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International Economic & Energy Weekly

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12 July 1985

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International
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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Perspective

LDC Industrial Targeting

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LDC industrial targeting in high-tech sectors is an emerging policy concern for industrial country governments and is creating a climate of uncertainty for multinational corporations (MNCs). These highly competitive firms are being forced by targeting policies to relinquish profitable LDC markets to local high-technology companies, particularly in Brazil, Argentina, and Mexico. MNCs, however, which have long-term working relationships with host governments, have learned to adapt to these policies but hope they do not spread. Meanwhile, increased management time is spent on administrative redtape and altering product lines to remain in the market. MNCs are beginning to have difficulty importing supplies, are losing potential sales and profits, cannot supply products at the best price and quality, and have problems introducing new products. LDC targeting seriously affects those MNCs that are new, have a narrow range of investments, and produce profitable items for the mass market.

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These industrial targeting policies are generally carried out through trade and investment restrictions that often lead to problems for the LDC:

- These restrictions inhibit the flow of technology necessary to sustain development, particularly in rapidly advancing high-tech industries.
- Though some LDCs have the ability to develop advanced technology over the long term, lack of financial resources and technical know-how relegates most LDCs to merely copying developed-country products.
- LDCs need to export to relieve debt burdens, but many of their products currently are not competitive. In some cases, lack of domestic competition results in higher priced, lower quality goods that other LDCs cannot afford and developed countries do not need.
- Trade and investment restrictions discourage new foreign investment that LDCs need, and we believe such measures may even cause some disinvestment.
- Many MNCs are not updating the technology of their LDC facilities to safeguard new techniques from potential competitors.

  Despite these problems, LDCs are probably encouraged by limited successes in developing domestic industry.

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The emerging trends in LDC industrial targeting place some LDCs on a collision course with US objectives in the upcoming GATT round. Major US goals include reducing trade barriers in services and high technology—issues that have not been directly addressed in past rounds. A number of LDCs want to avoid these areas for fear of being forced to reduce market protection they now maintain. Brazil, for example, was reluctant to agree to a US request for GATT consultations on its new informatics law. Brazil—the leading LDC opponent to including trade in services under the GATT—has proposed service negotiations separate from a trade round so that it would have the option of not participating. In a new trade round, however, high technology probably would be addressed in the context of other negotiating areas. Many LDCs believe the inclusion of services and high technology in GATT will perpetuate the dominance of developed countries in these industries; they view high tech as a new industrial revolution and do not want to depend on developed countries.

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Informatics Targeting: The Brazilian Model

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Developing countries are experimenting with various policies to spur growth and exports in high-technology sectors, particularly in informatics—a broad category including computers, microelectronics, scientific instrumentation, peripherals, and software. Brazil's 1984 Informatics Decree has imposed broad and severe limitations on imports and foreign investment in major high-tech industries. We are concerned about the negative precedent set by these practices during a time of preliminary preparation for a new round of GATT negotiations. In addition, we believe similar LDC trade and investment restrictions may spread to other sectors, inhibiting the free flow of technology.

Brazil's Policy

Brazil's informatics law officially codifies and broadens ad hoc policies in effect since 1977. The law, set to expire in 1992, places the Federal Informatics Secretariat (SEI) under the new Ministry of Science and Technology. SEI is overseen by CONIN, a new council composed of federal ministers and industry representatives.

The intent of the informatics program is to strengthen Brazil's domestic industry and make it an internationally competitive export earner. The plan has three main features:

- *Market reserve.* Gives Brazilian firms the exclusive right to manufacture and sell products in certain categories. The coverage is sizable and focuses on high-growth sectors of the economy.

- *Law of similars.* Prohibits the import of goods when a domestically produced substitute can be found. Companies have sometimes been forced to accept higher priced and lower quality goods.

- *Brazilianization.* Preference is given to national companies in government procurement, tax exemption, and long-term low-interest loan financing. Interest rates depend on an assessment of local content and are negotiated project by project. Joint ventures will only be approved if new technology is transferred. SEI sets guidelines for multinational firms to ensure exports exceed imports by a set amount.

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Internal Conflicts

Although the Informatics Decree has widespread support in Brazil, debate continues over the specific issues, such as the inclusion of software protection and the priority of regional versus sectoral laws. According to diplomatic reports, the ministers of CONIN have been unable to reach a consensus on these issues. SEI has presented a specific informatics plan to CONIN for submission to the Congress, but CONIN has postponed debate on the plan until sometime this month. Embassy reporting indicates that some government officials privately admit the law was nationalistically motivated, insufficiently debated, and will actually slow Brazil's technological advancement by protecting obsolete technology and inhibiting trade and investment. Problems with the proposed informatics plan identified in the Brazilian press include more favorable prices and financing available in other countries, a shortage of human and financial resources for R&D, and an insufficient local market. Press reports state that Brazilian hardware is 25 to 30 percent more expensive than comparable foreign products and is of inferior quality. Despite these high costs, SEI and most Brazilian and foreign informatics companies believe that the law has promoted a domestic informatics industry in Brazil.

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Software. In one area of conflict, the Brazilian Government faces increasing pressure to add software copyright protection to the informatics law. Diplomatic reporting states that both domestic and foreign mass-market producers—frequent victims of pirating—favor long-term protection. Brasilia, in contrast, views protection as a means for continued multinational domination of the Brazilian market—only 21 percent of the software registered with SEI was produced domestically. Nonetheless, the government is willing to offer limited coverage for software.

We believe the lack of an effective copyright law will inhibit both domestic and foreign investment, and a consequent lack of reciprocity will deny Brazilian software producers protection abroad. Nonetheless, Embassy reporting states that intellectual property legislation for software has been postponed, and we believe it will not likely be drafted before next year unless unified international pressure increases or Brazil experiences difficulty in acquiring foreign software.

Regional versus Sectoral Laws. In a second area of internal conflict, the strength of the informatics law was challenged in a controversy over whether SEI's ability to control investment in the informatics sector supersedes the ability of the Manaus Free Trade Zone (SUFRAMA) to grant benefits. SEI is concerned the entire industry may be attracted to the zone, affording firms dual incentives. SUFRAMA fears that the informatics industry will remain concentrated in the Sao Paulo region.

During the inaugural session of CONIN in May, the special fiscal incentives offered by SUFRAMA were eliminated for the informatics industry. In a special June session, the Senate restored the incentives and removed CONIN's authority to grant fiscal or financial incentives to informatics projects. If ratified, this will weaken CONIN's decisionmaking authority.

Other Targeted Sectors

Although President Sarney has stated that informatics is a special case and market reserve will not spread to other sectors, Brazil's national development plan calls for new industrial policies in a number of industries:

- *Pharmaceuticals.* Multinationals control 80 percent of Brazil's pharmaceutical chemical sales and invest almost $4 billion per year. A 1984 legislative directive and the 1985 National Pharmaceutical and Chemical Industry Program effectively reserve new chemical production for Brazilian firms. The programs provide fiscal incentives and R&D funds and apply the national "similars" test to imports of pharmaceuticals and chemicals.

- *Robotics.* SEI has extended market reserve to robotics. Preference is given to companies using Brazilian technology or transferring technology. Currently it affects only the production, not import, of robots.

The national plan also targets the precision instruments, biotechnology, and communications equipment industries. We believe these sectors, as well as others with a strong foreign presence and high-technology content, are vulnerable to market reserve policies.

International Reaction

International reaction to Brazil's policy has been muted, primarily because of uncertainty concerning the program's content and degree of flexibility. LDCs are assessing it as a development model, while several developed countries, which privately oppose the trade/investment restrictions, are following it closely but remaining quiet to protect their current Brazilian investments.

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The informatics law's tariff increases, local content rules, and other quantitative restrictions have drawn criticism from the United States—the biggest foreign investor and trade partner in Brazil's informatics market. Such measures are allowed under the GATT because of exceptions granted to LDCs. At first Brazil justified restrictions on national security grounds, then switched to an infant industry rationale. Most recently, in GATT consultations requested by the United States, Brazil cited balance-of-payments problems. The United States was unable to convince any other countries to participate in the discussions, although Sweden considered it.

Other Informatics Programs

Several other countries have recently formulated informatics policies, with varied degrees of success:

- ***India.*** Prime Minister Rajiv Gandhi's comprehensive development policy gives special attention to the electronics industry. Although New Delhi expects to maintain control over the economy, its policies are somewhat less restrictive than Brasilia's. The new policies encourage imports of advanced technologies and ties with foreign business and offer greater toleration of foreign equity investment to obtain needed technology. New Delhi is especially interested in promoting software exports. We also expect the policies to provide a more stable tax and import climate.

- ***Spain.*** The National Development Plan for Electronics and Informatics offers generous investment resources, high tariff barriers, and export credits and is intended to modernize Spanish industry. During its first year, the plan has attracted foreign investment but has failed to stimulate domestic industry development.

- ***Mexico.*** Mexico City is considering a comprehensive electronics sector program to regulate investment and production. We believe that Mexico, not a member of GATT, may impose stricter local content laws and boost tariffs and quantitative restrictions on imports of finished components. Internal conflicts have delayed the formulation of a final plan.

- ***Argentina.*** According to Embassy reporting, Argentina plans to introduce an industrial promotion law and a technology transfer promotion law to spread informatics investment to new regions, expand exports, and improve technological capability. Both laws would increase restrictions on foreign firms, focusing on computers, telecommunications, and electronics. Because the government is divided over the issue, policy has been implemented piecemeal. Argentina claims to have rejected the export-oriented Brazilian approach; they intend only to satisfy their small domestic industry needs.

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Brazil is actively promoting its informatics industry model in Argentina, Venezuela, Mexico, and Colombia and is considering lobbying in Southeast Asia. Potential regional cooperation, however, will be limited because of organizational and technological weaknesses.

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Outlook

We believe most LDCs will develop similar but much less ambitious programs than Brazil's to regulate foreign participation and strengthen domestic industry. It is unlikely that significant changes will be made in Brazil's existing targeting laws; however, Brazilian officials have said they are flexible, and laws will be applied pragmatically. They also recommend that multinationals work to improve their negative image and transfer technology to LDCs. We believe that Brazil's debt situation will force it to attempt to maximize high-tech exports. The highly competitive world market will probably inhibit this effort, although Brazil may find markets in LDCs that contend export controls reduce US reliability as a supplier of technology. We believe Brazil, over the short term, will face financial and managerial problems in its high-tech industry targeting effort.

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Multifiber Arrangement Renewal [1]

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A year before the current extension of the Multifiber Arrangement (MFA) expires, disagreements are already surfacing over renewal. Despite opposition of the LDC exporters, renewal of the MFA until at least the end of a new GATT round is likely because key importers want to retain the quota system. The LDCs, however, are likely to push for abolition of the MFA in any new trade round.

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The MFA

The Multifiber Arrangement sets guidelines that importing and exporting countries use to negotiate bilateral textile and clothing agreements. The MFA dates from 1974 and was renegotiated in 1977 and 1981. Except for the US agreement with Japan, all bilateral agreements under the MFA are between LDC exporters and industrialized importers. Although negotiated under GATT auspices, the MFA represents a departure from GATT rules. It allows importer countries to use quotas to control imports without having to (1) demonstrate injury to domestic producers, (2) apply the quotas on a nondiscriminatory basis, or (3) choose between compensating the restricted country or facing retaliation.

In anticipation of its expiration on 30 June 1986, the current arrangement, "MFA III," requires the GATT Textiles Committee to meet no later than this month to consider whether to extend, modify, or discontinue the Arrangement. Negotiations on renewal would begin this fall and could continue beyond the June 1986 expiration of MFA III. The Textiles Committee meeting on 23 July may be limited to an exchange of views because a working party report due this month may not be ready until November.

Early LDC Posturing

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In recent years, developing countries have become increasingly critical of the MFA. They believe its original goals—orderly expansion of trade, industrial country adjustment, and progressive reduction of trade barriers—have been disregarded by the industrial countries. They complain that industrial country producers, unrestrained by quotas, have expanded exports at the expense of developing countries. The United States has borne the brunt of Third World criticism, despite enormous increases in US textile and clothing imports from developing countries (19-percent growth in 1983; 58 percent in 1984). US rules-of-origin changes and countervailing duty actions have been attacked for being outside the safeguards measures contained in bilateral textiles agreements.

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Although diplomatic reporting indicates that most exporting countries doubt that the MFA can be abolished in the near term, developing country exporters reaffirmed their desire to end the MFA at meetings in Karachi in July 1984 and Mexico City in April 1985. We believe this hardline stance is attractive to LDC exporters because:

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- It papers over differences among them, which the industrialized countries have used to play off one group of exporters against another.
- It allows them to start renewal talks from a position of strength.

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As the June 1986 deadline approaches, however, we believe individual countries will behave as in the past and abandon the common exporter position to privately seek the best deal for themselves from importers.

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The LDC exporters' common, hardline position has enabled them so far to limit progress in the working party. According to diplomatic reporting, the devel-

[1] This article is one of an occasional series examining various issues and trends that will affect the upcoming new GATT round.

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oping countries have tried to turn the working party into a negotiating forum that would recommend full application of GATT rules. The industrial countries want the working party to examine all options—including liberalization under an MFA framework—without endorsing any. The industrialized countries have also tried to direct working party attention to developing country barriers to textile and clothing trade.

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Exporters Motives

With the MFA in force for over a decade, many exporting countries have adapted to it and might actually be hurt by a return to GATT rules. According to diplomatic reporting, some small- and medium-sized exporting countries find textile and clothing quotas helpful because they guarantee shares of industrial country markets and protect them against major exporters. MFA quotas also provide a pretext for extensive government control of the textile and clothing sector, and many officials receive personal gain from quota distribution. Many of these exporters, particularly the Latin American or ASEAN countries, favor renegotiation of the MFA with higher quotas awarded to themselves. According to diplomatic reporting, their opening positions will, however, still call for ending the MFA and returning to GATT rules.

The large exporters, Hong Kong, South Korea, Taiwan, and China, are least likely to receive much growth in quotas from a new MFA and appear to have the most to gain from ending the MFA system. We believe, however, they fear that in a hectic post-MFA period that they would be the major targets of developed country protectionism. Consequently, the major exporters will probably accept some form of MFA renewal as the least risky alternative, while continuing to work for gradual phaseout of the MFA.

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Industrial Country Importers

The European Community will probably wait until just before this month's Textile Committee meeting to agree on a formal position on MFA renewal.

According to diplomatic reporting, the United Kingdom, West Germany, The Netherlands, and Denmark support liberalization or abandonment of the MFA, but France and Italy are committed to a restrictive MFA. We believe the EC stance will come out close to that of France, with the northern tier countries probably willing to wait until a new GATT round to discuss liberalization.

Japanese and Canadian positions on MFA renewal are still being developed. Japan has never been a major participant in the MFA system. Its bilateral agreements with exporters are managed informally, so that officially Japan maintains no quotas under the MFA.

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MFA and the New GATT Trade Round

Although a new GATT round will not be directly linked to MFA renewal talks, developing country members of GATT are already placing liberalization of world textile trade high on their list of objectives. Knowledge that textiles and clothing could be a significant part of a new round's final package may prompt MFA participants to defer to the broader-based talks and extend the MFA only until the end of the GATT round. Talks on launching a new round will probably begin in September, but the round itself may be barely under way by the June 1986 MFA deadline.

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We believe that it may be unrealistic to expect the developing countries to begin to dismantle their own trade barriers if a huge exception to GATT rules, the MFA, is allowed to continue. Industrialized countries, for their part, are likely to want to retain a restrictive MFA during a new round so

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that it can be used as a bargaining chip. They may also offer to reduce some of their textile and clothing barriers in order to obtain import barrier liberalizations from developing countries. Developing countries, however, would probably resist trading import barrier cuts for MFA phaseout, claiming that they should not have to pay simply to return textiles and clothing trade to GATT rules.

Outlook

We believe that there is a better than even chance that MFA renewal talks will follow past patterns: little progress until the deadline nears, but eventual agreement on a renewal that is more advantageous to small- and medium-sized exporters. A possible scenario includes a 1986 decision to extend the MFA until the end of a new GATT round, at which time new agreements on a post-MFA textiles and clothing regime would begin to phase in. Clearly, renewing the MFA in 1986, even on a restrictive basis, need not be inconsistent with doing away with it during a GATT round.

Whatever the outcome, the industrial countries will come under intense pressure to allow LDCs—many of them experiencing debt problems, unemployment, and slow growth—to earn much more from textile and clothing exports. Liberalizations in a new round plus a possible phaseout of the MFA in the 1990s would increase even further the import competition faced by developed country textile and clothing producers, particularly those which have not substantially reduced costs through technological improvements.

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International Commodity Agreements: Ailing But Not Dead

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Last year the International Sugar Agreement collapsed after seven years of ineffectiveness, and the four remaining International Commodity Agreements (ICAs) face uncertain futures. ICAs with price-support mechanisms represent only 13 percent of the value of world nonoil commodity trade. With the UNCTAD Integrated Program for Commodities (IPC) cotinuing to founder, LDCs are likely to push harder in other arenas, such as GATT, for solutions to their commodity trade problems. We believe, however, that the LDCs lack the unity necessary for a firm multilateral effort on any significant commodity issue.

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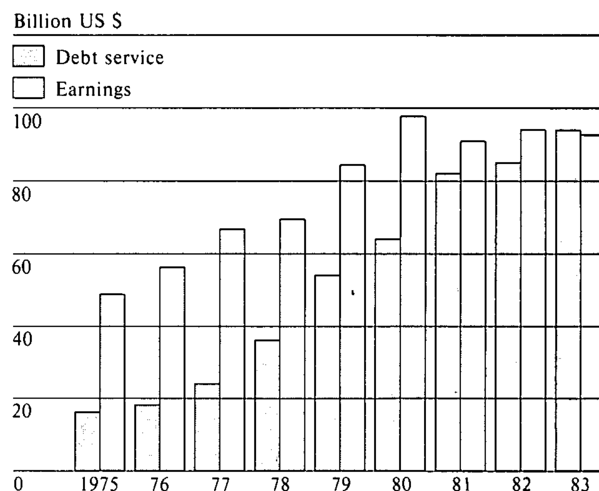
The Integrated Program for Commodities

An UNCTAD resolution in 1976 laid out the IPC aimed at improving LDC earnings by stabilizing commodity prices. Facing rapidly rising commodity prices and fearing a proliferation of OPEC-like cartels, the developed countries supported the IPC in principle to ensure future raw material supplies. The IPC called for price-stabilizing international agreements covering 18 commodities and ultimately the creation of a Common Fund with umbrella financing to replace the individual funds that currently finance bufferstocks.

The IPC has been a failure. Since 1976 only one new ICA has been established—the International Natural Rubber Agreement (INRA). Last year the ICA for sugar was dissolved, and efforts to form several new pacts have failed. Consumers have continued their participation in ICAs largely for political purposes. The Common Fund is still in limbo, lacking the necessary signatories to put it into effect. If and when the Fund enters into force, few observers expect it to be effective because it is insufficiently capitalized. The original goal of $6 billion has been pared back sharply, and even the current goal of $470 million is not likely to be reached.

Nonoil LDCs: Commodity Earnings and Debt Service, 1975-83



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Status of the Agreements

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The 1980 *International Cocoa Agreement* (ICCA) is operating under a one-year extension set to expire on 30 September. Prices have averaged less than the price floor of $1.06 per pound over the life of the agreement, and cocoa purchases for the bufferstock were halted in 1982 when funds became depleted. Producers and consumers are making halting progress on a new pact and are meeting this week to discuss another one-year extension.

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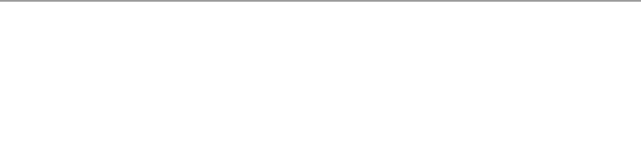

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range and the type of export control measures needed to supplement the existing bufferstock. Producers are pushing for a $1.05 to $1.35 range, while consumers are calling for 90 cents to $1.20.

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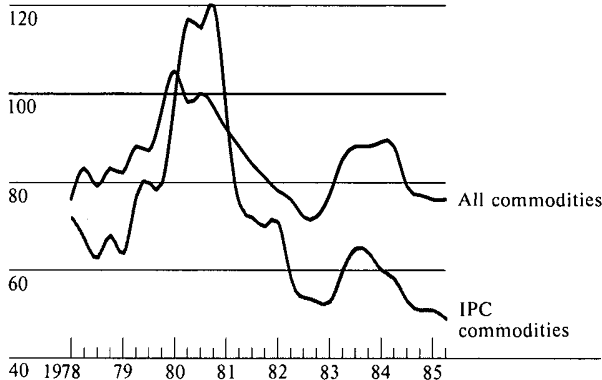
The *International Coffee Agreement*, scheduled to run until October 1989, relies on export quotas to maintain prices between $1.20 and $1.40 per pound. Although world coffee prices have hovered around the upper limit, several disputes between consuming and producing countries are creating an unstable situation. Because sales to nonmembers are not bound by quota regulations, a two-tiered market has developed, with large exporters, such as Brazil, providing discounts to nonmembers of up to 50 percent. Consumers have argued for more restrictions on sales to nonmembers and a release of more quota coffee onto the market to bring down prices to members.

The *International Tin Agreement* (ITA), which expires in July 1987, utilizes both export quotas and a bufferstock. Tin prices have been running only slightly above the ITA minimum since early 1982 because of declining demand, large producer and consumer stocks, and rampant smuggling to circumvent export quotas. Moreover, non-ITA countries—particularly Brazil—are expanding tin production. The ITA faces growing difficulty financing its bufferstock operations. It has begun borrowing from commercial sources, using tin as collateral, and may eventually have to sell some of its stockpile to service its debt. This would lead to lower tin prices and perhaps bankruptcy for the agreement. According to Embassy discussions with the ITC chairman, the governing council may not seek a new agreement, depending on the "market situation and position of the bufferstock" next year.

The current *International Natural Rubber Agreement* was extended to October 1987 at a recent INR council session. During this extension, producers and consumers will attempt to negotiate a new

Price Trends: An Index of Five IPC Commodities and of all Commodities



[a] The five IPC commodities include sugar, coffee, cocoa, tin, and rubber.

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pact. The main obstacle is agreement on the minimum price level, which producers consider too low for the long-term health of the industry. At approximately 40 cents a pound, rubber prices are near the INRA minimum. US diplomats report a "surprising" degree of solidarity among consumers on the price issue, but producers are likely to win some concessions. Consumers, however, want assurances that producers will not restrict rubber supplies unilaterally.

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The ICAs have had little effect on LDC export earnings during the last four years of depressed commodity prices. The average lifespan of ICAs has been less than five years, and their ability to stabilize prices is marginal. The IPC has done little to change this pattern, and we expect a further decline in the effectiveness of ICAs.

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Outlook

The failure of the IPC, along with waning consumer interest, has sparked LDC interest in other measures. Already there is a move toward administrative commodity agreements, which concentrate on facilitating better market information and product research but lack price provisions. Such agreements include sugar, wheat, jute, bananas, and tropical timber.

the Soviet Union is considering joining the Common Fund to bolster Moscow's image among LDCs. Even if additional Bloc countries follow suit, the limited financial resources of the Common Fund would hamper its ability to support prices and boost export earnings.

Taking another approach to the commodity price problem, UNCTAD is considering creating a compensatory financing facility. Such a facility would be similar to, but much larger than, the existing IMF facility used to compensate LDCs facing temporary earnings shortfalls because of low export prices.

Finally, LDCs may push for a reduction of commodity trade barriers during a new GATT round. LDCs have increasingly divergent self-interests on commodity issues, however. Although some countries see protectionism as a threat to their export earnings, others benefit from special market access through such arrangements as the Lome Convention. Indeed, producers capable of expanding output and exports are less apt to join established exporters in agreements that restrict supply and control prices. As a result, we believe LDC solidarity on commodity issues will grow even more elusive in the coming years.

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Colombia: "Narco-Dollars" and the Balance of Payments

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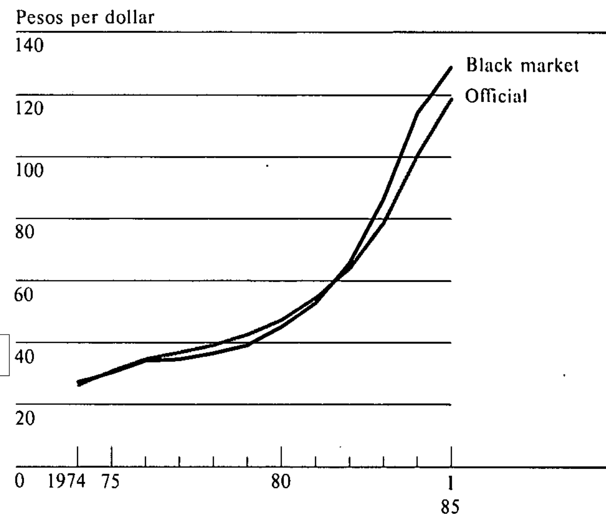
Only two countries in Latin America, Colombia and Paraguay, survived the negative economic forces that buffeted LDCs over the past several years without rescheduling their external debt. In the case of Colombia, inflows of drug money apparently helped sustain its international payments position. More recently, however, traffickers have brought fewer dollars back to Colombia, and this combined with a sustained depression in the coffee export business has substantially reduced foreign exchange receipts. In an effort to avoid harsh austerity, the Betancur government is experimenting with measures designed to maximize the inflow of foreign exchange. These have the side effect of encouraging increased inflows of narcotics profits to Colombia from foreign safehavens.

Colombia: Official and Black-Market Dollar Exchange Rates, 1974-85



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Dwindling Drug Money Flows

We calculate that drug money first became important in Colombia's external account balance about a decade ago when earnings from the burgeoning cocaine trade were added to the already substantial receipts from the marijuana business. Most academic research indicates that by the mid-1970s these drug money flows were equivalent to at least 15 percent of all foreign exchange receipts. The clandestine inflow of US dollars was sufficient to create a major upheaval in local exchange markets; from 1975 through 1981 the value of the US dollar on the Colombian black market was consistently below that offered by the Central Bank.

The annual drug money flow into Colombia apparently peaked in 1980 at about $2 billion. Although the Central Bank opened a *ventanilla siniestra* (no questions asked window) in 1980 to capture additional drug money, the inflow shrank to less than $1 billion in 1984, according to US Embassy estimates. The traffickers' disinclination to return funds to Colombia—a concern shared by legitimate businessmen—was in part a result of Colombia's deteriorating economic situation. It also reflected the increased financial sophistication of traffickers, who began to hold more of their profits outside the country in dollars rather than spending them in Colombia to enhance their lifestyle and their position in society.

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After 1982, trafficker disenchantment—reflected in reduced dollar inflows—was reinforced by a number of actions taken by the newly elected Betancur administration. In October 1982, only two months after taking office, President Betancur closed the notorious *ventanilla siniestra*. The government campaign against traffickers following the assassination of Justice Minister Lara in May 1984

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Colombia:
Current Account, 1980-85

Million US $

	1980	1981	1982	1983	1984 [a]	1985 [b]
Current account balance	**−159**	**−1,895**	**−2,895**	**−2,838**	**−2,840**	**−2,995**
Trade balance	−238	−1,544	−2,189	−1,755	−1,650	−1,495
Exports, f.o.b.	4,062	3,219	3,215	3,002	2,950	3,205
Coffee	2,375	1,459	1,577	1,537	1,799	1,850
Imports, f.o.b.	4,300	4,763	5,404	4,757 [c]	4,600 [c]	4,700 [d]
Net service and transfers	79	−351	−706	−1,083	−1,190	−1,500

[a] Estimated.
[b] Projected.
[c] Reflects tightening of nonessential imports and accelerated monthly devaluation pace.
[d] Reflects easing of import restrictions to comply with, IMF-monitored, self-imposed economic adjustments.

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also altered patterns of drug money movement. Clandestine dollar flows into Panama from Colombia increased [redacted] Some exodus of traffickers and their money to safehavens also has occurred. [redacted]

Recent Policy Changes

Faced with a worsening foreign exchange crisis and under intense pressure to turn around a deteriorating economy, Betancur has proposed two measures designed to reverse capital outflow:

- A tax amnesty on funds from abroad that are invested in high-priority development projects during a specified period of time.
- Legalized entry of imports purchased with private foreign exchange held abroad.

These measures, if enacted, could have the additional effect of encouraging inflows of narcotics dollars. Most of the funds held abroad by Colombians are in the hands of traffickers rather than legitimate businessmen. Drug traffickers, most of whom are also engaged in smuggling other contraband, will especially welcome the second provision, which legalizes this sideline. [redacted]

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Neither measure has been approved, but some evidence suggests traffickers take Betancur's proposal as signifying a more relaxed attitude and may already be moving more drug money into Colombia. During the first few months of 1985, $91 million entered the country under the heading of service income, including tourism, financial transfers, and "other." Tourism alone showed income of $9.3 million in the last week of February as compared with less than $1 million during that period in 1984. Economic experts say that the depressed tourist industry could not possibly have generated such sums. We therefore conclude that the increased "earnings" represent drug money entering Colombia through the exchange house system—a mechanism regularly employed to transfer drug revenues under the cloak of tourist income. [redacted]

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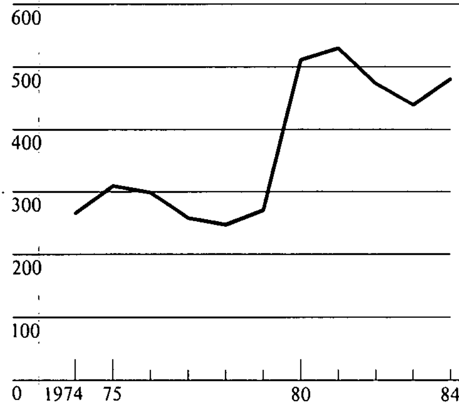
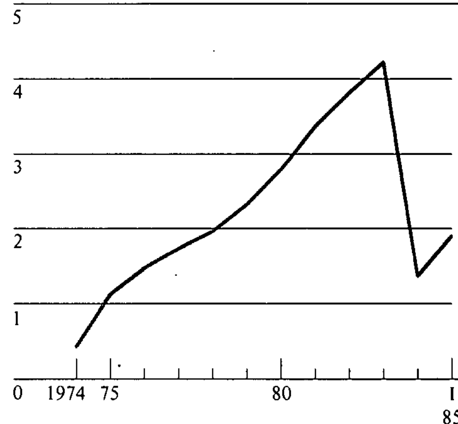
Colombia: Gold Indicators





[a] Based on amount reaching smelters.
[b] End of period.

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The Gold Rush

As a quick fix to reverse the decline in foreign exchange holdings, in March 1984 the Colombian Central Bank [1]—the sole legal purchaser of locally produced bullion—set a peso price for gold some 30 percent above the world market level. The declared purpose of this measure was to prevent illegal gold exports, but the net effect is to enable the Central Bank to finance the current account deficit, in part by reselling smuggled gold for foreign exchange. During 1984, gold purchases by the Central Bank totaled 700,000 troy ounces, but domestic output was less than 500,000 ounces.

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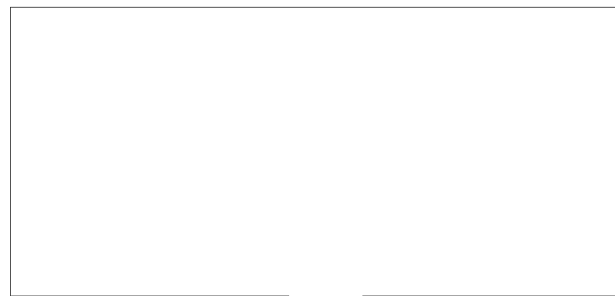

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Costa Rica almost certainly is one source of gold for drug traffickers. According to the San Jose press, Costa Rican officials claim that up to 70 percent of the country's gold output is being smuggled abroad despite premium prices offered by the government. They allege that drug traffickers are the principal purchasers. The Costa Rican press speculates that the traffickers are outbidding the government for local bullion, but we consider it more likely that they obtain a discount by offering

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[1] In Colombia the President of the Republic exercises control over the Central Bank through his Finance, Planning, Development, and Agriculture ministers, who constitute a majority of its Board of Governors.

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to deposit dollars in offshore bank accounts held by the sellers.

We have very little information about other sources of gold entering Colombia. At the very outside, Costa Rica in 1984 could have supplied only 70,000 of the 200,000 ounces of non-Colombian gold apparently acquired by the Colombian Central Bank. the official gold output of Brazil, Peru, Bolivia, and Ecuador in 1983 totaled 1.8 million ounces, and, in our view, substantial unrecorded output probably enters the underground trade. Whatever its origin, we judge the gold entered Colombia from neighboring areas via established smuggling routes exploited by traffickers.

Outlook

Probably only a small fraction of the money earned by Colombia's narcotics traffickers actually returns to Colombia. According to our estimates, they remove $3-6 billion annually from the United States—a sum at least as large as the projected Colombian current account deficit for 1985. In addition, Colombian traffickers obtain large profits from Europe, the second-most important market, and are establishing operations in Australia, the Persian Gulf, and other affluent areas.

The availability of such large revenues may be too much temptation for any financially strapped government to withstand. How far the Colombian Government will go to siphon off some of this enormous dollar pool will depend on a number of factors. In the short term, bank loans under IMF monitoring may reduce the lure of drug money, but persistent austerity and depressed living standards, over the longer term, may provide an incentive to turn a blind eye to this source of needed revenues. Antidrug pressure from the United States and other consuming countries, as well as the behavior of the traffickers themselves, will also influence government actions. A relatively low profile by traffickers could lead to an easing of government pressure on them and eventual facilitation of their financial transactions. A new round of trafficker-promoted violence, on the other hand, would undoubtedly cause an outraged government to slam all the drug money windows shut.

Drug Money Channels

Before the Colombian traffickers discovered gold, drug revenues generally entered Colombia as:
- *US currency or dollar instruments smuggled by traffickers. An unknown portion of such cash is exchanged for pesos on the currency black market.*
- *Pesos supplied by exchange houses against dollars received in Colombia or elsewhere. A considerable share of these receipts may be reported falsely as tourist revenues.*
- *Smuggled goods.*
- *Underinvoiced imports with the discounted balance paid in dollars abroad.*
- *Receipts for phony or overinvoiced exports.*

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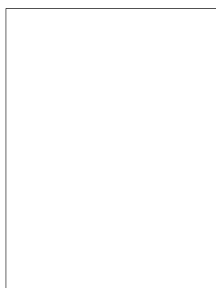
Briefs

Energy

Italy Increases Oil Imports From USSR



The Soviet Union has become Italy's second-largest supplier of crude oil after Libya—up from its fifth-place position of only five years ago. Although Italian crude oil imports have dropped 19 percent in the past five years, imports from the Soviet Union have nearly doubled and now account for 15 percent of the total. About 6 percent of Italy's petroleum products imports also comes from the Soviet Union. Crude oil, petroleum products, and natural gas account for 90 percent of Italian imports from the USSR. A recently released report by the Ministries of Industry and of Commerce, in conjunction with the military, does not express concern over this increased dependence on the USSR, pointing out that alternative energy sources are currently more unstable. With a $2.4 billion trade deficit with the Soviets in 1984, Rome wants to increase machinery sales to improve the trade balance. Curtailing oil or gas purchases, however, apparently has not been considered.

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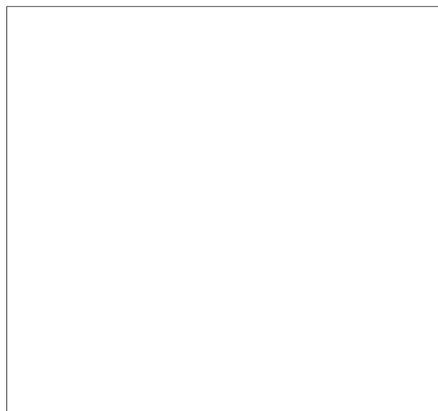
Dutch Nuclear Plans Proceed



On 27 June the Dutch Parliament approved the construction of at least two of the three nuclear power plants proposed by the government in 1980. Despite the controversy over nuclear issues in the Netherlands, the debate did not attract much protest. While the original proposal called for three 1,300-megawatt plants, the actual capacity will be determined by the utility companies, who will receive no subsidies from the government. Officials hope the plants will be completed by 1995, enabling the Netherlands to both increase gas exports and enhance energy security. Potential obstacles include finding a site for the plants—which the government hopes to do by February—and solving the waste disposal problem as a condition for final approval. The government has had difficulty finding a waste storage site and may want to avoid a final decision as next year's elections approach. Moreover, the Labor Party, which is opposed to the expansion of nuclear power, may reenter the government following elections.

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Record Chinese Oil Production

China produced 2.47 million b/d of oil during the first half of 1985, almost 11 percent more than the same period last year. About half the increase came from new finds at the Shengli oilfield in Shandong Province. Beijing plans to increase Shengli's production 150 percent by 1990 to 1.34 million b/d, surpassing current production at the Daqing field, where production is expected to decline. The introduction of resident foreign experts and foreign technology last year to China's major onshore oilfields has improved Beijing's exploration and enhanced recovery techniques. Most of the additional output is being exported to earn foreign exchange. About 85 percent of last year's increase was exported, and crude oil exports jumped 48 percent in 1984 to 439,000 b/d.

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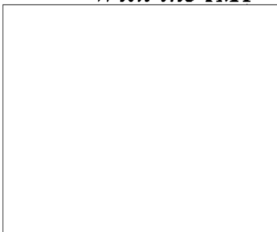
International Finance

Zambian Negotiations With the IMF



Zambian negotiations for a new IMF standby agreement to replace the one suspended in October 1984 are likely to be protracted and ultimately, unsuccessful. Declining copper reserves and poor copper price prospects virtually guarantee Zambia will be unable to cover its $145 million in debts to the IMF, World Bank, and private creditors that will have accumulated by October, the projected implementation date of the standby agreement. In addition, terms of a new IMF agreement are likely to include further currency devaluations and cuts in government spending—measures Lusaka believes are politically risky. Devaluations would add to inflation—already running over 25 percent—and to labor-government tensions. Spending cuts are likely to include reductions in the government work force, adding to an estimated 50-percent unemployment rate.

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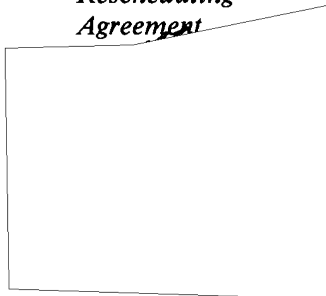
Ivory Coast Rescheduling Agreement



The Ivory Coast recently negotiated a rescheduling agreement with Paris Club creditors that covers 100 percent of principal and 50 percent of interest falling due over the next 12 months. The agreement is identical to last year's rescheduling and follows a new $66 million IMF standby arrangement concluded last month. The Ivory Coast's IMF-sponsored adjustment program—including tax increases, reduced food and housing subsidies, and a civil service payroll freeze—has reduced the budget and current account deficits by over two-thirds since 1982. The economy declined for the third straight year in 1984, however, and the debt service ratio has remained above 40 percent.

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Pakistan Seeks IMF Aid

Pakistan is seeking $330 million in aid from the IMF to help bolster its foreign exchange reserves. Foreign exchange reserves have fallen by roughly $1 billion in the past 12 months; we believe they will drop to $700 million by June 1986, in the absence of additional aid—equivalent to about six weeks of imports. Even if Pakistan receives all the aid requested its foreign payments problems will continue because of poor export performance, declining remittances from Pakistani workers, and unexpected increases in imports stemming from poor wheat harvests. An IMF official involved in the negotiations emphasized the linkage of additional economic reforms to improve the foreign payments position in the long term to any substantial amount of aid. Pakistan will request US aid in the hopes that the United States will impose fewer restrictions than the IMF.

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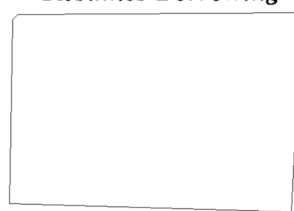
Bulgaria Resumes Borrowing



Bulgaria has taken advantage of favorable borrowing conditions to arrange its first syndicated credit since 1979. The seven-year loan, carrying an interest spread of only 0.375 percentage point over LIBOR, was offered originally for $100 million, but Western banks responded so eagerly that the amount was raised to $200 million. Sofia enjoys a good standing with bankers because of its small debt and reputation for financial conservatism.

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Constraints on energy, raw materials, and labor supplies and Soviet pressure to increase exports of high quality machinery and consumer goods have impressed on Bulgarian leaders the need to modernize industry. Sofia, however, may use the funds to restructure existing debt, rebuild foreign exchange reserves that were drawn down during last winter's energy crisis, and brace for increased grain imports if harvest prospects fail to improve. 25X1

Global and Regional Developments

EC Forecast of Slow, Steady Growth

The EC Secretariat currently projects the Community's GNP growth at 2.3 percent annually in 1985, up from last year's 2.1 percent but slightly lower than earlier forecasts for the same period. All of the acceleration in growth in 1985 is due to the end of the miners' strike in the United Kingdom. The other nine EC countries should register the same or slightly lower growth rates as last year because of the expected slowdown in the expansion of US demand for imports. The secretariat believes that the Ten can maintain the same 2.3-percent growth rate in 1986 because it expects nominal oil prices to fall slightly, real income to rise as inflation continues to ease, and job creation to keep pace with people seeking employment. Expectations that unemployment will be checked as a result of the slightly higher growth rate are overoptimistic; we expect EC unemployment will continue rising in 1986 after passing the 11-percent level later this year. Almost all of the EC governments are concentrating on inflation, which the secretariat believes will decline 0.9 percentage point in 1985 from last year's 6.3-percent average. This goal, we believe, is achievable unless governments shift to more stimulative policies. 25X1 25X1

Possible EC Move on Wheat Exports

The EC is planning to expand the use of subsidized credit to promote wheat exports in the 1985/86 marketing year beginning 1 August, 25X1 25X1 In particular, France is considering increasing by one-third the amount of French wheat eligible for government-backed export credits. Such measures would be the first significant EC reaction to the US export PIK program. The EC—faced with a wheat stockpile double last year's and an expected long-term decline in world prices—is anxious to retain and, if possible, expand its current 17-percent share of the world wheat market. Subsidized export credits, however, could tend to further depress prices. 25X1

Growing Frictions in Indonesian-Japanese Economic Relations

According to recent US Embassy reporting, Jakarta views Japanese import restrictions on manufactures, particularly plywood and textiles, as obstacles to its high-priority nonoil export drive. President Soeharto has publicly criticized high Japanese plywood duties. Indonesia also resents the Japanese penchant for dealing with the much-resented ethnic Chinese and the gradual shift in Japanese investments from import substitution projects to small-scale manufacturing. Although the economic relationship almost certainly is strong enough to weather these disputes, we believe that trade and investment will become a more contentious issue in the near term requiring closer cooperation between senior officials in Jakarta and Tokyo. 25X1

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Central American Common Market Trade Falters

A new round of unilateral trade restrictions by Central American Common Market (CACM) countries—Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua—is further reducing intraregional trade. By last year, financial problems and political turmoil cut CACM trade levels 40 percent below the 1980 peak. Recent calls for CACM unity have been ignored, and new country restrictions are redirecting a growing portion of intraregional trade into private channels. San Jose is halting credit sales to CACM partners to ease its growing overdue debt problem. Meanwhile, Honduras—which has a chronic CACM trade deficit—is restricting importers' access to foreign currency. Managua's nonpayment of regional bilateral debts—now exceeding $400 million—is forcing the other four countries to limit most trade with Nicaragua to barter or advance cash payment deals. The sharp depreciation of Guatemala's currency during the first half of this year is leading regional competitors, especially in El Salvador and Honduras, to press their governments for additional barriers to keep "cheap" Guatemalan goods out of their markets.

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National Developments

Developed Countries

Canada Subsidizing Grain Exports

Ottawa says it is prepared to use subsidies to sell grain on the world market, despite fears the practice will contribute to sharply lower grain prices and adversely affect the Canadian economy. Ottawa plans first to try to reach agreement with the United States and the EC on grain export policies, but it is determined to sell Canadian grain at whatever price it takes to make the sale. Despite their tough talk, the Canadians almost certainly hope the US-EC grain dispute will be resolved soon and will probably urge the issue be considered in a new GATT round. Ottawa is in a poor position to engage in a grain war, in part because a large budget deficit limits its ability to subsidize sales directly. Moreover, it cannot adopt measures similar to the US export PIK program because last year's drought required drawing down stocks to fill long-term contracts. Nevertheless, Prime Minister Mulroney's Tories need to protect their political base in western Canada and probably would run the deficit higher if necessary.

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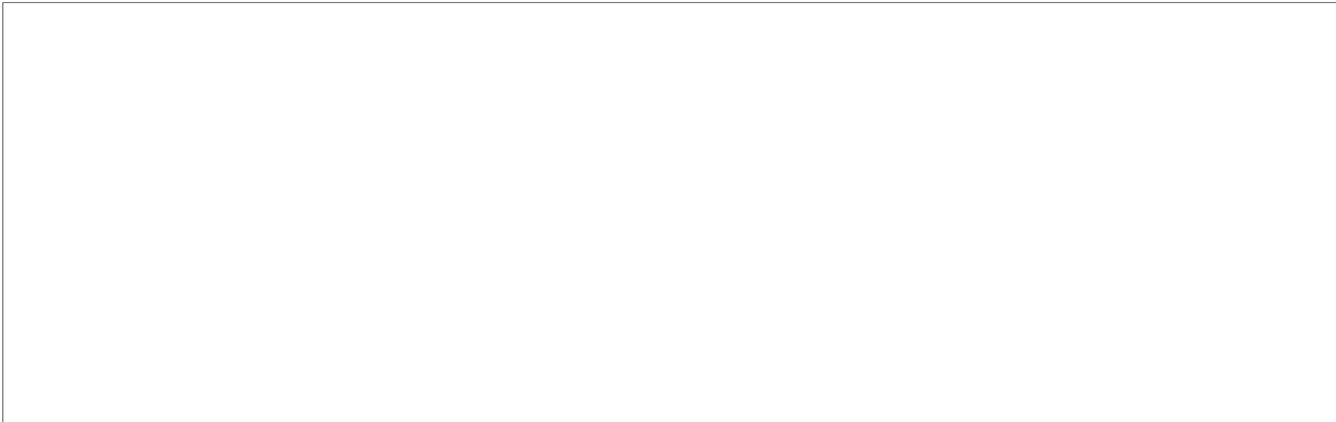

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US-French Trade Dispute

The GATT Government Procurement Committee has agreed to establish a working party to examine its members' policies on computer purchases as a result of an ongoing US-French dispute. Earlier this year, Paris announced its intention to buy the bulk of 160,000 computers plus computer-related equipment for its computer literacy program from French manufacturers. The United States claims this violates the GATT code on government procurement. EC officials publicly support the French position

The working party will study computer procurement as it relates to the code in general rather than judge this particular case, and Washington still has the option of requesting a panel to settle the dispute.

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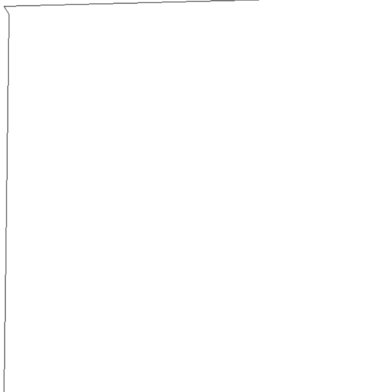
British Trade Back in Surplus



Britain's trade account was in surplus in May for the first time since February 1984 largely because of a recovery in the energy trade balance. The $290 million trade surplus and estimated net invisibles earnings of $650 million helped push the current account surplus to over $1.2 billion for the first five months of 1985, compared with an $850 million surplus during the same period last year. The oil trade surplus, which had deteriorated considerably during the yearlong coal miners' strike, rebounded in May to more than $1 billion. Meanwhile, imports of capital goods fell with the phasing out of a variety of capital allowances in March. For all of 1985 the current account surplus likely will be greater than last year's unusually low $833 million, but still well below the average $6.8 billion surplus registered in 1982-83. Improved external performance might enhance investors' confidence in the British economy and lead to a strengthening in the pound.

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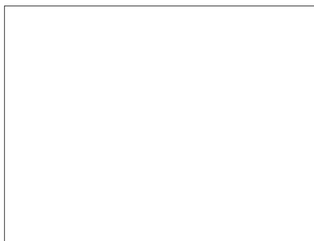
UK Tax Cuts Threatened



The Thatcher government's plans to cut taxes over the next three years could be jeopardized as a result of falling oil prices. Several prominent financial analysts forecast that a fall in oil prices could lower oil tax revenues this year by $3.9 billion, 22 percent below government projections. Higher-than-forecasted government spending—due in part to large public-sector wage settlements and increasing inflation—and calls to increase spending further to reduce unemployment also have cast doubt over the government's ability to cut

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taxes. London is under increasing pressure to deliver on the promised tax cuts and probably will look for alternate revenue sources. It might, for example, speed up the privatization program or increase borrowing but either option will be controversial. By privatizing more companies, Thatcher will be open to charges that she is selling state assets to finance current expenditures. Increased borrowing, on the other hand, will be perceived as inflationary. Should falling oil prices put downward pressure on the pound and raise the sterling price of oil, it would cushion the fall in tax revenues. The government, however, is attempting to defend the pound and has played down the link between oil prices and the pound to avert a fall in sterling's value. 25X1

Danish Current Account Deficit Grows

Denmark's current account deficit for first-half 1985—$1.5 billion according to US Embassy estimates—already exceeds earlier forecasts for the entire year. Unforeseen trade shifts have pushed the trade balance to a deficit of over $500 million for the first six months instead of an anticipated surplus. Strong import growth in oil, capital equipment, automobiles, and consumer goods more than offset only moderate export gains. Although the full-year current account deficit could top the 1979 record of $3.0 billion, the government apparently will not restrict consumption. Danish officials expect the current account to show improvement in coming months. More important, the conservative-led coalition is reluctant to take money out of consumers' pockets prior to the important municipal elections scheduled for this fall. 25X1

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Australian Tax Reform Troubles

Reeling from three days of criticism from virtually all the major interest groups represented at a national conference on tax reform last week in Canberra, Prime Minister Hawke is backing away from his efforts to impose a 12-percent retail sales tax. The tax was to offset reductions in the income tax, but union leaders complained it would strike low-income earners disproportionately; they threatened to break the government's wage-setting scheme. Business leaders told Hawke that investment and growth would suffer, and 25,000 farmers marched on the capital to protest anticipated higher operating costs. Hawke has never before made such a major retreat on economic policy, and his action will fuel charges that he has become an ineffective leader. Although Treasurer Keating maintains that the government will still enact the most radical tax reform in Australian history, future reform proposals are unlikely to be more than modifications of existing tax laws. 25X1

Less Developed Countries

South Korea Eases Monetary Policy

Seoul is reacting to weak first-half economic performance—mainly because of an export decline—by easing its austere monetary policy. The newly announced measures are likely to help domestic commercial banks that are saddled with low-yield government-mandated loans but will not spur economic growth to planned levels. The targeted 9.5-percent annual growth of the money supply, M2, was maintained through April but hit 12.9 percent by June. In addition, [redacted] the Bank of Korea will gradually issue $4.6 billion in new currency to service the debt of firms in financial 25X1

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difficulty—enough to cover all corporate bad debt, according to government estimates. The press reported that $575 million will be issued during 1985 as low-interest loans to commercial banks, but no timetable has been announced.

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We believe that economic policy makers still adhere to their price stability objective and will closely monitor the impact of added liquidity on inflation. Seoul's response to the economic slowdown has been measured, but enthusiastic acceptance of the recent Korea Development Bank syndicated loan is evidence that slow economic growth and a $1 billion current account deficit has not significantly eroded banker confidence in Korea's creditworthiness. Persistent economic sluggishness, however, may intensify opposition calls for protection of domestic markets that could slow the pace of economic liberalization and spark negative reactions from major trading partners such as the United States.

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Philippine Exports Slump

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Manila reportedly told the IMF last week that export earnings may drop by 15 percent this year—a sharp contrast to the 10-percent growth rate targeted by the Fund. The poor export performance is due largely to declining world prices for coconut oil, the world-wide slump in electronics, and the continued overvaluation of the peso. Declining export earnings are a major setback for Manila's economic recovery program and have led the US Embassy to revise down its GDP forecast to as much as a 4-percent decline this year. According to the US Embassy, the IMF is pressing Manila to lower the value of the peso, and we believe that a rebound in exports requires at least a 20-percent depreciation.

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Indian Export Promotion Efforts

New Delhi has announced modest new measures to stimulate nonpetroleum exports, which grew only 3.8 percent in dollar terms—but 20 percent in rupees—last year. According to the Commerce Minister, the government is launching a drive—probably in the form of trade missions—to push sales to the United States, and establishing export promotion organizations for electronics, computer software, and some agricultural products. Tax rebate benefits for more than 800 items have been revised slightly—increased, for example, for some clothing and steel products, but lowered on tea bags and leather goods. Price or credit subsidies have been raised for a few industrial inputs used in the production of export goods. New Delhi hopes that liberalized industrial controls and increased access to Western technology will help make Indian products more competitive. Current negotiations for an export promotion loan from the World Bank may lead to further policy changes, but, in our judgment, prospects remain poor for achieving the very rapid growth in export volume needed to ease forthcoming foreign-payments strains.

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Indian Industrial Decontrol Extended

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Further liberalization of government restrictions on private production indicates that Prime Minister Gandhi's efforts to make Indian industry more productive, while still cautious, are gaining momentum. A policy change

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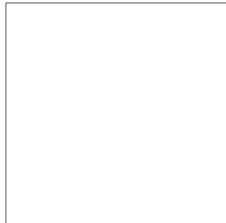

announced shortly after Gandhi's US visit last month authorizes manufacturers to vary their product mix within subcategories of 14 industrial sectors, including steel, agricultural machinery, metal products, and automobile parts, without government permission. The new rules benefit a much larger share of Indian industry than similar measures announced earlier this year for a few high-technology sectors of special interest to Gandhi. The latest measures do not apply to very large or foreign corporations, or to products reserved for small-scale industry. Nevertheless, decontrol will help adjust output to market demand and permit fuller use of existing capacity.

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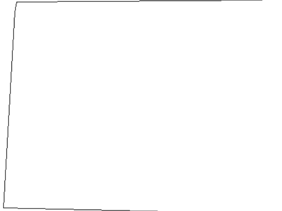
Sudan Cuts Diesel Price



The Sudanese Government reduced the price of diesel fuel by 20 percent earlier this week and is revising transportation fees to reflect the lower price. The price rollback follows increasing union pressures on the ruling military council to provide relief to consumers and could trigger other concessions. The US Embassy reports that the latest measure reverses a decision made a week earlier to hold the line on prices. Other price reductions, however, would send a strong signal to the IMF on the ability of the new rulers to comply with a Fund stabilization program. Sudan is attempting to clear up over $115 million in arrears with the Fund to qualify for a new standby arrangement.

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Thai Exports Stagnate

Thailand's exports for the first five months of this year amounted to $3 billion, an increase of less than 1 percent in dollar terms over the same period in 1984. Although the value of manufactures exports is up sharply, earnings from commodities—which account for 60 percent of foreign exchange revenues—remain depressed because of slack global demand. Bangkok will likely intensify its export drive to avoid continued cuts in capital goods imports, which have been largely responsible for the country's improving current account balances. Despite the adverse impact on US exports of its recent tariff hikes, Bangkok can be expected to press Washington to keep US markets open to Thai products.

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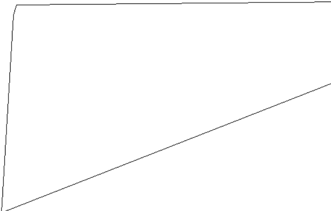
Thailand's Corn Surplus Grows



Higher production will push Thailand's exportable surplus of corn to at least 3.4 million metric tons for the 1985/86 season, an increase of at least 8 percent over the previous year's export level, according to the USDA. Bangkok may find it difficult to sell the surplus. World demand is expected to decrease, and the United States and Argentina—Thailand's traditional competitors—are harvesting large corn crops. In addition, China is emerging as a new threat to Thailand's corn exports, last year taking 15 percent of its Asian markets by offering lower prices and better quality. Although Bangkok is trying to diversify its markets—particularly in the Soviet Bloc—weak demand and continued quality problems will likely limit sales.

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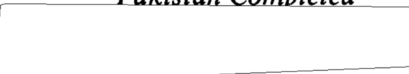
Islamic Banking in Pakistan Completed



Pakistan's banking system completed the final stage of its conversion to Islamic principles on 1 July. The new regulations eliminate all interest payments on deposits and loans. In return for loans, firms will share any profits or losses with the lending bank; the bank, in turn, will share its profits or losses

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with depositors. Although the framework for the Islamic system is now in place, some major pieces are still missing, such as a recognized accounting standard and banking tribunals to settle disputes arising from the new system. The new regulations have caused no major disruptions to the economy or the financial system, but have proved expensive in terms of both administrative costs and customer confidence.

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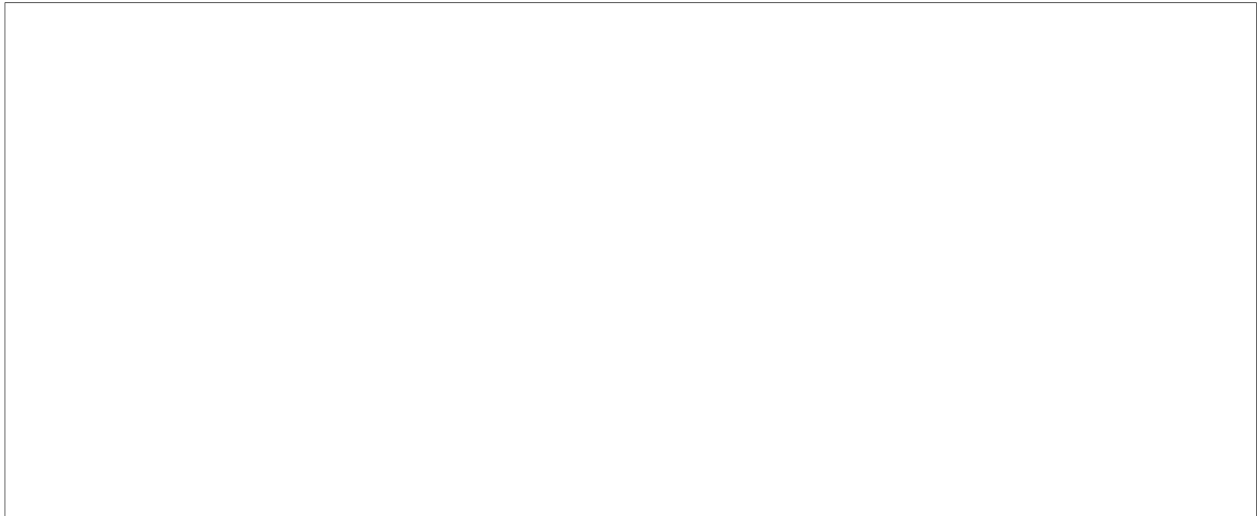

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Communist

Prospects for Soviet Economic Reform

In a recent speech, Yegor Ligachev, Gorbachev's senior lieutenant, stressed that the new leadership's economic program will not include any move toward a market economy or private enterprise. His comments echoed a recent warning by *Pravda* that efforts to introduce market forces into socialist economies "inevitably lead to severe economic, social, and political problems." The speech and article undoubtedly had Gorbachev's blessing, and may be designed to set the acceptable limits of debate on the economy. Although a forceful advocate of change, Gorbachev has clearly called market reform and private enterprise unacceptable options—at least for the present time.

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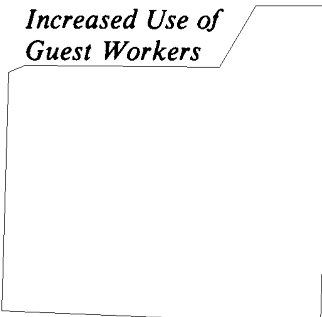
Soviet Journal Cites Increased Use of Guest Workers



A recent article in a Soviet labor journal suggests that use of guest workers by member countries of the Council for Mutual Economic Assistance (CEMA) is on the upswing. According to the article, 200,000 guest workers are employed in production activities alone in CEMA countries. The vast majority are evidently from the CEMA bloc. Czechoslovakia, the only individual country for which numbers are given, has 45,000 guest workers—of which 27,000 are from Vietnam. Other data indicate 18,000 Vietnamese worker-trainees in the USSR. It is not clear, however, what proportion of all Vietnamese labor on Soviet soil the 18,000 represents. We estimate that Vietnamese workers in the USSR in 1982 numbered about 15,000. While the article emphasizes the

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advantages of greater labor mobility within CEMA, it concedes problems with organization, pay, and control of guest workers. In any event, guest workers will likely remain a tiny fraction of the overall Soviet–East European labor force, currently about 0.1 percent of total employment.

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Renewal of the Intra-German Swing Credit

The two Germanys last week signed an agreement on renewing through 1990 the swing facility—the interest-free overdraft credit line used by East Germany for financing bilateral trade. The swing limit will rise from its current DM 600 million level to the DM 850 million ceiling that prevailed in 1976-82. Although Berlin has not used the swing substantially in the last several years—partly to avoid appearing overly dependent on West Germany—it still considers the facility a useful source of inexpensive financing that frees up cash for other imports. The East Germans relied heavily on the swing during the financial pinch of 1982-83 and may do so again to boost Western imports during the 1986-90 Five-Year Plan. The West Germans may hope that the renewal at higher levels will help sustain the appearance of progress in intra-German relations.

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New Chinese Corporation Pushing Foreign Military Procurement

China's BAOLI (Polytechnologies) Corporation—which specializes in overt purchases of foreign weapons and military supplies outside cumbersome official channels—is moving aggressively to buy modern equipment. Since the company was formed in January 1984 it has negotiated the purchase of Sikorsky S-70C helicopters, sophisticated aerial radars, and private jets for the use of senior government officials. A procurement arm of the military's General Staff Department, BAOLI was established as an importer of sophisticated equipment and technology that the Chinese view as "difficult"—meaning US or COCOM restricted—to obtain.

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In an effort to finance increased buying, the company has begun to negotiate the export of Chinese weapons and military equipment such as fighter aircraft. BAOLI has recently opened offices in Hong Kong

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