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Directorate of
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International Economic & Energy Weekly

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21 March 1986

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21 March 1986

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Synopsis

1 **Perspective—Third World Debt: The Risks of Muddling Through**

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We judge that time is running short for Western creditors to come up with a positive plan that effectively preempts radical debtor action and enlists the commitment of debt-troubled governments to a restructuring plan.

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3 **Brazil: Economic Stabilization Prospects**

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In a historic announcement, President Sarney ordered economic shock treatment in February and indicated his willingness to tackle major institutional reform. We believe, nevertheless, that a more determined effort to eliminate the fiscal and monetary causes of inflation is needed in the face of tough interest group demands before these reforms will provide long-term economic gains.

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7 **International Financial Situation: Egypt's Foreign Payments Squeeze**

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Egypt's foreign payments position will probably become unmanageable during 1986 without some combination of significant increases in external assistance, debt rescheduling, and large cuts in import growth.

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11 **Venezuela: Managing a Declining Economy**

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Recent sharp declines in world oil prices will test President Lusinchi's ability to manage the economy and govern the nation. There is virtually no hope for economic recovery this year, and a recovery before the 1988 elections is doubtful, with a sharp recession likely if oil prices stabilize at current levels.

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15 **Nigeria: Looming Debt Crisis**

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The plunge in world oil prices, coupled with Nigeria's rejection of an IMF agreement and failure to obtain a debt rescheduling, has pushed the country to the brink of financial default. We believe the hard-pressed Babangida government will stop or slow most of its debt payments in order to avert a devastating cut in imports and a politically unacceptable accord with the IMF.

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19 **Summit Issues: Big Six Economic Outlook** 25X1

Economic recovery is continuing at a moderate pace throughout the Big Six—for 1986, growth will probably average more than 3 percent. Steady Big Six economic growth is being accompanied by relatively good news about inflation and the balance of payments. 25X1

25 **Haiti: Economic Needs in the Post-Duvalier Era** 25X1

Haiti's interim government faces formidable economic problems that threaten its ability to maintain public order. Unless business confidence improves, investment will continue to deteriorate and even generous foreign aid—Washington will be the focus of Haitian requests—will do no more than temporarily prop up imports and living standards. 25X1

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Perspective

Third World Debt: The Risks of Muddling Through

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We judge that time is running short for Western creditors to come up with a positive plan that effectively preempts radical debtor action and enlists the commitment of debt-troubled governments to a restructuring plan. Hardline negotiating tactics by both sides are precluding effective communications that are essential to seeking more innovative solutions to the Third World's financial difficulties. For example, Mexico City's initial announcement that its financing gap this year would be $9 billion shocked creditors who have been scaling back their Third World lending. Similarly, creditors' demands for far-reaching economic reforms allow President de la Madrid little maneuvering room in dealing with powerful domestic opponents of further belt-tightening. Although we believe both sides are posturing, we are concerned about the possibility of miscalculation as each side tries to shift the burden of adjustment onto the other and assumes that Washington will step in to help if negotiations break down.

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Current creditor and debtor negotiating positions appear far apart. Debtors, especially in Latin America, are demanding some kind of interest rate relief, such as capitalization or rate reduction, to foster domestic growth and investment. According to press statements, they believe that they have borne the brunt of the adjustment to date and that further austerity measures are politically risky. In addition, they point to external conditions beyond their control as the main cause of their renewed financial problems and stagnant growth. Declining commodity prices—including oil—protectionism in developed countries, and the sharp cutback in new commercial lending have raised the domestic political costs for governments that continue to service their debt without pressing creditors for concessions.

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For their part, banks are adamantly opposed to any scheme that sets interest rates at or below international market rates, fearing that concessions to one debtor will quickly spill over into negotiations with others. In some cases, such as Brazil and Venezuela where new money has not been requested, bankers have agreed to reschedule principal repayments without an IMF-supported program at reduced interest rate spreads. However, in the case of Mexico—which is requesting interest rate concessions and new money— banks are offering minimum levels of new funds and insisting on an IMF-supported program that includes extensive reforms such as privatization of government-owned enterprises.

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We are concerned about the possibility of deadlocked negotiations prompting debtors to take more radical action. With less new money available, economic incentives for meeting debt obligations have declined significantly. At the same time, domestic political demands for a change in debt and economic policies are mounting. Increasingly, major debtor governments are viewing resolution of the debt burden as a political problem. In our judgment, they might see economic benefits as well as immediate political gains in taking a more confrontational stance if concessions are not forthcoming, particularly if they believe it would force Washington to move on its commitment for a new, more comprehensive debt strategy. Debt-troubled oil exporters will be increasingly inclined in this direction if oil prices fall further. Moreover, Manila faces tough IMF negotiations, and press reports indicate that President Aquino is considering repudiating some of the Marcos-era debts. 25X1

Many of the debtors view US action on debt relief as the central element in their current bilateral relationships with Washington. New democratic leaders, in particular, consider it a critical demonstration of support for their fragile democracies and essential to consolidation of their positions. With many debtors facing potentially acute economic and political tensions, the ultimate risk to US interests of not providing the expected financial support, in our view, is the emergence of more nationalist and anti-Western policies among Third World leaders. 25X1

While most debtors have welcomed the US debt initiative, they have expressed reluctance to undertake the structural reforms the plan would require. In our judgment, commitment to and monitoring of structural reforms is the major challenge. Under the current strategy, the central role of the IMF in monitoring quarterly economic criteria provides Third World leaders with a convenient scapegoat for domestic economic ills and enables them to avoid responsibility for creating more dynamic economies and forging the required social consensus. Greater debtor participation in formulating the adjustment program and monitoring its progress offers a better prospect for more responsible domestic economic policies, in our opinion. 25X1

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Brazil: Economic Stabilization Prospects

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While Brazil's achievements over the past three years in adjusting its external accounts have been the most impressive of all major Latin debtors, it has failed to pursue far-reaching internal reforms to break persistent high inflation. In a historic announcement, President Sarney ordered economic shock treatment in February and indicated his willingness to tackle major institutional reform. The program is drawing massive public support and should prove moderately successful in reining in inflation and keeping the payments accounts strong this year. We believe, nevertheless, that a more determined effort to eliminate the fiscal and monetary causes of inflation is needed in the face of tough interest group demands before these reforms will provide long-term economic gains.

Economic Performance in 1985

After he unexpectedly inherited the office in March 1985, Sarney sought to bolster his position by setting restoration of rapid growth and expanded social programs as his highest economic priorities. Official statistics indicate GDP rose more than 8 percent and industrial employment more than 5 percent last year—the best performances in this decade—largely because of stimulative government fiscal and monetary policies. According to the US Embassy, the administration also substantially increased spending on health, education, food, and housing programs to pay Brazil's "social debt" and allowed a 12-percent real wage increase to boost living standards.

The decision to soft-pedal stabilization in deference to politically popular rapid growth led to another hike in Brazil's triple-digit inflation—from 225 percent in 1984 to 234 percent last year. Brazilian economists report that the surge would have been considerably higher had it not been for price controls and other artificial restraints. As the public-sector deficit soared to a record high in 1985, institutional reforms languished. Sarney made no progress in implementing plans to reduce the bloated and inefficient state-owned corporations and to dismantle the indexation system—key to reining in inflation.

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Despite these stimulative policies, Brazil maintained a strong foreign payments position last year, largely because of its successful import-substitution program. The resulting $12.4 billion trade surplus was Brazil's second-highest ever. Notwithstanding aggressive devaluations, exports fell 5 percent because of slowed OECD growth and low commodity prices. The moderate drop in foreign sales, however, was largely offset by a $1.1 billion cut in oil imports as domestic crude production rose. The large trade surplus permitted Brasilia to cover its interest payments—reduced substantially by falling LIBOR rates—hold its international reserves at more than $11 billion, and take an increasingly tough stand in its relations with the IMF and foreign banks.

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Historic Economic Policy Shift

By early 1986, however, swelling price pressures evoked strong public concern. Monthly inflation accelerated to more than 400 percent at an annual rate between November 1985 and February of this year. The combined effects of expanding domestic demand, drought-induced food shortages, and dwindling excess industrial capacity overwhelmed the government's patchwork inflation-fighting measures. [redacted] growing pessimism in the private sector about future inflation, coupled with tightening profit margins, caused many domestic and foreign firms to abandon plans for investment. According to the US Embassy,

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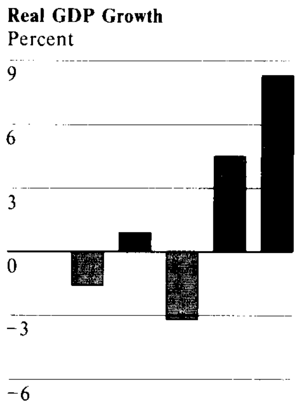
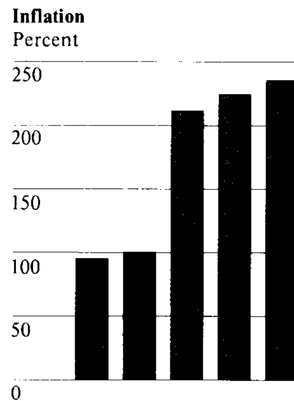
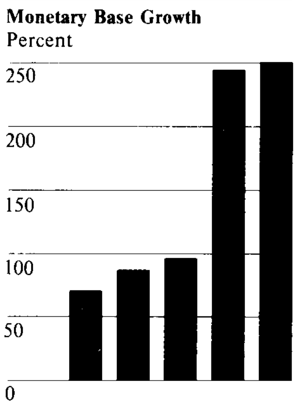
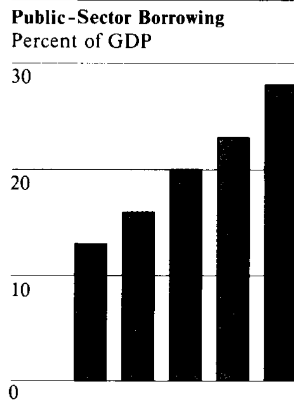
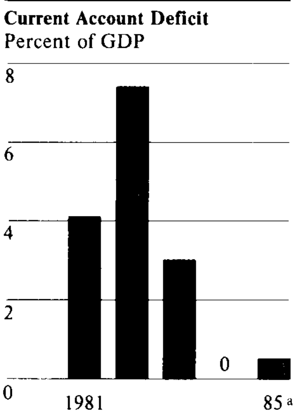
Brazil: Economic Indicators, 1981-85

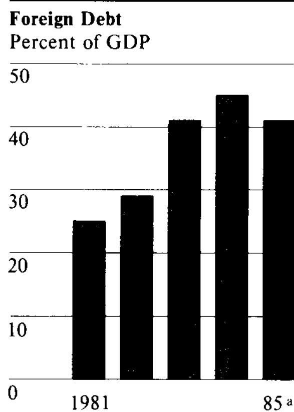












[a] Estimated.

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Brazilians also worried about the eventual negative impact of accelerating prices on their external accounts. 25X1

Disturbed by the potential political consequences, Sarney made his boldest move since taking office when he announced on 28 February a sweeping emergency economic program. According to the decree-law, the program ends the pervasive indexation system for wages and financial transactions that had been perpetuating inflation. The program also features a new currency unit, the cruzado, pegged to the US dollar, a temporary wage and price freeze, and an unemployment insurance scheme. Sarney emphasized in his address to the nation his aim to drive inflation abruptly down to near zero, but pledged not to permit another recession. Although Brasilia had announced in late January major reforms of the federal budget process and mechanisms for controlling the money supply, Sarney gave no indication of plans to further tighten fiscal and monetary policies. 25X1

A secondary motive behind the program 25X1 25X1 is Sarney's interest in continued large trade surpluses to facilitate debt servicing and strengthen the government's bargaining position with creditors. Because the cruzado is pegged to the US dollar, the recent decline in the dollar will help Brazil's near-term export performance. We believe the government will adjust the exchange rate if future inflation threatens export competitiveness. The administration also believes, according to the US Embassy, that large external trade surpluses and timely interest payments provide justification—consistent with the US case-by-case approach on debt—for a multiyear rescheduling based on only a consultative arrangement with the IMF. In any event, Finance Minister Funaro has stressed publicly that a formal IMF standby agreement will not be politically possible this year, and we believe the Brazilians are unlikely to relent, given the public animosity toward the Fund. 25X1

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Brazil: Balance of Payments, 1983-86 *Billion US $*

	1983	1984	1985	1986 [a]
Current account	−6.8	0.1	−1.2	−0.7
Trade balance	6.5	13.1	12.4	12.0
Exports (f.o.b)	21.9	27.0	25.6	26.0
Oil	1.4	1.8	1.5	1.6
Nonoil	20.5	25.2	24.1	24.4
Imports (f.o.b.)	15.4	13.9	13.2	14.0
Oil	8.2	6.9	5.8	4.3
Nonoil	7.2	7.0	7.4	9.7
Net services and transfers	−13.3	−13.0	−13.6	−12.7
Interest on debt	10.2	10.2	10.4	9.1
Other, net	−3.1	−2.8	−3.2	−3.6
Capital account	5.5	6.1	1.2	1.2
Long-term inflows, net	6.6	8.3	1.0	0.5
Principal payments	3.4	2.0	2.1	2.5
New borrowing	10.0	10.3	3.1	3.0
Direct investment	1.4	1.6	1.3	1.3
Short-term movements	−2.5	−3.8	−1.1	−0.6
Reserve changes	**−1.3**	**6.2**	**0**	**0.5**

[a] Projected.

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Foreign Payments Prospects

In our judgment, Brazil's foreign financial position will remain strong this year, bolstered by another large trade surplus and lower world interest rates. Coffee earnings will surge because of a price boom, and sales of manufactured goods will rebound, reflecting faster OECD growth and the decline of the US dollar. At the same time, another drop in the oil import bill—stemming primarily from slumping world prices—probably will keep overall imports near $14 billion, despite expected large foreign grain purchases to offset drought-inflicted crop losses. Brazil's current account will be in near balance for 1986, and its modest foreign financing needs probably will be met easily through foreign direct investment, loans from multilateral development banks, and supplier's credits. 25X1

For the most part, we believe the Sarney administration probably will relegate its relations with the IMF and other foreign creditors to the background in the coming months to prevent their becoming a significant issue before the important November congressional elections. According to the US Embassy, government officials insist they will not request new commercial bank money. Moreover, the banks have tentatively agreed to reschedule $6 billion in 1985 arrears, defer $9.5 billion in principal coming due this year, and maintain $15.5 billion of short-term credits until 1987 without the precondition of a formal IMF agreement. Using that as a precedent, the Brazilians have tried unsuccessfully to negotiate a Paris Club rescheduling of bilateral official debt without an IMF program. In our view, they will also pressure official creditors by withholding payments. 25X1

Maneuvering Room

We believe the emergency economic program will benefit from broad popular support for much of this year and, accordingly, will prove moderately successful. Despite the 33-percent increase in prices for January and February, the program probably will cut annual inflation to under 100 percent in 1986. The emergency measures, however, may stall recovery later in the year by squeezing business profits and consumer spending. This will probably discourage new private investment at a time when capital expansion will be necessary to sustain industrial growth. Furthermore, a falloff in tax revenues and restraints on price increases for state enterprises may erode the government's financial position and prevent the public sector from picking up the slack. 25X1

As the economy begins to sputter, in our judgment, the Sarney administration will probably face rising domestic criticism of its economic policy, especially from the left. Accordingly, Brasilia may ease wage and price restrictions to bolster economic growth before the congressional elections. A relaxation of

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controls late in the year should permit Brazil to record a politically acceptable 3- to 5-percent real economic growth. By that time, several months of impressive monthly price performances may convince the government that it has conquered inflation and can relax fiscal discipline.

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To prevent inflation from returning to the 200- to 300-percent range after wage and price ceilings are eased, the Sarney government will need to take a hard stand against budgetary and monetary excesses. In particular the government will have to confront a variety of interest groups ranging from the armed services demanding higher military appropriations to the lower classes pushing for redress of long-neglected social inequities.

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International Financial Situation: Egypt's Foreign Payments Squeeze

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Egypt's ability to meet both import requirements and external debt obligations is deteriorating rapidly in the face of falling world oil prices. Its foreign payments position will probably become unmanageable during 1986 without some combination of significant increases in external assistance, debt rescheduling, and large cuts in import growth.

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Hard Currency Earnings Plummet

The outlook for Egypt's petroleum exports is poor. Production has been averaging 870,000 b/d, and output much beyond the range of 900,000 to 950,000 b/d is unlikely, Meanwhile, domestic oil consumption has been increasing at an annual rate of 10 to 13 percent over the past several years, cutting ever deeper into the exportable surplus.

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This negative trend has now been reinforced by the precipitous slide in world oil prices. If the average price per barrel for the year falls to $20, Egypt would lose about $650 million in hard currency oil revenues. If average prices fall to $15 per barrel, Egypt could lose $1.2 billion.

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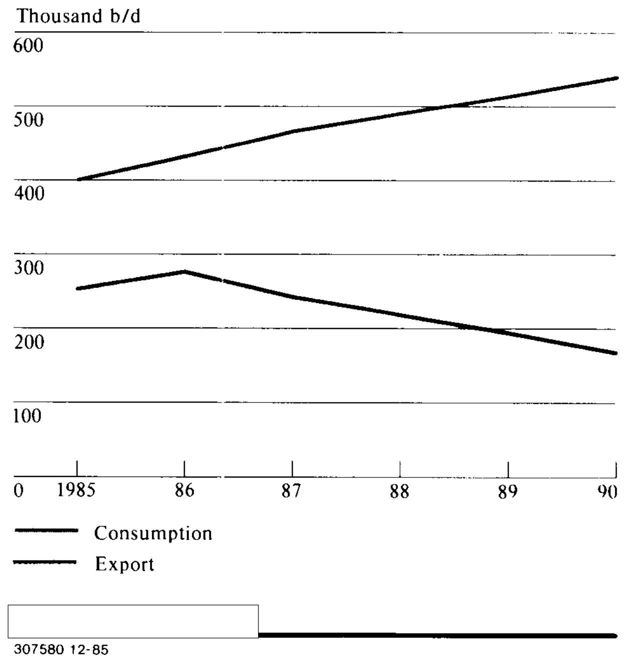
Foreign earnings losses even at the $20 per barrel level will strike Egyptian Government finances particularly hard in the coming months. Cairo has already experienced serious difficulties in servicing its international debt obligations, now estimated at about $3.7 billion annually. Lengthening delays in repayment, a large debt burden, and declining earnings potential have effectively prevented Egypt from negotiating further medium-to-long-term commercial loans. Egyptian borrowers are experiencing increasing difficulties in obtaining short-term credits as well.

Egypt: Oil Consumption and Export Projections, 1985-90



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Other major sources of foreign exchange—remittances and tourism, in particular—are unlikely to compensate for the loss of oil earnings during the current year. We can, in fact, detect no component of foreign earnings likely to experience significant growth over the current year. The economic downturn in the oil economies of the Persian Gulf—the area employing most of Egypt's overseas workers—has already begun to affect expatriate earnings. Layoffs will occur particularly among less skilled workers, and reductions in pay and benefits are probable for many more. Similarly, tourist earnings, which provided over $400 million in hard currency last year, are likely to decline, especially in the wake of the February police riots, which, aside from their bad publicity, destroyed tourist facilities as well.

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Egypt: Estimated Foreign Debt *Billion US $*

	December 1985
Civilian	29.2
Medium and long term	23.7
Short term	5.5
Military	7.8
Of which:	
US FMS debt	3.7
Total	**37.0**

Policy Options

The Mubarak regime will probably accelerate reform, but we doubt it will take the form of a coherent, integrated program. More than likely, reform will remain piecemeal, given Mubarak's excessively cautious approach and the fragmentation of economic decision making within the current government. Certain commodities will be subjected to substantial price hikes, while others, probably including bread, will be left relatively untouched. Some measures, including harsh import controls, may throttle economic activity and do more harm than good if selectively implemented to fall disproportionately on the private sector. In any case, it is unlikely that unilateral reform alone, at this late stage, will provide sufficient relief to extricate Egypt from its economic crisis.

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Substantial funding from foreign sources is probably not a viable alternative. The Gulf Arab states—the most likely source of additional financing—would probably seek a major political reorientation by the Egyptian Government—including deemphasis of the Camp David accords—as a quid pro quo. The countries, however, are also financially pressed because of falling oil revenues and would not be inclined, we believe, to provide the substantial additional aid Egypt will require. Moreover, the political realignment required to secure Arab aid would jeopardize current US assistance levels of approximately $2.3 billion annually and leave Cairo no better, and possibly worse off, than before.

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Rescheduling of Egypt's large debt servicing obligations, while an attractive economic alternative, would be extremely difficult to implement in political terms. Rescheduling of public-sector debt—including US Foreign Military Sales obligations, which Cairo believes can be easily restructured—is traditionally contingent upon having an IMF-supported economic adjustment program in place. For Egypt, an IMF standby agreement would entail adherence to strict financial and monetary guidelines, including much more rigorous subsidy reforms and more rapid movement toward a unified exchange rate. Such adjustments almost certainly would force substantial increases in consumer prices and probably provoke more political unrest.

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In the absence of large increases in aid, Cairo probably will be forced into some form of rescheduling this year. Most likely, Egypt will try to negotiate a standby agreement with the IMF and pursue a Paris Club rescheduling of official debt. A rescheduling of commercial bank debt, however—which accounts for more than half of Egypt's total debt—would be a lengthy and fragile process that would be derailed if Cairo were to fall out of compliance with its IMF program.

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Alternatively, the Mubarak regime could decide to go it alone, as some Third World countries already have done, and limit debt payments without an agreement with creditors. Such a move could involve a unilaterally imposed debt moratorium, a freeze on principal repayments, or a decision to repay only those creditors Cairo believes are likely to provide fresh funds. Because this approach avoids any foreign role in domestic economic policies, it would be more politically palatable than an IMF program. This course, however, probably

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would result in a drastic reduction or cutoff of short-term credit lines, an event that would slow imports to a trickle, given Egypt's low foreign exchange reserves.

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Venezuela: Managing a Declining Economy

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Recent sharp declines in world oil prices will test President Lusinchi's ability to manage the economy and govern the nation. Although Lusinchi had hoped that his successes in rebuilding international reserves and rescheduling the external public debt would permit him to turn full attention to the moribund domestic economy this year, the emergence of huge financial gaps as a result of the oil revenue shortfall has forced renewed vigilance over the external accounts. Such gaps could total $14 billion over the 1986-88 period, requiring tough adjustment measures to ensure the nation's capacity to meet interest obligations. We believe that further debt reschedulings are almost certain. The oil price collapse also signals continued problems for the domestic economy. There is virtually no hope for economic recovery this year, and a recovery before the 1988 elections is doubtful, with a sharp recession likely even if oil prices stabilize at current levels.

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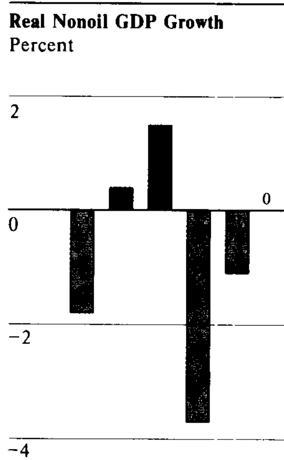
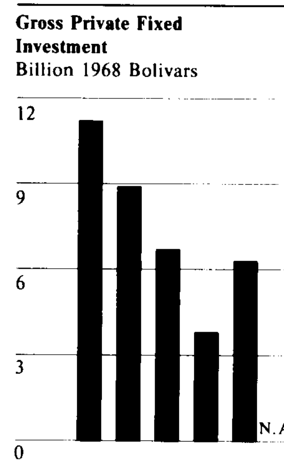
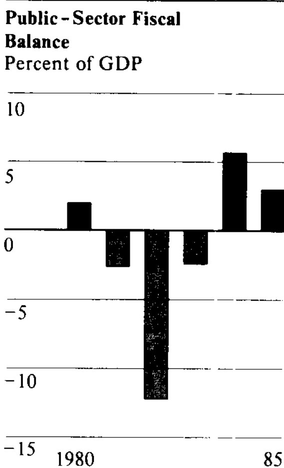
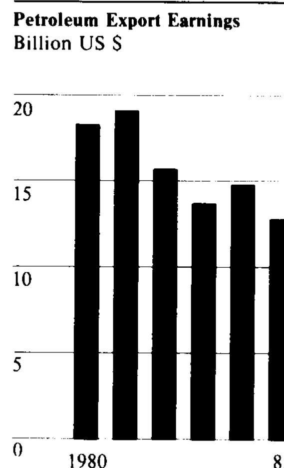
Venezuela: Economic Indicators, 1980-85









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Roots of Current Problems

Venezuela's economic problems predate the soft world oil market—real per capita GDP has declined 27 percent since 1978. According to the US Embassy, the economy's chronic stagnation, even as oil revenues reached record levels in 1980 and 1981, is directly related to sagging investor confidence in the government's management of the economy. Official unemployment climbed from 5.0 percent in 1978 to 14.5 percent in 1984 before dipping to 12.5 percent in 1985. Last year, the domestic economy again registered no growth, as private investment remained dormant and the public sector posted a second successive surplus. Slack demand, however, combined with the government's restraint on wages to limit inflation to 9.1 percent last year, following 13.7 percent in 1984. The external accounts were another bright spot, with the current account registering a third successive surplus and international reserves closing the year

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up $1.3 billion. On the basis of these successes, international lenders agreed to a multiyear rescheduling of $21 billion in external public debt.

25X1

Program for Domestic Recovery

Lusinchi's hopes for economic recovery now ride on a three-year program to invest $5 billion in roads, public buildings, low-cost housing, and public utilities. The Planning Ministry anticipates that such outlays will create 600,000 new jobs and generate annual economic growth of 3 to 5 percent over the program period. For 1986, total government expenditures would increase by 12 percent over 1985, converting 1985's budgetary surplus—about 3 percent of GDP—into a deficit this year. Reaching the program's targets, however, depends on the program's success in triggering a resurgence of private investment.

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This fiscal stimulus program is already threatened by the collapsing world oil market. Each $1 billion shortfall in oil exports cuts government revenue by about $700 million. To cover the looming fiscal deficit, the government secured agreement from its foreign bank creditors in February 1986 to defer $923 million in principal due this year, freeing these resources for other uses in the 1986 budget. According to press accounts, the government is also considering a 10-percent cut in current outlays and a steep inheritance tax. Nonetheless, the Embassy believes that the administration also will stretch out or delay funding for major investment projects. Despite the government's concern about inflation, it is already planning to sell treasury bonds to the central bank.

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Managing the External Accounts

Prospects for the external accounts have deteriorated sharply in the last two months. The government's initial foreign exchange budget for 1986-88, based on an oil price of $24.50 per barrel, projected a cumulative current account surplus of $8.9 billion. This surplus would have allowed Venezuela to meet its external debt service obligations, while maintaining the central bank's reserves above the government's $9 billion comfort threshold. With Venezuela's average oil export price now hovering around $15 per barrel, reserve levels and debt service capacity are threatened.

25X1

Venezuela: Current Account Trends 1982-85 *Billion US $*

	1982	1983	1984	1985
Current account balance	**−3.2**	**4.4**	**5.3**	**3.9**
Trade balance	3.9	8.4	8.6	7.6
Merchandise exports (f.o.b.)	16.5	14.8	15.9	14.2
Petroleum	15.7	13.8	14.8	12.8
Nonpetroleum	0.9	1.1	1.1	1.4
Merchandise import (f.o.b.)	12.6	6.4	7.3	6.6
Consumer goods [a]	3.8	1.9	1.6	NA
Raw materials [a]	3.0	2.3	3.1	NA
Capital goods [a]	5.8	2.2	2.6	NA
Services balance	−6.5	−3.7	−3.1	−3.6
Nonfactor services (net)	−5.0	−1.6	−1.8	−1.6
Interest and dividend receipts	2.6	1.5	2.2	1.7
Public sector	2.0	0.9	1.1	0.9
Private sector	0.6	0.6	1.1	0.8
Interest and dividend payments	4.1	3.6	3.5	3.7
Public sector	3.0	2.9	3.1	2.9
Private sector	1.1	0.7	0.4	0.8
Net transfers	−0.6	−0.2	−0.1	−0.1

[a] Estimated.

25X1

To assess the impact of the sharply lower oil prices on Venezuela's debt servicing capacity, we have examined two Venezuelan oil price scenarios—$18 and $13 per barrel—projecting the balance of payments through 1988: [1]

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[1] In each scenario the following are held constant over the 1986-88 period: money-center interest rates; oil export volume of 1.4 million b/d; trade restrictions; foreign exchange controls and policies; and plans for major investment projects. Zero economic growth is assumed.

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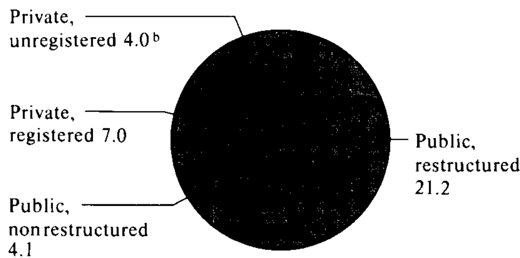
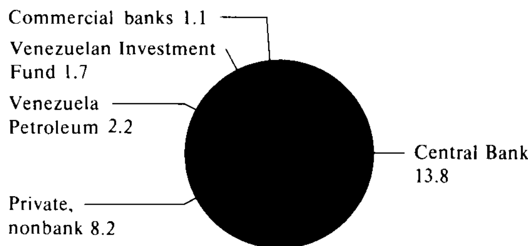
Venezuela: External Debt and Financial Assets, 1985[a]

Medium- and Long-Term External Debt
Total: $36.3 billion



Financial Assets
Total: $27.0 billion



[a] Yearend 1985.
[b] Estimated.

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- With oil at $18 per barrel, the current account surplus almost evaporates, producing a financial gap—current account balance plus scheduled debt amortization—of $2.6 billion in 1986. Although such a gap could be covered this year by drawing down central bank reserves, cumulative financial gaps of about $8.6 billion through 1988 would be too large to be covered comfortably by reserve drawdowns.

- If oil falls to $13 per barrel, the current account registers a $2.1 billion deficit in 1986, which, when added to required principal repayments, yields a financial gap of about $4.8 billion. Such a gap also could be covered this year by drawing down foreign exchange reserves, but cumulative financial gaps over the period would total almost $14 billion—exceeding central bank reserves.

25X1

Bridging the Gaps

Although domestic political sensitivities probably preclude IMF assistance or non-project-related loans from international lenders, the government nevertheless appears to have adequate options to cover the financial gaps that would be produced by oil prices in the $13 to $18 range. The options most likely to be considered could produce about $13 billion in foreign exchange savings over the 1986-88 period, which, in conjunction with reserve drawdowns, would permit Venezuela to service interest on the external debt:

- *Tighten trade controls.* Consumer durable imports now eligible for the official rate of 7.5 bolivars per dollar would probably be switched to the parallel market rate, currently 19 per dollar, and import licensing requirements would probably be expanded. Because imports have already been sharply squeezed, the potential foreign exchange savings would be limited. We believe that new import reductions exceeding $1 billion annually would have a sharply negative effect on the economy.

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- *Delay or stretch out development projects.* Projects whose foreign exchange costs are not covered by the financing of multilateral development banks will probably be postponed or stretched out. Potential foreign exchange savings total about $200 million per year.

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- *Further reschedule debt.* The $3 billion in principal due on the rescheduled public debt over the period to 1988 could be deferred. Although more difficult, $1.9 billion in principal on the external public debt due over the same period, but not included in the February deal, could be rescheduled. Lastly, $3.6 billion in scheduled principal repayments on the registered external private debt could be delayed or stretched out. Although unlikely to be realized in full, potential savings from reschedulings total $8.5 billion.

- *Devaluation and capital controls.* A devaluation and limits on foreign exchange purchases in the parallel market would substitute for direct import controls. Capital controls could yield savings of about $400 million per year on travel abroad and private capital transfers.

The Economy in 1986

We concur with US Embassy and independent Venezuelan analysts who forecast further recession this year. The oil market slide and the resulting uncertainty over the administration's policy response will almost certainly dash demand for consumer durables and planned private-sector investment outlays. Paramount among business fears are expanded controls on imports, a price freeze, and a devaluation coupled with limits on capital transfers. Although an energetic implementation of the administration's fiscal stimulus program would cushion the shortfall in private demand, the US Embassy believes that the administration is, instead, likely to adopt a go-slow approach out of fear that deficit financing would be inflationary. Even if the administration forges ahead, the US Embassy questions the ability of the bureaucracy to implement such a program, when, over the past two years, it has been unable to meet more modest investment targets. Management of the foreign payments position will continue to take top priority. We believe that Lusinchi will move decisively to ensure the nation's capacity to service interest obligations on the external debt and to protect international reserves.

A Longer Term Perspective

The next three years promise a stern test of Lusinchi's ability to manage the economy and govern the nation. Even under the most optimistic oil market scenarios, we believe that Venezuelan investors are unlikely to repatriate savings from abroad to invest in the uncertain domestic environment any time before 1988. More pessimistic oil market scenarios would put private investment in the deep freeze and necessitate cuts in the investment budgets of the state oil company and other public enterprises. In our view, overall economic activity will remain stagnant at best, and, in the more pessimistic case, would decline by 3 to 7 percent by 1988. We expect continued recession to cause political problems for Lusinchi and the ruling party. As the 1988 elections approach, Lusinchi will find it increasingly difficult to turn aside appeals from ruling party insiders and their labor allies to abandon his conservative strategy in favor of sharp boosts in outlays on social programs, more controls on prices, and generous wage increases. Inflationary pressures will mount, if Lusinchi is forced to make such concessions.

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Nigeria: Looming Debt Crisis

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The plunge in world oil prices, coupled with Nigeria's rejection of an IMF agreement and failure to obtain a debt rescheduling, has pushed the country to the brink of financial default. we believe the hard-pressed Babangida government will stop or slow most of its debt payments in order to avert a devastating cut in imports and a politically unacceptable accord with the IMF. Lenders, however, already have significantly cut credit lines to Nigeria, and even a unilateral moratorium probably will not offset the expected decline in export earnings.

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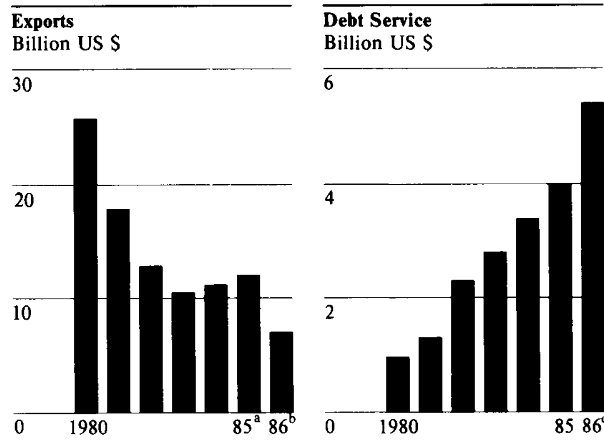
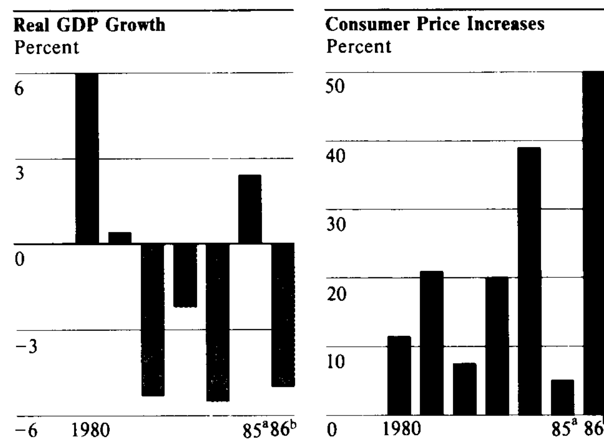
Nigeria: Selected Economic Indicators, 1980-86





[a] Estimated.
[b] Projected.
[c] Projected obligations.

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No Deal With the IMF

Nigeria's oil exports—which account for 97 percent of foreign exchange earnings—dropped from $25 billion in 1980 to about $11.7 billion in 1985. Barring a major rebound in oil prices, export revenues probably will decline to less than $7 billion this year. Efforts to muddle through the four-year crisis have led to a 10-percent drop in real GDP, shortages of basic commodity imports, and steadily rising unemployment. Many Western bankers and economists had expected Lagos to cushion the blow by agreeing to an IMF program, which would have provided timely relief by:

- Enabling Nigeria to borrow about $3 billion from the IMF and World Bank over a three-year period.
- Facilitating the rescheduling of Nigeria's medium- and long-term commercial debt, for which an IMF agreement is generally a prerequisite.
- Allowing the rescheduling of official trade debt. Western export credit agencies organized under the Paris Club have refused to reschedule without an IMF agreement.

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After taking power in a coup last August, President Babangida pledged to break a two-year negotiating deadlock with the IMF. Two previous governments had balked at the political risks of a major devaluation of the naira, elimination of domestic petroleum subsidies, and trade liberalization. Babangida sought a popular mandate to negotiate with the Fund by initiating a national debate on the issue. He created a special commission—stacked with officials who favored an agreement, according to the US Embassy—to guide the debate and issue a final recommendation. A torrent of negative public opinion spearheaded by the newly emancipated press quickly dominated the forum, however, and by December Babangida announced an end to the IMF option. A senior Nigerian financial official later told the State Department that Babangida was the only member of the 28-man Armed Forces Ruling Council to vote in favor of an IMF agreement.

The government subsequently unveiled its 1986 budget, which largely relies on the previous policies of austerity, countertrade, and gamesmanship with the creditors to offset lower export revenues. Babangida has maintained stringent foreign exchange controls—which have cut Nigeria's import bill by about 55 percent over the past four years to about $8.3 billion in 1985—and will continue to promote countertrade agreements despite his previously stated doubts. The regime also announced last January that debt service would be limited to 30 percent of export earnings, which would have covered only about one-half of this year's obligations even before the recent plummet in oil prices.

Mounting Foreign Payments Problems

Nigeria's new debt service ceiling effectively formalized and expanded a tactic employed since 1982, when Lagos first stopped paying its short-term debts to ease the decline in exports. Some $2 billion of arrears owed to bankers was rescheduled in 1983, but the government still has not fulfilled its 1984 pledge to reconcile $6-8 billion in overdue supplier's claims. So far only $1.3 billion of supplier credits has been rescheduled, and only $433 million has been paid to Western export credit agencies, which hold another $2 billion in arrears. Moreover, Nigeria again has fallen behind in payments on short-term bank debt: the US Embassy reports that about $1 billion in letters of credit now are over 120 days past due. As a result, both official and commercial creditors for several years now have stopped issuing medium- or long-term loans, and the press reports that short-term trade credits have dwindled as well.

25X1

The US Embassy estimates that Nigeria's 1986 debt obligations now total $5.4 billion, roughly three-fourths of projected export revenues at current oil prices. We believe that Lagos almost certainly will not earmark more than the 30 percent of exports—$2 billion—for debt payments. Lagos probably would have to negotiate a freeze on short-term debt payments and reschedule over 80 percent of this year's obligations to both commercial creditors and the Paris Club if it is to avoid an outright default.

25X1

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Significant differences between the Babangida government and its creditors, however, reduce the likelihood that a comprehensive rescheduling can preempt a default. bankers are demanding a major currency devaluation before any rescheduling, while the Paris Club still insists on an IMF agreement. Babangida has stated publicly, however, that a sharp devaluation is out of the question. Nor do we believe Babangida is likely to restart negotiations with the IMF this year, even though he recently cut petroleum subsidies as recommended by the Fund. Several recent controversial moves by Babangida—including the execution of 10 military coup plotters and the decision to join the Islamic Conference Organization—have left him, in our judgment, poorly positioned to endure additional domestic strife.

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Outlook

A rescheduling stalemate appears likely and probably will coincide with an increasingly severe shortage of imported commodities. As a result, Lagos will probably cease servicing most of its debts. Babangida probably would calculate that the potential savings outweigh the loss of Nigeria's remaining trade credits and also would provide a temporary boost to his sagging domestic popularity. In our judgment, however, the government is not likely to repudiate outright its debt obligations because it probably hopes eventually to reenter into the long-term credit market.

25X1

Regardless of the government's debt service policies, real GDP almost certainly will drop sharply in the absence of a significant turnaround in the oil market. The US Embassy reports that the import-dependent industrial sector already is operating at 15 percent of capacity. Economic decay contributed to the downfall of the two previous governments and almost certainly has weakened the Babangida regime, which appears increasingly vulnerable to a coup. The danger exists that a group of radical junior officers could seize power and launch a still more nationalistic and autarchic economic course.

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Summit Issues: Big Six Economic Outlook

25X1

Economic recovery is continuing at a moderate pace throughout the Big Six—for 1986, real GDP growth will probably average more than 3 percent. Private investment in plant and equipment will again be the strongest growth component, while government spending will be relatively weak in most countries as Big Six governments continue their deficit reduction efforts. Pushed on by lower oil prices and the lagged effects of the previous strong dollar, the combined Big Six current account surplus will surge another 50 percent this year, to about $90 billion, with Japan and West Germany again accounting for almost all of the total. With inflation expected to slow further in all of the countries except Canada, the average rate for the Big Six will drop to just below 3 percent this year.

25X1

Recovery Continuing

Big Six aggregate GDP growth is estimated at 3.3 percent for 1986. In broad terms, slower growth of net exports in 1986 is largely being offset by stronger growth of domestic demand:

- Private nonresidential investment (that is, plant and equipment) will again be the strongest growth component for the Big Six, although the 5.4-percent increase that we expect represents a decline of one-third from the 1985 figure.
- Private residential investment should increase about 4 percent this year, following a small decline in 1985. Despite lower interest rates, residential investment remains weak for most of the Big Six countries.
- Government investment in the Big Six should rise about 1.7 percent this year following a 4.2-percent decline in 1985. The United Kingdom will have the sharpest turnaround, in part because government investment figures are distorted by the transfer of assets out of the public sector under Prime Minister Thatcher's privatization program.
- Private consumption is continuing its steady, if unspectacular, increase throughout the Big Six. For the group as a whole, growth should pick up to about 2.9 percent in 1986.
- Government consumption will remain sluggish in 1986 as all Big Six governments continue to limit expenditures.

25X1

Inflation and the Balance of Payments

Steady Big Six economic growth is being accompanied by relatively good news about inflation and the balance of payments. All Big Six countries achieved single-digit consumer price increases last year, and all except Canada should make further progress in 1986, pulling the group average to just below 3 percent.

25X1

With lower oil prices, most countries will see their current account positions improve in 1986; only in the United Kingdom and Canada—net oil exporters—will current account balances remain little changed. The Big Six combined current account surplus, which reached $60 billion last year, should jump another 50 percent in 1986. Japan ($59 billion) and West Germany ($24 billion) will continue to be the major contributors to the surplus.

25X1

Unemployment and Interest Rates

Big Six unemployment should finally stabilize in 1986. We estimate the average rate for the group at 7.7 percent this year—down slightly from

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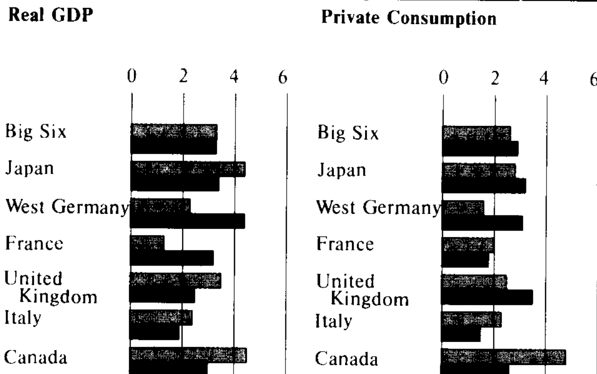
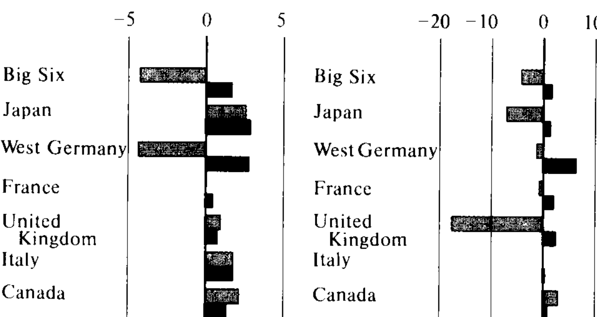
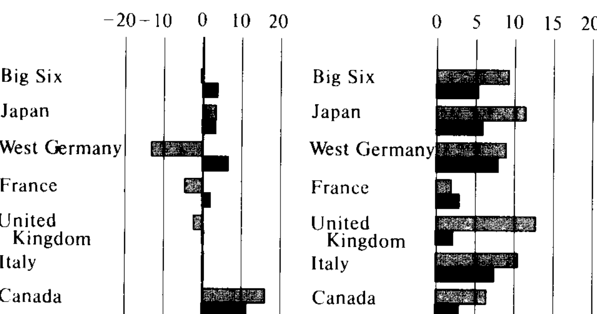
Big Six: Growth of GDP Consumption and Investment

Percent







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1985—as decreases in Canada and West Germany just offset small increases in Japan and Italy. The wide disparity in rates will continue, however, ranging from 2.8 percent in Japan to 13.1 percent in the United Kingdom. 25X1

Interest rates are generally still declining across the Big Six, continuing the trend that began about four years ago, and helping to fortify the economic recovery. In February, long-term government bond yields in Canada, France, the United Kingdom, and Italy were down about 6 percentage points from early 1982 levels. West German and Japanese yields—in single digits in 1982—have fallen by about 2 to 3 percentage points. As a result, interest rate differentials among the Big Six have narrowed substantially from four years ago. 25X1

Government Policy Remains Conservative

Economic policy has not changed dramatically in any Big Six country since the French Socialists shifted from expansion to austerity in mid-1982. All six governments are following, or trying to follow, generally conservative fiscal and monetary policies. Budget deficit reduction is a goal in all cases, although the results have varied widely. West Germany and Japan may hold their deficits below 1 percent of GDP this year, down from about 3.5 percent in 1982. At the other extreme, the Italian deficit seems stuck at 16 percent of GDP as the divided coalition government is unable to agree on a budget-cutting strategy. 25X1

Impact of Future Changes in the Dollar and Oil Prices

Any further fall of the dollar below its present level, or drop in the average price of oil much below $20 per barrel, would influence our forecast for economic prospects in 1986. If the dollar continues to decline, export performance in the Big Six would suffer more than we presently expect, trimming economic growth. For example, our Linked Policy Impact Model (LPIM) of the world estimates that

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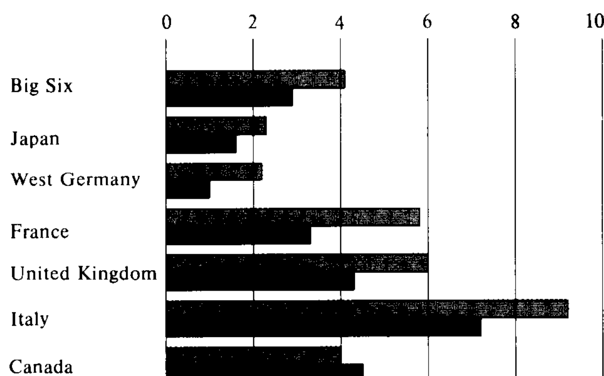
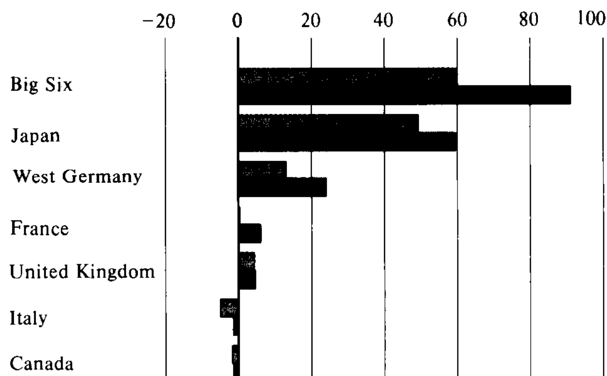
Big Six: Inflation and the Balance of Payments





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economic growth in 1985 was 0.3 percentage point lower than what it would have been had the dollar remained constant. Only Canada gained because of a depreciating US dollar since its currency followed the US dollar down. According to the LPIM, each additional $5 per barrel decline in oil prices would stimulate Big Six growth by 0.2 percentage point above our present projection. In addition to lower oil import costs, lower inflation would help pull down interest rates, prompting more investment and spending by consumers on durable goods.

Country Profiles

The slowdown in the ***Japanese*** economy, which began last summer, will probably continue through 1986. We expect real GDP to fall well short of the official forecast of 4 percent. The stronger yen is reinforcing the slowdown in exports to the United States and China under way since early last year. The deteriorating economy is becoming a tough political issue for Prime Minister Nakasone, who is being pressed for fiscal stimulus before this summer's parliamentary elections. Tokyo will probably adopt minor pump-priming measures, including a small cut in income taxes, but we expect no major reversal of the government's four-year-old budget austerity.

25X1

West German economic growth should lead the Big Six this year after a rather lackluster showing in 1985. Growth will be more balanced, as stronger domestic demand replaces dependence on exports. Fiscal and monetary policy will remain relatively tight with continuing emphasis on reducing the budget deficit. Consumer price inflation will be the lowest among the Big Six, and unemployment is also likely to fall—for the first time since 1979.

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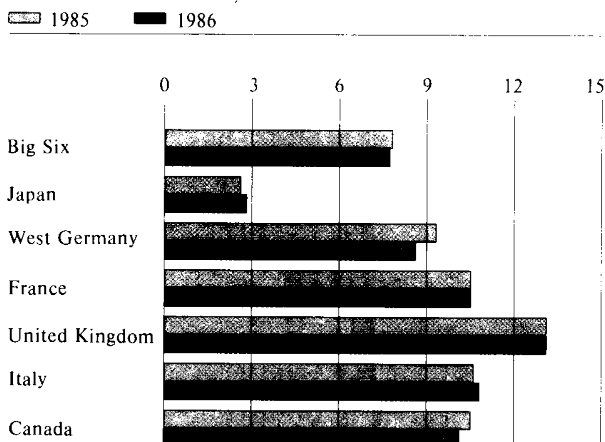
Big Six: Unemployment Rates



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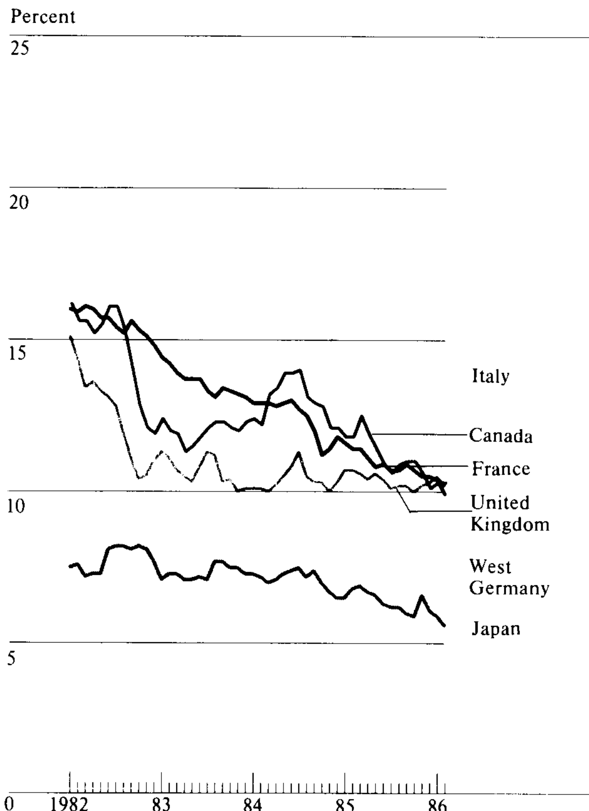
Big Six: Long-Term Government Bond Yields



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25X1

French economic growth, although sluggish in recent years, will pick up to more than 3 percent this year. The steady decline in the French inflation rate since 1981 is perhaps the government's most important achievement and has helped spur business and consumer confidence. Unemployment remains the bleakest aspect, but even here there are recent signs of improvement.

25X1

British economic growth this year will be tempered primarily by sharply reduced growth in plant and equipment investment. The current account will remain in surplus as strong invisibles earnings take up the slack for the likely shortfall in net oil export earnings and a projected boom in consumer imports. Unemployment remains the most serious problem facing the Thatcher government as the next general election approaches. Nonetheless, we believe the government will continue to reject both direct jobs programs and any formal incomes policy.

25X1

Italy's poor export outlook and a maturing of the investment boom will probably slow real GDP growth this year. Italy's already-high interest rates could rise further because the divided governing coalition will have difficulty curbing the budget deficit and will have to borrow to meet its debt obligations. Despite the priority given to fighting inflation, the government will miss its target by at least 1 percentage point. Unemployment is also a growing concern, and the ad hoc programs to

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encourage hiring are unlikely to offset the continuing shedding of labor in industry.

25X1

The ***Canadian*** economy will probably slow this year because of higher interest rates and higher taxes. Ottawa's primary economic focus is on unemployment. Although job creation has been strong—Canada created more jobs in 1985 than all of Western Europe—much of the gains have been offset by labor force growth. The government is also under great pressure to reduce the federal deficit—but is doing so by relying primarily on higher taxes. Ottawa sharply tightened its monetary policy early this year to defend its currency, pushing up short-term rates.

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Haiti: Economic Needs in the Post-Duvalier Era

25X1

Haiti's interim government faces formidable economic problems that threaten its ability to maintain public order. Unless the government quickly secures new foreign aid for critical food and fuel imports, public unrest probably will grow. With a virtually bankrupt treasury, government attempts to meet popular expectations for improved living standards risk overspending, which could threaten a needed IMF accord essential to the restoration of business confidence. Unless business confidence improves, investment will continue to deteriorate and even generous foreign aid—Washington will be the focus of Haitian requests—will do no more than temporarily prop up imports and living standards. Moreover, sustainable economic growth will not occur until President Namphy undertakes politically perilous economic reform to reduce corruption and lessen wide income disparities. In the best case, economic progress would be slow, hampered by an eroded agricultural base, primitive transport and communication networks, an uneducated work force, and a shortage of skilled managers.

25X1

Namphy's Economic Challenges

Duvalier's ouster intensified economic problems that have been particularly acute since 1980, and the government will have to scramble to avert further economic decline. Food and petroleum supplies probably will be adequate until mid-April, but prospects for the following months are unclear. Foreign grants, for example, will cover immediate needs for 15,000 metric tons of wheat. The government recently obtained a $5 million commercial loan from local banks to cover one month's oil imports, but the slim foreign exchange reserves of the local banking system will prevent continued access to such loans.

US Embassy reports indicate that business confidence, already low in the uncertain political climate, is dropping further as a result of worker demands for higher wages. Workers, flush with victory, probably hold unrealistically high expectations for better living standards. Employees in more than a dozen factories and government offices have gone on strike since Duvalier's overthrow, demanding increases in the current $3 per day minimum wage and the removal of managers who had ties to the former regime. Investment, which dropped in reaction to anti-Duvalier protests, will dip further if the government decrees substantial wage hikes. At least one foreign-owned plant reportedly plans to close down rather than raise wages.

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We estimate that Haiti needs roughly $125 million in new foreign aid this year—in addition to the $150 million already committed by various donors before Duvalier's fall—to stop the economic slide. To boost real GDP by 3 percent—and regain the peak 1980 level—we calculate that Haiti would have to raise imports 20 percent above last year's depressed level to about $400 million. Of this total, about $100 million would be needed for food purchases, which we estimate have fallen at least 20 percent in real terms since 1980. Although falling world oil prices will help, we calculate that Haiti still would need roughly $70 million for petroleum products this year. The remaining $230 million would finance imports of raw materials and intermediate goods for agriculture and manufacturing, as well as medical supplies, building materials, and small amounts of consumer goods.

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We believe that Haiti's foreign exchange earnings in 1986 will not exceed $250 million, partly as a result of the recent unrest, and the trade deficit will rise to about $150 million. Despite rising world prices for coffee—Haiti's main agricultural export—disruptions to harvests and exports from October through January will limit Haitian earnings We judge that other

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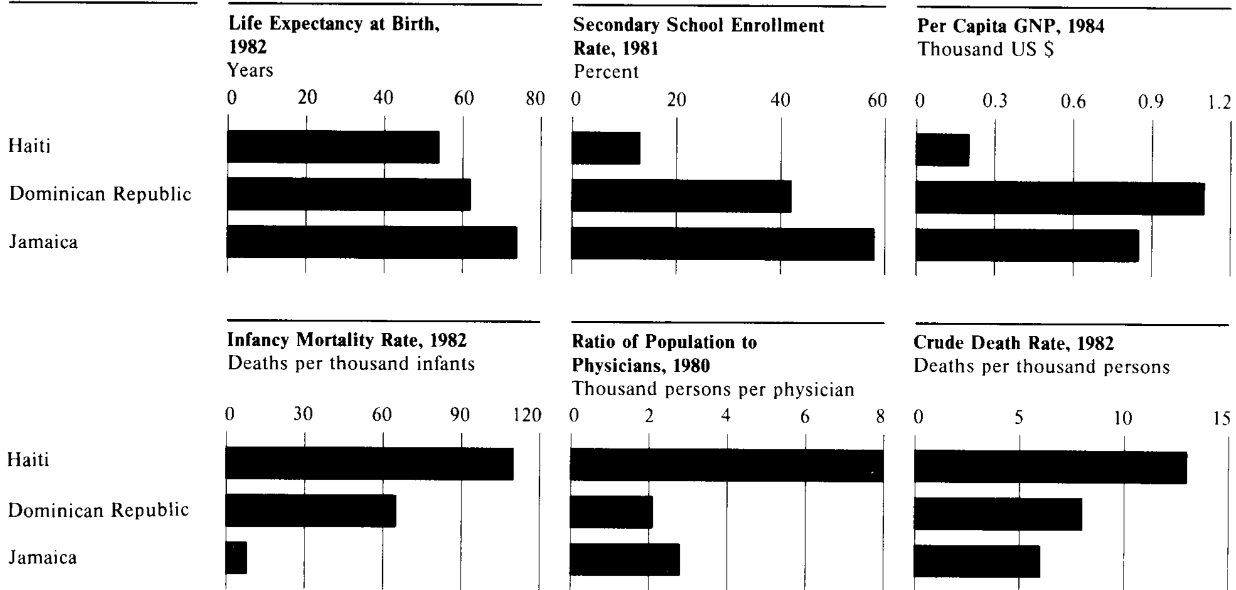
Haiti: Socioeconomic Comparisons



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commodity exports, including cocoa and sugar, at best will stagnate near last year's $47 million earnings. Foreign sales of light manufactured goods, Haiti's largest export earner, also are likely to be disappointing.

In addition to the trade deficit, scheduled external debt repayments, other service payments abroad, and capital flight probably will boost total foreign funding needs to about $275 million. To cover this financial gap, we can identify $150 million in aid commitments made before the change of government. Of this total, $130 million are grants from governments, multilateral institutions, and charitable organizations, according to IMF data. In addition, the World Bank is slated to distribute $20 million in concessionary project financing.

Other potential sources of funds include the IMF, the EC, and other industrialized nations:

- The IMF is willing to send a team to Haiti soon to lay the groundwork for a $17 million standby to take effect as early as June,

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- In addition to the $20 million already in the pipeline, the World Bank probably will approve a $26 million transportation credit for disbursement this year—a project that would help to ease unemployment.

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Haiti: Balance of Payments, 1984-86 *Million US $*

	1984	1985 [a]	1986 [b]
Current account	**−60.9**	**−56.3**	**−98**
Trade balance	−122.5	−105.9	−153
Exports (f.o.b.)	229.5	228.0	247
Coffee	54.0	48.0	70
Light manufactures	124.6	132.9	130
Other	50.9	47.1	47
Imports (c.i.f.)	352.0	333.9	400
Services, net	−61.5	−66.5	−75
Tourism	28.0	25.1	20
Transfers (grants)	123.2	116.1	130
Capital account	**60.9**	**56.3**	NA
Net official capital	55.3	37.3	NA
Net private capital, errors and omissions	−6.8	−6.1	NA
Drawdown in international reserves and increase in arrears	12.4	25.1	NA

[a] Estimated.
[b] Projected, based on 1980 import volume.

- The Organization of American States recently agreed to augment humanitarian aid in order to help Haiti move toward democracy, according to press reports.

No Quick Fix

If the Namphy government can quickly convince potential donors that real political and economic reform is under way, we believe Haiti could receive the aid needed to raise real GDP to the 1980 level. Even rapid and generous aid flows, however, would do no more than temporarily support higher imports and living standards. We doubt that substantially larger aid inflows would improve economic conditions much more, however, because Haiti lacks the administrative and technical capacity to manage massive assistance programs. Warehouse space and refrigeration for food supplies are limited and reliable distribution channels are scarce. The work force is poorly skilled and would require training before many construction projects could be implemented.

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Unless the government moves quickly to present a reasoned economic policy statement, we believe that a crisis of business confidence could force a devaluation of the gourde and dim hopes for economic recovery. Speculative pressures and capital flight are weakening the gourde, and US dollars trade on the parallel market at a 17-percent premium above the official rate. In response to the uncertain business and political atmosphere, exporters are hoarding foreign exchange rather than depositing it into the Central Bank, according to an IMF report. If the gourde were devalued, politically risky hikes in food and fuel prices would occur. Moreover, we believe economic activity would slow because rising costs of essential imported inputs would discourage production and investment more than stimulate exports.

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Need for Structural Change

In addition to these immediate concerns, the government ultimately must adopt real economic reforms to reduce corruption and lessen the wide gap in incomes if sustained economic improvement is to

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occur. Entrenched corruption acts as a confiscatory tax on legitimate economic activity that robs the few domestic resources otherwise available to investors hoping to take advantage of Haiti's industrious work force, strong private-sector orientation, and inclusion in the Caribbean Basin Initiative. Although we believe some members of the new government will continue past corrupt practices, there is a precedent for foreign influence on this issue. For example, lender intolerance for obviously shady bookkeeping practices led to the demise of the notoriously corrupt Tobacco Bureau in the early 1980s. [redacted] 25X1

Imbalances in incomes, in our view, will prove more difficult to moderate. The ruling elites have a clear interest in maintaining the status quo despite the wide gulf in living standards that deters some foreign investors, [redacted] Moreover, although malnutrition and disease cut deeply into labor productivity, according to the World Bank, businessmen probably will continue to resist wage increases or higher taxes to finance greater spending on food programs, sanitation, or medical care. [redacted] 25X1

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Implications for the United States

We believe the highly publicized US role in Duvalier's departure has raised Haitian Government and popular expectations that Washington will provide guidance and generous economic help. As a result, Namphy will press the United States to lead international aid efforts. In this environment, US stipulations to encourage economic and political reform can be expected to carry more weight than under the Duvalier regime. Because the Haitian economy is not yet capable of self-generated growth, similar requests will recur for some time. Repayment of the roughly $220 million in Haitian debt owed to US creditors will remain in jeopardy. Moreover, we doubt that illegal migration will slow over the next few years. No foreseeable economic path could quickly lessen unemployment or raise the minimum wage enough to reduce the lure of US economic opportunity, particularly to rural Haitians. [redacted] 25X1

[redacted] 25X1

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Briefs

Energy

OPEC Production Update

OPEC crude oil production averaged 18.1 million b/d in February, a 500,000-b/d increase from January levels. Increased Saudi output, spurred by netback sales to the Far East, accounted for most of the rise. Intense competition has allowed OPEC to capture some non-OPEC market share, but at the cost of plummeting prices—which have fallen to as low as $13.75 and $12.00 for North Sea and US spot crudes, respectively.

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OPEC: Crude Oil Production, 1985-86 *Million b/d*

	Quota	1985	1986	
			January	February
Total	**16.0**	**16.4**	**17.6**	**18.1**
Algeria	0.66	0.7	0.7	0.7
Ecuador	0.18	0.3	0.3	0.3
Gabon	0.14	0.2	0.2	0.2
Indonesia	1.19	1.2	1.4	1.4
Iran	2.30	2.3	2.4	2.1
Iraq	1.20	1.5	1.7	1.7
Kuwait [a]	0.90	1.1 (0.9)	1.2 (1.0)	1.2 (1.0)
Libya	0.99	1.2	1.1	1.0
Nigeria	1.30	1.5	1.2	1.5
Qatar	0.28	0.3	0.3	0.3
Saudi Arabia [a]	4.35	3.5 (3.3)	4.3 (4.1)	4.9 (4.7)
UAE	0.95	1.1	1.2	1.3
Venezuela	1.56	1.6	1.6	1.4

[a] Amount in parentheses excludes production from the Neutral Zone, whose output is divided between Saudi Arabia and Kuwait and included in their country quotas; the Neutral Zone has no production quota of its own.

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Major Chinese Coal Discovery

Beijing claims to have found an enormous new coalfield with verified reserves of more than 200 billion metric tons. The 40,000-square-kilometer field, located in Shaanxi and Nei Monggol Provinces, would raise China's coal reserves by 25 percent to almost 1 trillion tons. China expects the field to produce 35 million tons annually by the year 2000. China currently lacks the infrastructure to develop this coal, although the rail line between Datong and the port of Qinhuangdao is being improved and could be extended to the new find. Beijing expects coal to continue to account for about 70 percent of China's energy into the next century, with annual production of 1.2 billion tons slated for the year 2000. Low international prices and strong domestic demand will probably keep China from becoming a major exporter.

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International Finance

Reserve Positions of Problem Debtors

Total foreign exchange reserves in problem debtor countries remained roughly constant during 1985, primarily because of events in a few key countries. Mexico was the major factor as declining oil revenues and a significant rise in imports before the June elections led to a sharp drawdown in foreign exchange reserves. Similarly, Nigeria experienced a loss of almost 50 percent in reserve holdings last year because of lower oil export revenues. In contrast, Argentine reserves nearly doubled with new credit inflows and a debt rescheduling agreement; even with the increase, however, reported reserve levels will only support six months of imports. Venezuela's reserve position was bolstered by a sizable current account surplus and is equivalent to 17 months of imports.

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Debtor LDCs: Foreign Exchange Reserves [a]

	Reserves (*Billion US $*)		Reserve-to-Import Ratio, 1985 (*months*)
	1984	1985	
Total	**37.3**	**37.4**	
Argentina	1.2	2.3 [b]	6
Bolivia	0.3	0.2 [b]	4
Brazil	11.5	11.5	10
Chile	2.3	2.4	4
Colombia	1.4	1.6	6
Ecuador	0.6	0.7	3
Ivory Coast	NEGL	NEGL [b]	1
Mexico	7.3	4.9 [b]	3
Morocco	NEGL	0.1	NEGL [c]
Nigeria	1.5	0.8	1
Peru	1.6	1.9 [b]	8
Philippines	0.6	0.6	2
Uruguay	0.1	0.2 [b]	3
Venezuela [d]	8.9	10.2	17

[a] Total reserves minus gold; yearend.
[b] Third quarter.
[c] Less than half a month.
[d] Reserves in central bank only.

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OECD Export Credit Meeting

The EC nearly agreed in private discussions with the United States on a compromise to increase discipline over the use of tied aid credits during last week's OECD Export Credit Meeting in Paris, according to diplomatic reporting. Opposition by West Germany and the Netherlands to a proposal by Chairman Axel Wallen to adopt a new interest rate system, however, resulted in a collapse of the US-EC compromise. Wallen also proposed new methods to calculate the grant element—opposed by Japan—and an increase in the minimum grant element. In contrast, the US-EC compromise called for eliminating tied aid credits for highest income countries and doubling the minimum grant element—the aid portion of these credits—to at least 50 percent for the least developed countries. The issue of tied aid credits will probably be on the agenda for the OECD Ministerial next month. EC ministers are scheduled to meet on 5 April to develop a mandate based on the proposed US-EC compromise.

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Philippines Skirmishing With Foreign Creditors

Tough IMF recommendations and hints that President Aquino is considering defaulting on part of the country's foreign debt suggest she will face problems with foreign creditors in the months ahead. According to the US Embassy, talks between the government and the IMF last week centered on Manila's budget problems. The IMF estimates that the budget deficit through mid-March reached $540 million—four times the original IMF projection. Embassy sources say the Fund is urging Manila to prepare a new budget and will probably advise it to trim the deficit through tax increases when negotiations resume next month. The Fund reportedly is prepared to allow some leeway on the deficit only if Manila begins to make major economic reforms soon. Meanwhile, Deputy Foreign Minister Shahani and Economic Planning Minister Monsod told the press last weekend that the government is discussing repudiating selected portions of the country's $26 billion foreign debt, including borrowings by businesses owned by associates of former President Marcos. Failure to agree on a financial program could further delay a $230 million loan disbursement from the Fund and a $350 million disbursement from a commercial bank financing package. A default on selected foreign loans would go far beyond Aquino's campaign pledge to limit debt repayments to a fixed percentage of foreign exchange earnings and would almost certainly result in a cutoff of badly needed commercial financing. How quickly and effectively Aquino's more conservative economic advisers—such as Finance Minister Ongpin—thwart it will be an important indicator of their influence with Aquino.

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Polish Debt Rescheduling Agreement

Poland recently reached agreement with its Paris Club creditors on rescheduling official debt. The amount of debt relief exceeds $1.7 billion but is short of the $2.1 billion requested by Warsaw. All maturities due this year will be rescheduled over 10 years, with repayment to begin in 1991. Payments due under the rescheduling agreements of 1981 and 1985 are not affected, and interest originally due last December on the 1982-84 rescheduling will be payable later this year. Having reached agreement with government creditors, the Poles must now obtain debt relief from commercial banks. The Paris Club wants the banks to provide $1.1 billion in relief under its formula for an equitable sharing of the burden, but the bankers have indicated a willingness to reschedule only $600-800 million of principal. Even if the banks were to provide all the desired relief, Warsaw is likely to continue missing payments under the rescheduling pacts with the Paris Club.

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Burma's Debt Management Problems

Burma's dismal export performance is fueling speculation by US bankers that Rangoon may reschedule some of its $3 billion foreign debt, according to the US Embassy. Merchandise exports for the current fiscal year, which ends 31 March, are likely to drop almost 20 percent from the previous year's $375 million—the second year of sharp decline. Foreign exchange reserves have already dipped as low as $20 million—about 2 weeks' import coverage—forcing Rangoon to borrow at least $55 million in short-term commercial funds to finance imports of raw materials and spare parts. As a result, Burma's debt

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service ratio—including short-term principal repayments—probably will top 70 percent. With grace periods on many of Burma's loans due to expire soon, we believe continued export difficulties could prompt a rescheduling as early as this summer unless Rangoon obtains substantial balance-of-payments assistance. 25X1

International Trade

Renewal of International Wheat Agreement

Recent Soviet efforts to sabotage the International Wheat Agreement were squelched as a group of 60 wheat importers and exporters approved a new five-year pact to take effect 1 July. The agreement includes a Wheat Trade Convention to collect market information and a Food Aid Convention that commits 11 donor countries to supply at least 7.6 million metric tons of food aid per year for humanitarian relief. The Wheat Trade Convention lacks market provisions such as strategic stocks, price setting, or market sharing. The Food Aid Convention continues to effectively guarantee minimum food aid levels to needy countries; donations in recent years have topped 10 million tons, largely to Sub-Saharan Africa. 25X1

Hong Kong's Economic Status

The Sino-British Liaison Group has agreed to let Hong Kong become an independent GATT member next month—it has been represented by the United Kingdom. Hong Kong's GATT membership may also allow China to increase its influence in the organization, particularly if Beijing's own efforts to join succeed. The group also agreed on a formula for Hong Kong's continued participation in the Multi-Fiber Arrangement and established a subgroup to work out more than 800 international treaties affecting the territory. The two sides further agreed that Hong Kong residents may use UK-issued travel and identity documents after the UK lease expires in 1997. The friendly atmosphere of the talks and concrete results should help allay the worries of many Hong Kong firms. Beijing's cooperation reflects its economic interest in a smooth transition. 25X1

Central American Common Market Woes

Prospects for a revival of the Central American Common Market (CACM) have been further weakened by the Costa Rican Central Bank's decision to halt preferential trade with Honduras and El Salvador. San Jose last month discontinued processing Honduran and Salvadoran transactions through the CACM clearing house, and put trade on a cash basis because of mounting unpaid bills. 25X1 the combined Honduran and Salvadoran debt to Costa Rica now stands at nearly $100 million, compared to $67 million last summer. The US Embassy in San Jose reported that Costa Rica resumed preferential trade with Guatemala last December after Guatemala City promised to pay its clearing house obligations. Although regional foreign exchange problems have caused intra-CACM trade to decline by one-third in recent years, CACM remains the most important market for the region's industrial exports. 25X1

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Global and Regional Developments

Tokyo To Push Oil Price Stabilization at Summit

Worried that falling oil prices will further boost its trade surplus, undercut its efforts to diversify supply sources, and lead to general uncertainty, Japan probably will suggest measures to stabilize prices at the upcoming Economic Summit. Prime Minister Nakasone and Foreign Minister Abe broached the subject during talks with US officials in March.

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A recent Japanese press piece speculates Tokyo will propose that energy ministers of advanced countries formulate a joint strategy to smooth global price fluctuations, including expanding oil demand through increased stockpiling, and convincing London to alter its policy of nonintervention in North Sea production.

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Japanese Machine Tool Manufacturers Seek Soviet Trade

According to recent press reporting, Japanese machine tool manufacturers see the October 1986 Trade Fair in Moscow as an opportunity to offset the potential for shrinking exports to the West. The Japanese firms, whose exports are under pressure from the yen's rise, are concerned that they will have to cut production in 1986. Moreover, they also face either a voluntary restraint program imposed by the Japanese government or potential US import restraints. Consequently, we believe a number of Japanese machine tool builders are anxious for Soviet business. They could increase sales to Moscow sharply without violating COCOM restrictions because the Soviets need relatively unsophisticated robots, NC machine tools, metal-pressing machines, and plastic injection molding machines.

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Yugoslavia Avoiding US Export Controls

The Yugoslav firm Nikola Tesla has redesigned a computer-controlled telephone exchange of a type subject to COCOM controls to avoid the use of US-origin components This particular model—the ARE 13—is made in Yugoslavia under license from the Swedish company LM Ericsson. According to an article in the Soviet press, an ARE 13 is in operation in Kiev. Although neither Sweden nor Yugoslavia is a member of COCOM, sales of the ARE 13 to COCOM-proscribed destinations have been restricted because of its use of US-origin components. If the official's statement is true, the company is now free to export without restrictions. COCOM governments will find it difficult to enforce the embargo, if companies in their countries conclude that firms in neutral countries are taking advantage of the situation.

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Asian Countries Improve Copyright Protection

As a result of strong US pressure, a number of Asian countries have recently improved their protection of copyrighted works. Seoul approved a draft review of the current copyright law allowing for the protection of US works and extending protection from 30 to 50 years after the death of the copyright holders. Taiwan granted all American authors copyright protection equal to that received by nationals. Singapore is expected to introduce a new copyright bill to Parliament in the next couple of weeks. The law will probably stiffen penalties and double the period of protection from 25 to 50 years.

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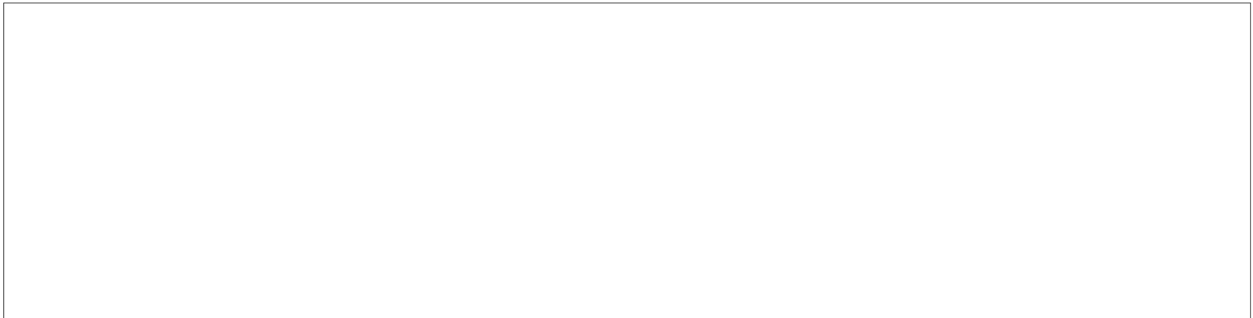

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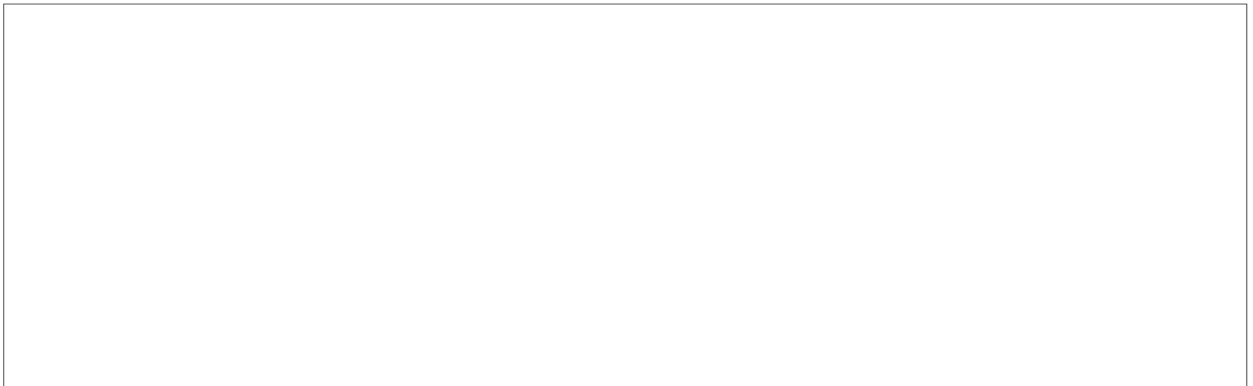
National Developments

Developed Countries



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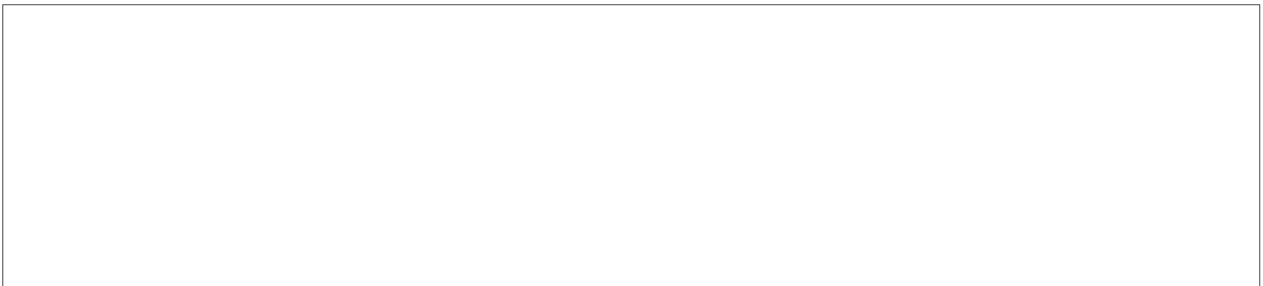

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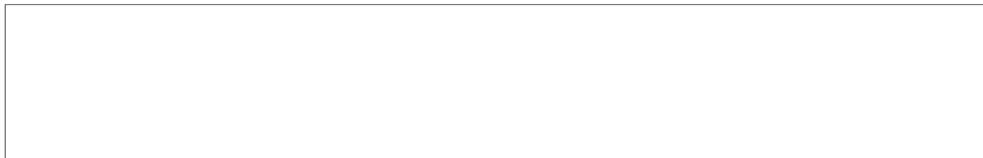

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Britain's New Budget

London presented a budget this week designed primarily to reassure financial markets that its economic policies are on track. The target for the Public Sector Borrowing Requirement was lowered from $10.5 billion to $9.8 billion—equivalent to less than 2 percent of GDP—raising expectations of an imminent cut in domestic interest rates. Citing falling government revenues from North Sea oil, Chancellor of the Exchequer Lawson announced a tax reduction package of only $1.5 billion, aimed at individuals in the lower tax brackets. In an overtly political move, he promised further cuts of almost $3 billion next year, in the last budget before the next general election. Meanwhile, Lawson rebuffed widespread calls for greatly increased spending to alleviate Britain's critical unemployment, reiterating the government's position that the solution lies with the private sector. Instead, the budget proposes some additional expenditure on existing programs that encourage the jobless to accept low-paying jobs.

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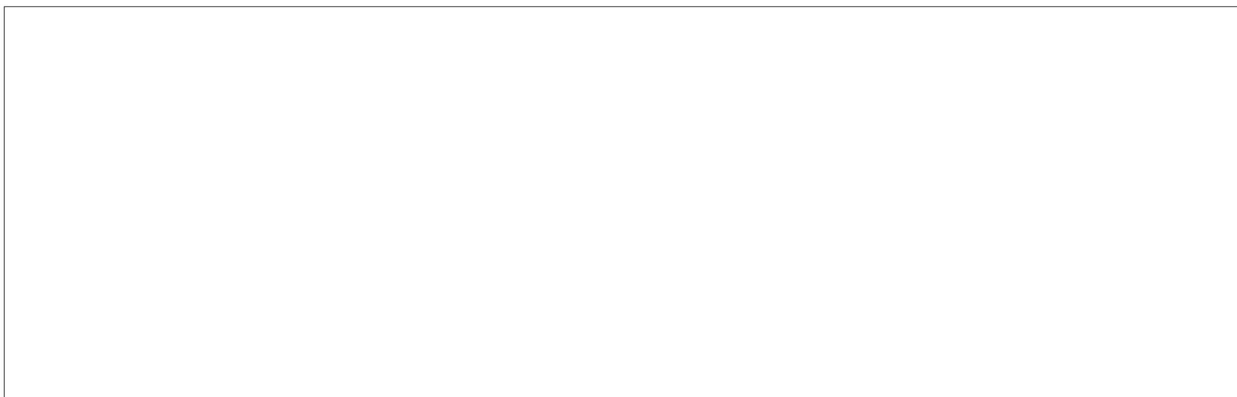

New Turkish Foreign Investment Law

Ankara has introduced new rules for foreign investment intended to attract foreign capital. Current stiff export performance requirements—up to 50 percent of output for the textile industry—have been waived completely. In addition, the Foreign Investment Department of the State Planning Organization will be empowered to make decisions on issues such as capital increases and changes in the company's activities, which formerly were referred to the Council of Ministers. Despite Prime Minister Ozal's efforts to attract foreign investment, the inflow thus far has been disappointing—about $100 million in both 1984 and 1985. The new law probably will have some success as interest in Turkey remains high among potential investors, but inflation in the 43- to 45-percent range and domestic interest rates exceeding 65 percent will continue to discourage investment inflows.

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Less Developed Countries

Mexican Export Promotion Campaign

Mexico City earlier this week announced a new export promotion scheme designed to boost sales of nonpetroleum goods and services by at least $1 billion in 1986. The new program will aid private exporters by reducing taxes, increasing trade credits, and loosening transportation and import restrictions. Mexican businessmen would respond favorably to any new export incentives, according to the US Embassy, to compensate for an anticipated fall in domestic sales this year. Even though these initiatives may boost nonpetroleum export revenues temporarily as businessmen take advantage of special government concessions, the program does not include the reforms that, in our view, are needed to sustain a long-term buildup and diversification of Mexico's export base. We believe that Mexico City instead may resort to a reintroduction of import quotas and export subsidies and requests for special US trade concessions to make Mexican exports more competitive.

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Lower Guatemalan Oil Bill

Lower world oil prices and the completion of the Chixoy hydroelectric project are likely to reduce Guatemala's 1986 petroleum bill by one-half, but the government is still likely to face short-term difficulties paying for oil imports. Chixoy—which started up last fall and reached full capacity in February—will reduce oil imports by 25 percent, according to US Embassy estimates. Oil import savings may total roughly $85 million.

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The government has been using revenues from gasoline sales to cover general government expenses, rather than to pay for oil imports. the new economic plan tentatively calls for higher gasoline prices and an end to subsidies for kerosene and diesel fuel but rejects the higher pricing levels proposed by the Central Bank, which would generate sufficient revenues to pay for oil imports.

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Communist

Intensive Technology in Soviet Grain Production

Soviet plans for 1986 call for greater use of "intensive technology" to increase grain production, including the use of high-yield grain varieties, planting after leaving land fallow, improved transportation, and appropriate use of agrochemicals. Recent plans call for an additional 26 million metric tons of grain on 31 million hectares allocated to intensive technology. At the party congress General Secretary Gorbachev praised the intensive technology effort of 1985, which he said "allowed production of an additional 16 million metric tons," apparently of grain. Gorbachev's figure is higher than the 10-million-ton increase Soviet agricultural officials claimed earlier and considerably higher than the US estimates of 5-8 million tons. The 16-million-ton figure probably represents the increased output on lands where intensive technology was employed, but does not take into account the concurrent production fall in

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areas where these resources were pulled. The expansion of intensive technology—coupled with the Soviets' experience and reported increased training in its use—could add another 10-15 million tons to this year's grain production.

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Poland's Economic Performance in 1985

Official Polish statistics indicate that national income grew 3 percent last year (an estimated 2.3 percent in Western GNP terms), a significant slowdown from the previous two years. Industrial production grew 3.8 percent—slightly below plan—as a surge in output during the last four months of 1985 helped to overcome the effects of a severe winter. Agriculture experienced its fourth consecutive good year. Uncontrolled investment spending continued—capital expenditures rose 6.3 percent more than planned and project completion rates decreased from nearly 70 percent in 1984 to less than 66 percent. Real wages outpaced productivity gains while forced savings accumulated because of continued shortages of goods. A reduced trade surplus with the West—hard currency imports rose 8.1 percent while exports dropped 3.8 percent—contributed to Warsaw's failure to make payments of about $515 million due Western government creditors last December. In the continued absence of vigorous economic reform, we believe national income is unlikely to grow significantly faster in 1986.

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Polish Price Increases

The announcement last Saturday, with virtually no warning, of price increases on many basic foodstuffs will probably increase worker dissatisfaction and may lead to more protests or job actions. This is a sharp departure from the regime's policy in recent years of trying to prevent adverse reaction to the traditionally sensitive issue of food price increases by conducting elaborate public consultations beforehand. Prices of staples such as bread, sugar, and dairy products increased by about 9 percent. Meat prices are slated to rise by 8 percent in August. The regime did not announce any additional wage or benefit increases, claiming that continuing increases in wage levels, recent boosts in pensions, and low-income supplements will partially offset the price rises. The Polish statistical office announced last month that real wages increased by about 3 percent in 1985. Lech Walesa said protests would be justified but left it to the workers to decide what form they should take. According to Western press sources, several thousand Poles marched to protest the price increases in Gdansk but were dispersed without violence. Chairman Jaruzelski is probably confident of his control over the security situation but may have miscalculated the willingness of the people to accept the hikes as passively as they did last July.

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