fluctuations in consumption.
- To ensure against unexpected delivery shortfalls or surges in demand.

Primary inventories are stocks held by major companies and refiners. Government-owned stocks are also included in primary stocks, although they are outside normal commercial channels. [redacted]

The exact stock level of an individual company is determined by its expected future needs as well as by any miscalculations that occurred in balancing past supply and demand. Factors influencing decisions on the level of stocks to be held include:
- Expectations about future supply availability, particularly stability in certain key oil-producing nations.
- Estimates of future consumption levels including the strength of economic recovery.
- The level of interest rates.
- Expectations about future price movements.
- Government policies that dictate the maintenance of mandatory stock levels.

Expectations of a decline in oil prices, lower oil consumption, high interest rates, and surplus productive capacity all have provided incentives for oil companies to reduce inventory levels. [redacted] 25X1

The Present Stock Situation

Although inventory accumulation resumed in third-quarter 1983 at about 1 million b/d, the buildup was only half the normal third-quarter rate. We estimate that total primary oil stocks including government-owned stocks in the industrialized countries stood at about 3.2 billion barrels—about 93 days of forward consumption at the end of September. Commercial stocks, including compulsory stocks, approximated 2.7 billion barrels, and government-owned stocks in West Germany, Japan, and the United States totaled approximately 500 million barrels. This is roughly the same total level as in the 1978-79 period. Then, however, commercial inventories averaged about 3 billion barrels while government-owned stocks averaged only slightly more than 100 million barrels. [redacted] 25X1

[redacted] a large portion of commercial stocks—about 55 days of consumption—represent minimum operating stocks needed

[1] OECD countries excluding Australia and New Zealand. [redacted] 25X1

Third-Quarter Oil Stocks in Industrialized Countries [a]

	Million Barrels						Days of Forward Consumption					
	1978	1979	1980	1981	1982	1983	1978	1979	1980	1981	1982	1983
Stocks including government owned												
United States	1,263	1,369	1,507	1,513	1,446	1,490	66	74	87	95	96	97
Canada	153	147	172	173	131	102	79	75	90	101	84	64
Japan	392	437	509	491	467	423	69	78	97	103	98	87
Western Europe	1,215	1,339	1,515	1,410	1,293	1,162	79	90	110	106	107	94
Of which:												
France	214	229	269	229	205	157	78	92	103	104	106	80
Italy	158	166	196	188	180	156	73	77	94	94	101	85
United Kingdom	152	168	170	147	134	116	75	87	107	93	84	71
West Germany	227	226	299	302	276	268	77	91	124	128	126	120
Total OECD [b]	**3,023**	**3,292**	**3,703**	**3,587**	**3,337**	**3,177**	**72**	**80**	**97**	**95**	**100**	**93**
Government-owned stocks [c]												
United States	47	91	93	199	278	361	2	5	5	12	18	23
Japan	0	33	33	54	70	79	0	6	6	11	15	16
West Germany	44	44	53	55	55	55	15	15	22	23	25	25
Total OECD	**92**	**168**	**179**	**309**	**402**	**495**	**2**	**4**	**5**	**8**	**12**	**14**
Stocks excluding government owned												
United States	1,216	1,278	1,414	1,314	1,168	1,129	64	69	82	82	77	74
Canada	153	147	172	173	131	102	79	75	90	101	84	64
Japan	392	404	476	437	397	344	69	72	91	92	83	71
Western Europe	1,171	1,295	1,462	1,355	1,238	1,107	76	87	106	102	102	90
Of which:												
France	214	229	269	229	205	157	78	92	103	104	106	80
Italy	158	166	196	188	180	156	73	77	94	94	101	85
United Kingdom	152	168	170	147	134	116	75	87	107	93	84	71
West Germany	183	182	246	247	221	213	62	76	102	105	101	95
Total OECD	**2,931**	**3,124**	**3,524**	**3,278**	**2,935**	**2,682**	**70**	**76**	**92**	**87**	**88**	**79**

[a] End of period.
[b] Excluding Australia and New Zealand.
[c] Excluding Sweden.

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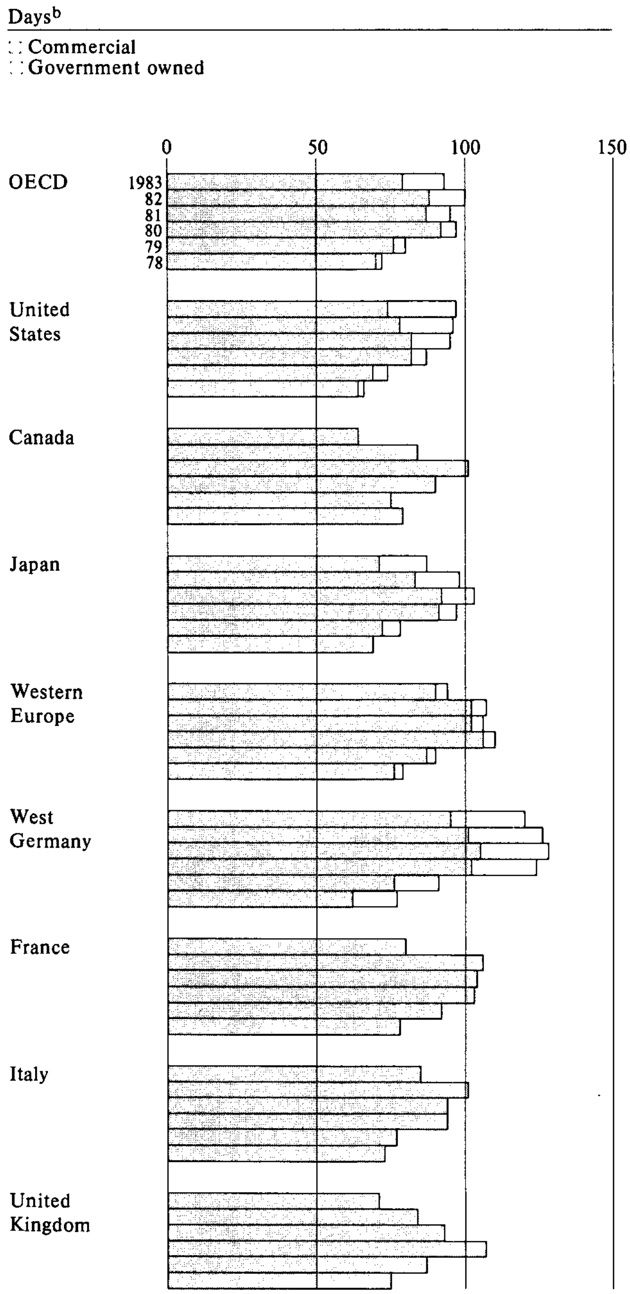
to ensure a smooth functioning of the distribution system. Another 15 days represent compulsory stocks that companies maintain to meet government requirements. The balance of about nine days of consumption represents usable commercial stocks that provide added flexibility to meet seasonal as well as unexpected changes in demand. These provide only a small cushion, however, to cope with a major supply cutoff. 25X1

OECD: Third Quarter Oil Stocks[a]



[a] OECD excluding Australia and New Zealand.
[b] Days of forward consumption.

[redacted]

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IEA Stockpile Goals

Following the 1973 oil embargo, the 21 member countries of the International Energy Agency (IEA) agreed to an emergency stockpiling program that would require stocks to reach at least a 90-day level of net imports by 1 January 1980. Emergency stocks are defined as total oil stocks (crude and products) minus a 10-percent allowance for stocks unavailable for use. Originally the number of days of emergency reserves was to equal physical stocks divided by the previous year's level of net imports. Procurement and storage of the stockpile were left to the discretion of individual countries. With the exception of Turkey and Luxembourg, the 1980 targets were met or exceeded. [redacted] 25X1

The decline in net imports in member countries after 1980 caused the IEA to become concerned that the reduction in the volume of mandatory stock requirements could result in inadequate emergency reserves once demand increased. As a result, the IEA Governing Board agreed in December 1981 that IEA members should not let stocks fall below the equivalent of 90 days of 1980 net imports, except where lower oil consumption reflected long-term structural changes. In December 1982, the Governing Board again revised the calculation of net imports, this time to include the average net imports of the preceding three years. [redacted] 25X1

According to the IEA, oil stocks for the 21 members was 2.8 billion barrels at the end of second-quarter 1983, about 12 percent below the 1980 volume levels. At midyear total IEA stocks equaled 153 days measured in days of net imports during the previous three years. Among member countries only Spain, Portugal, Turkey, Belgium, Luxembourg, and Ireland recorded stock levels below the 90-day commitment. Preliminary third-quarter data indicate these countries remained below the 90-day commitment. [redacted] 25X1

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Stocks: IEA Member Countries [a]

	1 July 1980		1 July 1983	
	Million barrels	*Days of net imports 1979*	*Million barrels*	*Days of net imports 1980-82* [b]
IEA total	**3,240**	**145**	**2,845**	**153**
United States	1,372	178	1,308	255
Canada	163	1,105	99	742
Japan	466	93	425	96
Western Europe	1,196	128	969	106
Austria	26	126	23	118
Belgium	50	99	34	81
Denmark	45	152	36	170
West Germany	348	121	282	123
Greece	32	122	26	106
Ireland	12	93	7	69
Italy	170	92	159	91
Luxembourg	2	84	1	80
Netherlands	93	230	65	173
Norway	20		17	
Portugal	20	93	18	74
Spain	91	92	84	80
Sweden	66	119	44	96
Switzerland	42	149	43	166
Turkey	9	38	14	47
United Kingdom	170	614	117	
Australia	34	173	37	219
New Zealand	9	136	7	93

[a] Stock levels and net imports are adjusted according to IEA definitions.
[b] Average net imports for 1980 through 1982.

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Major Government-Owned Stockpiles

Although oil inventory goals have been set up by the IEA for member countries, individual governments have instituted a variety of stockpile policies to meet their commitments. There are three basic forms of stockpile programs in the industrialized countries:

- Government-owned stockpiles intended for civilian use.
- Public storage corporations set up with government assistance to finance or administer energy reserves.
- Government requirements that the oil industry maintain emergency reserves.

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Some governments have adopted more than one of these programs. The responsibility for procuring

Major Industrialized Countries: Storage Programs

	Government Reserve	Public Corporation	Industry Minimum Storage	No Program
Australia			X	
Austria			X	
Belgium			X	
Canada				X
Denmark			X	
West Germany	X	X	X	
Greece			X	
Ireland			X	
Italy			X	
France			X	
Japan	X		X	
Luxembourg			X	
Netherlands		X	X	
New Zealand				X
Spain			X	
Sweden	X		X	
Switzerland		X	X	
United States	X			

and storing oil stocks has been given to commercial firms in most industralized countries. These firms maintain physical control over stocks and carry the financial burden of storage, although concessions are granted in some countries. Despite the lack of direct government control over stocks in most countries, all member governments can exercise control during an emergency either by law or as a result of "gentlemen's agreements" with the oil companies. In three countries—the United States, Japan, and West Germany—the government itself has become a major stockholder through the purchase and storage of crude oil.

United States. Until 1975, all oil stocks in the United States except military requirements were controlled by commercial firms with no government involvement. As a result of the Arab oil embargo in 1973-74, the government decided to establish a Strategic Petroleum Reserve (SPR) to procure oil stocks that would be wholly government-owned and funded. The SPR totaled 361 million barrels at the end of September 1983 and is expected to increase by about 68 million barrels in 1984. The current objective of the program is to accumulate 750 million barrels by 1991. The crude oil is stored underground in salt domes or mines and is in addition to reserves maintained by commercial firms. 25X1

Japan. Tokyo's stockpile program requires the petroleum industry to maintain 90 days of product equivalent of the previous year's consumption with the Ministry of Trade and Industry (MITI) responsible for setting annual objectives. In 1977 the government decided to develop its own stockpile with the objective of acquiring an additional 63 million barrels of oil stocks by early 1983. The goal subsequently was expanded to acquire 189 million barrels by 1988. Purchases began in 1978, and by September 1983 the government-owned stockpile held 79 million barrels. In late October, the government announced plans to buy an additional 7.86 million barrels by yearend and may purchase a similar amount early next year. 25X1

West Germany. Bonn initially required refiners and importers to meet the IEA stockpile objective even though the government had been accumulating a separate strategic stockpile since 1970. In 1978 responsibility for compulsory stocks was shifted to the Compulsory Storage Corporation (EBV), a state corporation. EBV was required to purchase a 65-day supply of oil based on the previous year's consumption and acquire sufficient storage capacity for these supplies. In early 1983, EBV stocks stood at about 117 million barrels. The government also requires refiners to hold an additional 25 days of stocks as working stocks. In addition to these compulsory stocks, the government's strategic stockpile currently contains 55 million barrels with an ultimate goal of 73 million barrels. Budgetary constraints have prevented Bonn from adding to the strategic reserve since 1981. 25X1

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Government Storage Programs

	Present Size 30 Sep 83 (*million bbl*)	Planned Size (*million bbl*)	Target Date	Type of Oil Held	Storage Sites
United States	361	750	1991	Crude	Salt dome
West Germany	55	73	NA [a]	Crude	Salt dome
Sweden	45 [b]	Unknown	Unknown	Crude and products	Rock caverns and tanks
Japan	79	189	1988	Crude	VLCCs [c] and onshore sites

[a] Target date flexible. Government buys oil when budgetary circumstances allow.
[b] Size of stockpile is an estimate.
[c] Very large crude carriers; the oil will be moved to on-land storage tanks or special floating storage islands during the 1980s.

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Stockpile Programs in Other Countries

Companies operating in **France** must maintain stocks equivalent to 90 days of the previous 12 months' inland sales; the government has expressed no interest in maintaining a separate strategic reserve. A French Government rule that took effect on 1 September eliminated a seasonal factor in calculating mandatory middle distillate stocks. According to industry sources, this rule change, combined with industry annoyance at recent government moves to hold down product prices, led to a 120,000 b/d inventory drawdown in September.

Increasing domestic production has enabled the **United Kingdom** to reduce stock requirements. Oil companies maintain the bulk of oil reserve stockpiles. There are no announced stockpile programs in two other major oil-producing countries, **Canada** and **Norway**.

The **Italian** Government requires oil companies to maintain 90 days of emergency oil stocks. After introducing legislation in 1981 to build a government-owned stockpile of 7-15 million barrels, interest in the program has waned as a result of soft market conditions and a need to limit government spending.

Belgium relies on oil companies to meet IEA objectives. Private petroleum companies are obliged under a 1965 law to hold stocks equivalent to 90 days consumption based on the previous year's consumption rate. Stock requirements are specified for gasoline, diesel, and residual fuel oil, but companies retain the option of varying the mix of these stocks based on conditions set forth by the government. In a crisis, control of Belgian stocks would pass to the National Emergency Sharing Organization. The government presently has no plans to build a government-owned stockpile.

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In **Sweden**, industry is required to hold stocks equal to 110 days of the previous year's consumption. Government-owned stockpile levels and target goals are a closely guarded secret. According to one industry estimate, however, the government stockpile is scheduled to reach about 45 million barrels or 90 days of consumption by the end of this year.

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In **Switzerland**, compulsory stocks are equivalent to 180 days of the previous year's consumption and are held by industry. Oil companies in the **Netherlands** are required to hold stocks equivalent to 90 days of the previous year's consumption, and oil

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traders are required to hold an additional 70 days of stocks. According to industry sources, the public-sector corporation ICOVA also has acquired 30 days of supplies, including a mix of crude and products. [redacted] 25X1

Outlook

Commercial stocks have declined sharply since 1980 and could decline further in the coming year, given the prospects for continued weakness in oil prices and ample surplus productive capacity. Commercial stocks as measured in days of forward consumption are now approaching levels that existed before the outbreak of the Iranian revolution, which precipitated the most recent runup in oil prices. Should another major supply disruption occur, we believe companies will have little cushion available in the form of usable stocks to offset reduced oil flows. [redacted] 25X1

We believe government-owned oil stocks will continue to grow despite budgetary constraints. As a result, government-owned stocks could play an important role in offsetting any future oil supply disruption. So far, however, government's have not announced specific plans that would indicate how they would use strategic stocks during an emergency. Because of the absence of such plans, one senior official in a major oil company has stated that he views government stockpiles as inaccessible and that his company would react as if these stockpiles did not exist. Without specific disposal plans, we believe the relatively large government stocks probably will do little to calm market fears during a major supply disruption. [redacted] 25X1

[redacted] 25X1

Prospects for Cuts in Soviet Large-Diameter Pipe Imports 25X1

Imports of Western 1,420-mm-diameter pipe by the USSR could drop from an annual average of 2.2 million metric tons during 1981-85 to as little as 500,000 tons annually during 1986-90 as a result of a slowdown in oil and gas pipeline construction and increased Soviet pipe production. We estimate that annual 1,420-mm-pipe requirements will probably decline by about 800,000 tons. The startup and expansion of output at a new pipe mill at Vyksa, which will use domestic steel, should add some 500,000 tons to Soviet capacity of 1,420-mm pipe. Additional capacity for 1,420-mm-pipe production at Khartsyzsk will probably increase from 400,000 tons in 1982 to as much as 800,000 tons by 1990 but will depend on imports of high strength–low alloy (HSLA) steel plate. 25X1

Background

At the start of the 1960s, the Soviets relied on imports of large-diameter pipe. Soviet production was almost negligible—about 50,000 tons a year of 1,020-mm pipe—an amount sufficient to support construction of less than 200 kilometers (km). In 1962 NATO embargoed exports of large-diameter pipe to the USSR in an effort to delay construction of an oil pipeline to Eastern Europe because the pipeline would enhance Soviet military capabilities. The embargo probably delayed completion of the "Friendship" oil pipeline by about one year. More importantly, however, the embargo accelerated Soviet efforts to boost capacity to produce large-diameter pipe. By 1965 the Soviets produced nearly 700,000 tons of 1,020-mm pipe. 25X1

Soviet production of large-diameter pipe increased steadily during the late 1960s and 1970s, reaching about 2 million tons per year by the end of the decade. While the USSR can manufacture the steel plate and strip used in 1,020-mm- and 1,220-mm-pipe production, nearly all of the 1,420-mm pipe currently produced in the Soviet Union for high-pressure gasline service (about 400,000 tons) is of single-wall construction using HSLA steel plate imported from the West. (As the diameter of pipe is increased, maintaining the same operating pressure creates additional stress, and the strength of the steel must be increased.) 25X1

Pipe Requirements and Imports for 1981-85

On the basis of Soviet media reports, we estimate that the Soviets will lay about 20,000 km of 1,420-mm pipelines during 1981-85, requiring about 2.6 million tons of pipe per year. To meet these goals, annual imports of 1,420-mm pipe will probably average about 2.2 million tons during this period, and HSLA plate imports for domestic 1,420-mm-pipe production will average 400,000 tons per year. Thus, the Soviet Union will be almost totally dependent on the West, primarily Japan and West Germany, to meet its 1,420-mm-pipe requirements. Annual hard currency expenditures for this pipe and HSLA steel plate will amount to about $1.3 billion. 25X1

Pipe Requirements During 1986-90

We estimate annual Soviet domestic pipe requirements will fall during 1986-90 because of a slowdown in the construction of gas pipelines and the absence of new large-diameter oil pipeline construction during this period. We believe that annual Soviet requirements for 1,420-mm pipe will drop to about 1.8 million tons per year during 1986-90, compared with about 2.6 million tons per year during 1981-85. Similarly, annual requirements for 1,020- and 1,220-mm pipe probably will fall to about 1 million tons per year during 1986-90, compared with about 1.3 million tons per year during the current five-year plan. 25X1

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USSR: Installation of Large-Diameter Pipeline per Five-Year Period

Kilometers

	1961-65	1966-70	1971-75	1976-80	Plan 1981-85	Estimate 1986-90
Total	**7,935**	**17,482**	**27,811**	**30,374**	**36,400**	**28,000**
Oil (1,020-1,220 mm)	1,300	3,400	8,000	6,900	3,200	NEGL
Gas (1,020-1,220 mm)	6,635	14,082	16,103	12,474	13,200	14,000 [a]
Gas (1,420 mm)	0	0	3,708	11,000	20,000	14,000

[a] Including replacement requirement.

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We believe the USSR will construct no large-diameter oil pipelines during 1986-90.[1] Oil production is increasing at less than 1 percent per year and probably will peak and begin to fall later in the 1980s. If this estimate is correct, major additions to the pipeline network will not be required. With the completion in 1985 or 1986 of a new West Siberian oil pipeline (currently under construction), the usable throughput of the West Siberian oil pipeline network will increase to about 8.9 million barrels per day. This capacity should be more than enough to transport the 7-8 million b/d that we estimate will be produced in West Siberia in 1990. 25X1

In contrast to oil production, gas production most likely will increase. We estimate that annual production will amount to about 595 billion cubic meters in 1985 and will increase to roughly 710 billion cubic meters in 1990. Thus, the need for new gas-pipeline construction will continue through 1990. We estimate that the Soviets will need to lay about 25,000 km of new, large-diameter gas pipelines during 1986-90, of which about 14,000 km will be 1,420 mm in diameter. 25X1

Our estimate for 1,420-mm pipeline construction is about 30 percent less than the planned 20,000 km for 1981-85. Some Soviet economists have commented that the growth of gas production in West Siberia may slow because the cost of pipeline construction in West Siberia is so great. According to the Soviet minister in charge of pipeline construction, the total cost of the gas export pipeline will amount to about 15 billion rubles (about $20 billion). The Soviets also face limits on the amount of gas that can be absorbed in the domestic economy. Construction of storage and distribution systems is lagging, limiting the opportunities for increased gas use. 25X1

Even if Soviet construction of 1,420-mm pipelines slows as we expect, the pace of construction will still be rapid. Specifically, during 1986-90 the Soviets may build four or five pipelines, each about 3,000 km in length, compared with six such lines during 1981-85—a pace of pipeline construction unmatched worldwide. 25X1

Soviet Pipe Production Capacity During 1986-90

At the same time that Soviet requirements for large-diameter pipe will be declining, domestic production will be increasing. We believe Soviet production of 1,420-mm pipe suitable for use in gas pipelines may rise by as much as 900,000 tons, to 1.3 million tons per year by 1990. The startup and expansion of output at the new pipe mill at Vyksa (near Moscow) should add some 500,000 tons to Soviet capacity for production of 1,420-mm pipe. In addition, the capacity available for 1,420-mm pipe production at Khartsyzsk will increase from

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400,000 tons to as much as 800,000 tons. Production at Khartsyzsk, however, will probably depend in large part—and perhaps entirely—on imports of steel plate from the West.

The new mill at Vyksa will produce 1,420-mm pipe of a multilayered construction in contrast to the single-walled pipe imported from the West or produced at Khartsyzsk. The multilayered pipe will be produced from ordinary low-carbon steel sheet—which the Soviets can manufacture—in contrast to the HSLA steel plate used in single-walled pipe for high-pressure gasline service. The multilayer technology is far behind Western state of the art, but US metallurgical experts believe the Soviet pipe will work as planned. Because of increased metal, energy, and welding requirements (the pipe is about 50 percent heavier than Western pipe), this kind of pipe would be prohibitively expensive to manufacture in the West.

Construction at Vyksa has proceeded rapidly and should be completed by 1985. The Soviets have announced that the plant will produce 250,000 tons of pipe in 1983. Pipe production schedules provided to a Western firm indicate final capacity of about 500,000 tons per year of conventional pipe equivalent.[2]

Until recently, the Khartsyzsk plant produced mostly 1,020- and 1,220-mm pipe because the demand for pipe of this size was great. We foresee that, with a decline in demand for 1,020- and 1,220-mm pipe, Khartsyzsk may be able to devote some, if not most, of its capacity (about 800,000 tons) to production of 1,420-mm pipe. The Khartsyzsk plant has the fabrication equipment to produce 1,420-mm pipe. It only needs the steel plate with the requisite strength and ductility. According to media reports, the Soviets intend to expand production of 1,420-mm pipe at Khartsyzsk—currently about 400,000 tons and relying on imports of HSLA steel plate—using domestically produced steel plate during 1986-90.

[2] Because multilayered pipe is heavier than conventional pipe, we have expressed annual production at Vyksa in terms of an equivalent weight corresponding to the amount of pipeline that could be laid if conventional, single-layered Western pipe were used. 25X1

The USSR's track record, however, indicates that it will, at best, develop the capability to produce HSLA steel plate for civilian consumers slowly over the 1986-90 period. Soviet technical journals indicate that limited production of HSLA steel plate for use in 1,420-mm pipelines began in 1978 at the Azovstal' Steel Works. The Soviets, however, are still importing HSLA plate for pipe production, suggesting that they have not worked out all the problems in large-scale production of HSLA steel plate. 25X1 25X1

During 1986-90, about 800,000 tons of capacity will be available at Khartsyzsk for 1,420-mm-pipe production. If unable to produce adequate amounts of high-quality HSLA steel plate during 1986-90, the Soviets will have to increase steel plate imports substantially from the current level of 400,000 tons per year to meet the requirements for expanded 1,420-mm-pipe production at Khartsyzsk. 25X1

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Hard-Currency Impact

The expected cutback in total imports of large-diameter pipe and steel plate would help Moscow meet other priority import requirements. We estimate, for example, that annual Soviet hard currency expenditures for 500,000 tons of 1,420-mm pipe and 800,000 tons of steel plate for manufacture of 1,420-mm pipe during 1986-90 could drop to as little as $500 million a year (at 1982 prices) compared with $1.3 billion a year during 1981-85. The substitution of purchases of steel plate for imports of pipe is attractive because the price of steel plate per ton is only about half the price per ton of 1,420-mm pipe. Since our estimates indicate that the USSR will be able to increase its total hard currency imports little if at all in the second half of the decade without a sizable runup in its hard currency debt, a cut in pipe imports would help Moscow significantly. 25X1 25X1

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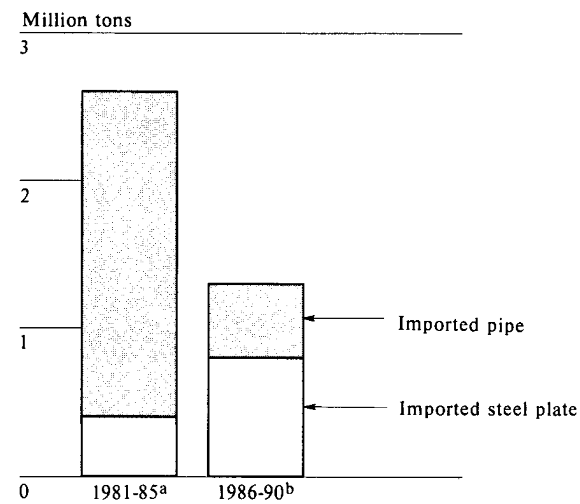
Soviet Union: Projected Annual Imports of Steel Plate and 1,420-mm Pipe



[a] Projected.
[b] Estimated.

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Political vs. Economic Trade-Offs

In the period to 1990, imported 1,420-mm pipe and HSLA steel plate probably will continue to be technically superior to the Soviet-made pipe and plate and—when all aspects of pipeline construction and operation are factored in—cheaper. We believe, however, that the Soviets will go ahead with the large-scale manufacture of 1,420-mm pipe, even at substantial economic costs, reflecting Moscow's ongoing concern about possible vulnerability to Western economic sanctions and a desire to conserve hard currency. 25X1

The Soviet decision to proceed with manufacture of multilayer pipe illustrates Moscow's penchant for self-sufficiency through import substitution. US experts who have studied the technology employed at Vyksa have commented that if this process were used in a Western plant, costs could be at least double current Western levels because of increased metal and energy requirements. Moreover, each weld will take longer to perform and more pipelayers will be required to handle the heavier pipe sections. 25X1

Impact on Western Suppliers

A substantial drop in Soviet imports of 1,420-mm pipe would most affect Japan and West Germany—the USSR's largest suppliers. Several of the largest West German mills are currently producing only for the Soviet market. It is doubtful, however, that the Soviets would make sudden, sharp cuts in pipe purchases. Instead increased Soviet output of 1,420-mm pipe will probably be phased in over a period of several years, giving Western suppliers some room to adjust. We believe the Soviets would want to avoid consequences that could result from sharp, unexpected cuts in orders placed in countries with which the USSR is trying to improve ties. 25X1

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