Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Directorate of Intelligence

~~Secret~~

25X1

International Economic & Energy Weekly

25X1

4 April 1986

~~Secret~~

DI IEEW 86-014
4 April 1986
Copy 838

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

25X1
Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Page Denied

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

25X1

International Economic & Energy Weekly

25X1

4 April 1986

iii Synopsis 25X1

1 Perspective—South Korea's Economy: Vulnerable to Political Unrest 25X1

3 South Korea: Outlook for Trade and Economic Growth 25X1 25X1

7 South Korea: Penetrating Communist Markets 25X1 25X1

13 North Korea's Approach to the West 25X1 25X1

17 Summit Issues: Big Six Budget Deficit Trends 25X1 25X1

21 USSR: Facing the Dilemma of Hard Currency Shortages 25X1 25X1

25 Pakistan: On a Foreign Payments Tightrope 25X1 25X1

31 Briefs
- Energy
- International Finance
- International Trade
- Global and Regional Developments
- National Developments

25X1

Comments and queries regarding this publication are welcome. They may be directed to 25X1 *Directorate of Intelligence* 25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

25X1

International Economic & Energy Weekly

25X1

Synopsis

1 **Perspective—South Korea's Economy: Vulnerable to Political Unrest**

25X1

Opposition efforts to marshal broad popular backing for political reform face a less receptive audience because of the economy's rebound from last year's lackluster performance. Nonetheless, a hardline government response to popular pressures and demonstrations could hurt the economy and growth prospects.

25X1

3 **South Korea: Outlook for Trade and Economic Growth**

25X1

South Korea's export-oriented economy is poised for a recovery spurred by Seoul's exchange rate policy and export promotion programs and by an expected upturn in foreign demand and export prices.

25X1

7 **South Korea: Penetrating Communist Markets**

25X1

After almost a decade of indirect trade with the Communist world—largely as a political tool to undercut North Korea—South Korea has recently begun to profit from its economic relationships with P'yongyang's longtime allies. Growing trade relations between South Korea and Communist countries could not only displace US sales to the South Korean market but may also provide a new conduit for transfer of sensitive technologies.

25X1

13 **North Korea's Approach to the West**

25X1

Faced with chronic shortages in its economy and a failure to secure increased support from its Communist trading partners, P'yongyang has begun to look to the West for equipment and technology to modernize its industry. So far, however, this flurry of activity has yielded few payoffs because of North Korea's abysmal repayment record during a similar turn to the West in the mid-1970s.

25X1

17 **Summit Issues: Big Six Budget Deficit Trends**

25X1

Bix Six efforts to trim budget deficits have had mixed success during the 1980s. For FY 1986, most Big Six governments plan budget tightening and, if they succeed in implementing more austere budgets, we expect fiscal policy to have a negative or, at most, neutral impact on growth.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

25X1

21 **USSR: Facing the Dilemma of Hard Currency Shortages** 25X1

Declining oil earnings took a heavy toll on the USSR's hard currency position in 1985 and will do so again this year. 25X1

25 **Pakistan: On a Foreign Payments Tightrope** 25X1

We judge Pakistan will face serious foreign payments problems despite recent agreement on a $4 billion, six-year US economic and military aid package. We believe the financially strapped Junejo regime will probably face increased political activism from groups such as students, labor, and small farmers, who were neglected during the martial law years. 25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5 25X1

International
Economic & Energy Weekly 25X1

4 April 1986

Perspective

South Korea's Economy: Vulnerable to Political Unrest 25X1

Opposition efforts to marshal broad popular backing for political reform face a less receptive audience because of the economy's rebound from last year's lackluster performance. Nevertheless, a hardline government response to popular pressures and demonstrations could hurt the economy and growth prospects. 25X1

The downfall of President Marcos has given new impetus to the political struggle between President Chun and the South Korean opposition. Opposition leaders now believe they have a window of opportunity to press Chun for a commitment to genuine political liberalization by 1988. In the next few weeks, the possibility of violent clashes remains high as the main opposition party pushes its petition drive for direct presidential elections and as students demonstrate to commemorate several symbolic events—particularly the 17-27 May anniversary of Chun's takeover in the wake of the bloody 1980 riots. 25X1

Harsh government tactics historically have provoked stronger opposition defiance in Korea—and these days the chances for escalating confrontation and repression are even greater because Chun's antagonists believe they have him at a disadvantage. To assuage foreign reaction, Chun backed off from his initial crackdown on the opposition's petition campaign. He visits Western Europe next week, and the British and Canadian prime ministers will visit South Korea in May. Because the Asian Games in Seoul are only six months away and the 1988 Seoul Olympics are on the horizon, Chun is making domestic stability his top priority. Nonetheless, the president is surrounded by hardliners, and the potential for political turmoil remains high over the next two years. 25X1

Three decades of remarkable economic development have instilled most South Koreans with confidence in the future and a jaundiced view of political unrest that could endanger continued economic growth. As a result, the unemployed and underemployed workers spawned by last year's sluggish GNP growth did not join the opposition in the street. In 1986, we expect the economy will remain, on balance, a plus for the government:

- Chun will continue to benefit from the expert management of economic policy by his largely apolitical technocrats. However, the failure of a large business group, a major financial scandal, or further rapid increases in foreign debt could lend credence to opposition charges of economic mismanagement.

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

- Sparkling export performance in the first two months of this year—up 35 percent—and favorable exchange rate and oil price trends will help stimulate the economy.

- The gains from South Korea's "economic miracle" are remarkably well distributed.

- Although some violence has occurred as workers press hard for wage gains, labor is largely unorganized or under government control.

25X1

Our optimism about the economy does not allay our fears that an unstable political climate could sour growth prospects in the months ahead. Seoul calculates it will need $6 billion in foreign loans annually through 1988. Some bankers, however, are already skittish about adding to their South Korean exposure. If South Korea's credit rating falls because of civil strife, Seoul at a minimum will face higher interest rate spreads, which would add to the debt burden. Moreover, South Korean economic planners are counting on foreign investment and rising domestic savings to complement the increased lending as a way to spur capital spending and maintain Korea's industrial competitiveness. Political unrest that undermined the confidence of foreign investors and businessmen could cut short the recovery and erode one of the major sources of Chun's strength.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

South Korea: Outlook for Trade and Economic Growth

25X1

South Korea's export-oriented economy is poised for a recovery spurred by Seoul's exchange rate policy and export promotion programs and by an expected upturn in foreign demand and export prices. After a poor export performance last year, we forecast higher growth of real exports, imports, and GNP over the 1986-90 period, although growth rates probably will be below the average for 1970-84. Although continued high unemployment could unite domestic opponents to trade liberalization, we do not believe that economic issues will provoke a dramatic confrontation between the South Korean Government and the opposition.

25X1

Low Export Growth in 1985

South Korean export growth slowed dramatically in 1985. We estimate that export earnings increased less than 1 percent, down from the 13-percent increase recorded in 1984 and the smallest export gain in 30 years. Three factors contributed to the export slowdown:

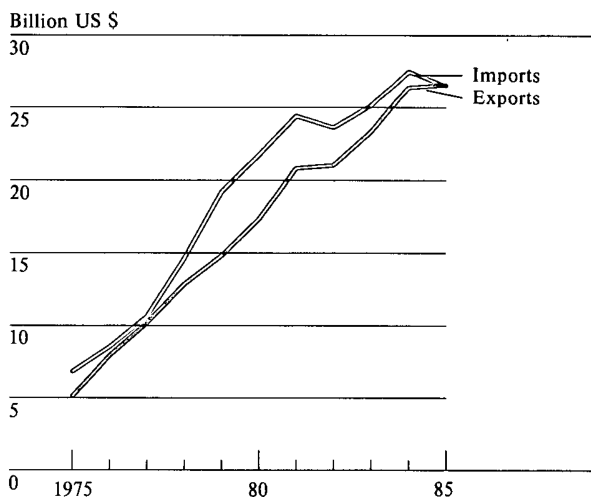
- Slowing growth of OECD real GNP—especially in the United States and Japan—reduced the growth of demand for South Korean exports. OECD real income increased about 3 percent last year, compared with nearly 5 percent in 1984.

- Lower export prices—due to weakening demand, greater competition, and Seoul's aggressive devaluation of the won—sliced South Korean export earnings last year. We estimate that US-dollar-based export prices declined 7 percent, after a 4-percent drop in 1984.

- Increased trade protectionism reduced South Korean export revenue. As of February 1985, South Korean goods faced trade restraints—including antidumping measures, import quotas, and voluntary export restraints—in 20 industrialized countries. South Korean authorities estimate that these restrictions cost $1 billion in lost export earnings in 1985.

25X1

South Korea: Export and Import Trends, 1975-85



25X1

308721 4-86

Stronger Export Growth in the Medium Term Likely . . . [1]

Over the medium term the pace of export growth should increase. Under our baseline scenario, we forecast an average annual 13-percent increase in export earnings during 1986-90, with real (inflation-adjusted) export gains averaging just over 9 percent per year. This real export growth, however, would be well below the pace recorded during 1970-84.

25X1

[1] Our assessment of export growth is based on econometric analysis, with exports assumed to be dependent on OECD real GNP and the South Korean real exchange rate. Under our baseline scenario, we assume real OECD income growth of 3 percent annually during 1986-90.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

South Korea: Projected Growth of Exports and Import Capacity, 1985-90 [a]

Billion US $ (except where noted)

	1985	1986	1987	1988	1989	1990
Exports	26.5	28.9	32.5	37.0	42.5	48.6
Change over previous year *(percent)*	0.6	9.1	12.5	13.8	14.9	14.4
Import capacity	26.4	28.7	32.6	36.9	42.3	48.2
Change over previous year *(percent)*	−3.5	8.7	13.6	13.2	14.6	13.9

[a] Figures for 1985 are based on preliminary data; all export and import figures are reported f.o.b.

Three factors will have a positive influence on exports:

- ***Real exchange rate depreciation.*** South Korean exchange rate policy is geared toward improving the foreign payments position, and we believe Seoul will allow the real (price-adjusted and trade-weighted) exchange rate to depreciate at a moderate pace (about 3.5 percent per year) to improve export competitiveness vis-a-vis other Asian countries.

- ***Higher export prices.*** South Korean export prices, when measured in US dollars, have fallen every year since 1981, and we forecast an additional 1-percent drop in 1986. However, export prices should begin to rise after this year as steady economic growth in the major industrialized countries, combined with the expected real exchange rate depreciation, boosts demand for manufactured goods.

- ***Export promotion programs.*** These include simplified export procedures, favorable export financing, increased loans to small- and medium-sized firms for export facilities, and the providing of funds to the textile industry for modernization. In addition, South Korea's rapid climb up the technology ladder should continue, a trend that should raise the importance of higher value technology-intensive products in the export mix and boost Seoul's export earnings over the next five years.

25X1

. . . But With Potential Obstacles

There are two powerful factors, however, that could limit future export gains: industrial country protectionism and competition from other Asian nations. Protectionist pressures are particularly strong in the United States—South Korea's largest market and one where its textiles, steel, and footwear have made substantial inroads. Moreover, bilateral trade frictions have increased particularly over intellectual property rights and US access to South Korean insurance markets. Although some progress is being made to resolve these issues, other problems—such as import liberalization—remain, and additional restraints on US imports of South Korean goods are possible if negotiations stall or exports to the United States continue to rise sharply.

25X1

Foreign competition is also likely to dampen South Korean export growth. Seoul is reducing its dependence on light manufacturing as it loses competitiveness with countries such as India and Bangladesh. Even in technology-intensive industries such as electronics and transport equipment, where South Korea has a labor cost advantage, competition with established exporters such as Japan and Taiwan is likely to be fierce.

25X1

Impact on Imports and Economic Growth

Our baseline export scenario indicates that South Korea will be able to increase real imports at a rate that should allow for domestically acceptable rates of real income growth.[2] Real GNP gains would

[2] To reach our assessment we used a methodology that linked our expectations of export growth, our figures for debt service payments, and our estimate of the services balance (excluding interest payments). We also assume that the level of new credit extended to South Korea remains unchanged at last year's level, and that foreign exchange holdings remain unchanged over the next five years.

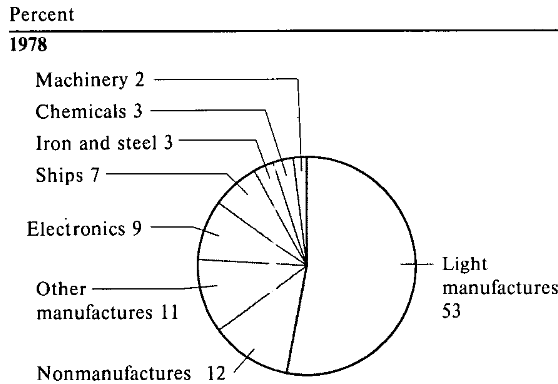
25X1

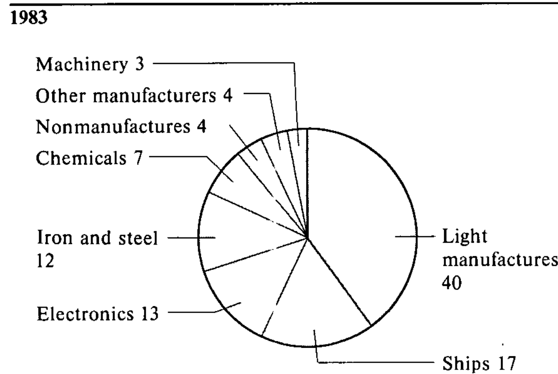
Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

South Korea: Exports by Commodity

Percent





308722 4-86

Falling Oil Prices: Substantial Benefit to South Korea

Lower petroleum prices will have a substantial impact on South Korea's import bill. In addition, South Korea will save on debt servicing costs because of declining interest rates. Our analysis indicates that a drop in oil prices to $15 per barrel saves South Korea $2.4 billion per year in energy costs and an additional $432 million per year in interest costs. A decline to $10 per barrel would reduce Seoul's yearly oil import bill by $3.5 billion and annual interest payments by $620 million.

25X1

Savings of these magnitudes would have a favorable impact on South Korea's ability to boost imports of other essential inputs. In turn, this could increase real GDP growth at a time when South Korea is facing a period of below-average income gains. Our calculations indicate that, if oil prices remained at $15 per barrel through the end of the decade, annual real GDP growth could average about 1 percentage point above the baseline case. Should oil prices fall to $10 per barrel and remain at that level, annual real income gains over the medium term could be increased by about 1.5 percentage points over the baseline scenario.

25X1

average about 6 percent per year during 1986-90 under our baseline scenario—lower than the average annual growth rate of 8.3 percent between 1970 and 1984, but an improvement over last year's estimated 4- to 4.5-percent real growth rate. We forecast that import capacity will rise nearly 13 percent per year on average, with real import gains averaging around 7.7 percent per year, compared with growth rates of 20.5 percent and 12.5 percent per year, respectively, during 1970-84. Lower export growth will be the main factor contributing to the import slowdown. With foreign exchange reserves at about $8 billion (less than four months' import coverage), South Korea would need to sharply increase foreign borrowing to boost import growth—an unlikely policy given Seoul's concern over the size of South Korean debt.

25X1

25X1

Broader Implications

President Chun has deflected much of the criticism aimed at his economic policies by pointing to cyclical factors, an upsurge in protectionism, and slack world demand for South Korea's exports. With real GNP growth forecast to pick up over the rest of the decade, we feel that the economy is

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

unlikely to become a source of confrontation between the South Korean Government and the opposition. Economic growth, however, will probably merely keep pace with new entrants into the labor market. As a result, unemployment—particularly among college graduates—will remain an exploitable issue for the political opposition.

25X1

We believe trade will probably remain the most contentious issue between the United States and South Korea over the next few years. Chun's reorganization of the cabinet in January apparently signals his continued backing for the proponents of liberalization even in the face of the economic slowdown and rising domestic tensions over US–South Korean trade. If opponents of liberalization can be held off until the economy revives, additional progress in this area would help defuse bilateral strains.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

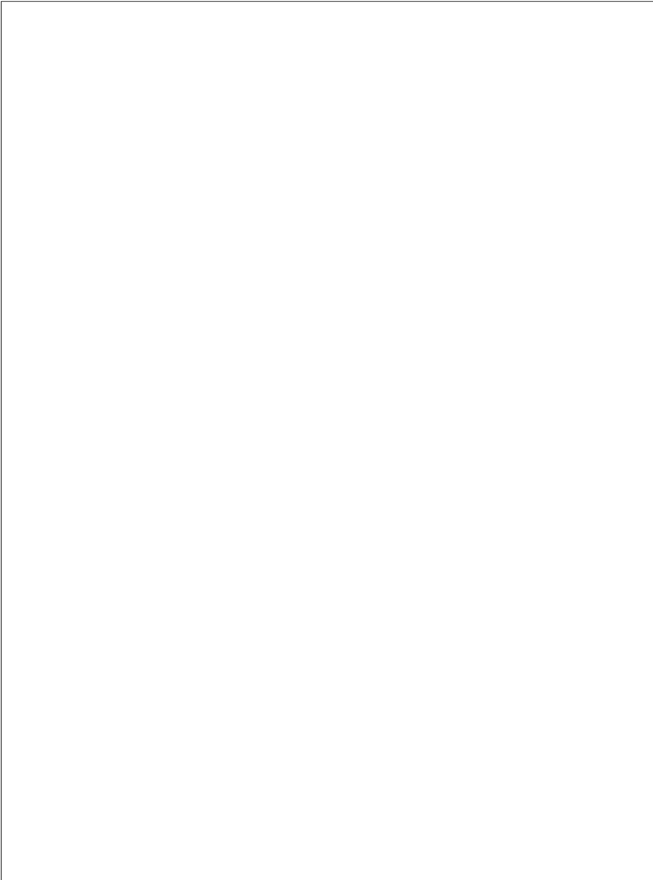
Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

South Korea: Penetrating Communist Markets

25X1

After almost a decade of indirect trade with the Communist world—largely as a political tool to undercut North Korea—South Korea has recently begun to profit from its economic relationships with P'yongyang's longtime allies. Total trade between South Korea and Communist countries in 1985 was about $1.3 billion—four times the 1983 level—with China accounting for a 90-percent share. Last year, South Korea made its first investment—albeit indirect—in a Communist country, and commercial travel by South Korean businessmen to Communist countries tripled. Although the long-term outlook for commercial relations between South Korea and Communist trading partners is good, political factors—primarily Soviet and Chinese ties to North Korea—will continue to hamper development of open trading relations and investment. Growing trade relations between South Korea and Communist countries could not only displace US sales to the South Korean market but may also provide a new conduit for transfer of sensitive technologies.

25X1



25X1

Seoul Courts Markets in Communist Countries

South Korea's payoff from trade with Communist countries over the last two years has resulted from an open-door economic policy launched in the mid-1970s. Initially, Seoul wanted to use unofficial trade as a first step toward improved relations—at the expense of its North Korean rival. That motivation is still strong in South Korean efforts to isolate and weaken the North diplomatically, and we expect it to become more pronounced as Seoul tries to cement Communist country participation in the 1988 Olympics. South Korea undoubtedly sees the Soviet Union's role, in particular, as a key to the success of the 24th Olympiad—not only in political terms but also from a business perspective, to generate world interest and hence revenue.

25X1

Notwithstanding South Korea's important political motives, we believe Seoul increasingly views Communist countries as potentially lucrative export markets as well as sources of energy, raw materials, and semifinished manufactured goods. Although this trade is only about 2 percent of the total, Communist countries are now South Korea's eleventh-largest trading partner. In the face of growing protectionism in South Korea's traditional markets, expanded trade with Communist nations may help

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

sustain export growth. For instance, last year—a year in which exports of goods and services grew a sluggish 3.3 percent—about one-fourth of Seoul's export gain came from greater sales to Communist countries, according to our estimates.

25X1

Growing Ties to China

Commercial ties between South Korea and China have been the most successful:

- ***Trade.*** We estimate total trade in 1985 reached almost $1.2 billion—the second consecutive year that this trade doubled. South Korean imports of corn, cotton, and coal accounted for much of the increase. South Korean sales focused on textile fibers, fabric, consumer electronics, and steel.

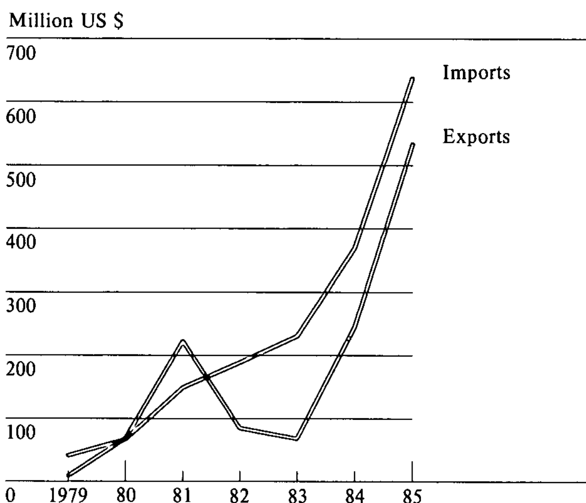
- ***Investment.*** A Hong Kong subsidiary of Daewoo has invested $250,000 in a refrigerator and television assembly plant in Fujian Province—the first investment in China by a South Korean corporation. South Korean firms are considering investment in Chinese manufacturing operations and coal mines,

- ***Construction.*** A South Korean firm will build a bridge between China and Hong Kong. South Korean workers, who will be involved in a project on Chinese soil for the first time, will be required to keep a low profile to avoid publicity.

- ***Commercial Travel.*** The number of South Korean businessmen traveling to China increased from 10 to 30 between 1984 and 1985, according to the US Embassy in Seoul. One in three reportedly entered China using South Korean passports. The US Embassy also reports a similar flow of Chinese technicians and economic officials who visited industrial facilities in South Korea.

Despite these positive developments, China did not let trade grow unbridled in 1985. Beijing restricted access to foreign exchange last summer after surging imports during the first half of the year drained

South Korea: Trade With China, 1979-85[a]



[a] Estimated.

308733 4-86

25X1
25X1

reserves. In addition, logistic problems and fraud contributed to the slowdown in trade growth. Seoul's interests were particularly hard hit when the Chinese again centralized their control over trade. The South Koreans had traditionally bypassed nettlesome and politically sensitive contacts with officials in Beijing in favor of dealing with local Chinese in the special economic zones and the provinces. China's stricter policies were applied across the board, and we do not believe they were directed at South Korean firms.

25X1

The Bloc: Trade Up, Travel Booms

25X1

Unofficial contacts between South Korea, the Soviet Union, and Eastern Europe have rebounded since the 1983 downing of a Korean Airlines 747 by a Soviet fighter. In addition to several sports and

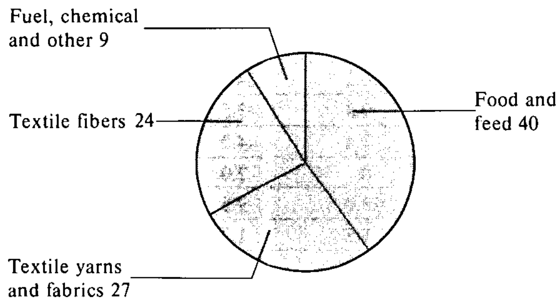
Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

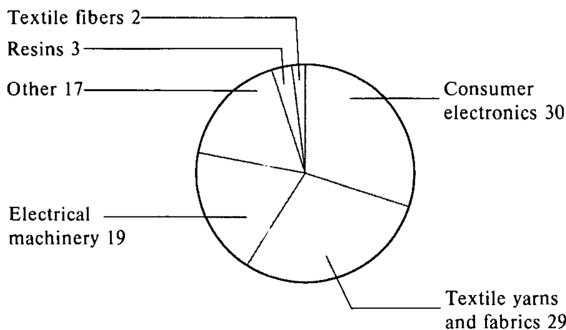
South Korea: Estimated Composition of Trade With China, 1985

Percent

Imports



Exports



308731 4-86

academic exchanges, the US Embassy in Seoul reports that 159 South Korean businessmen visited the Soviet Bloc, primarily East European countries, in the first 11 months of 1985—trebling the 1984 tally. Two-way trade increased nearly 50 percent in 1984 over the previous year—but showed a smaller gain of 20 percent last year, according to closely held South Korean trade statistics.

Although Hungary is far from being South Korea's largest Communist trading partner, commercial relations between the two are the most open. We believe that negotiations to establish a correspondent relationship between South Korea's Export-Import Bank and the Hungarian National Bank are progressing well, and that an agreement may be signed this year. In addition, the semiofficial Korea Trade Promotion Organization (KOTRA) is negotiating a trade pact with Hungarian and East German trading organizations, according to Embassy reporting. These agreements reportedly will authorize Hungarian and East German firms to contract directly with the overseas branches of South Korean trading companies located primarily in Western Europe. We believe these arrangements will have little immediate impact on trade, but they will enable the South Koreans to make their business dealings with at least two Communist countries routine. Still, we see no evidence—or likelihood—that the arrangements will have a bandwagon effect on other East European countries.

25X1

Outlook for Trade

Trade growth with the Communist countries is likely to slow primarily because of China's continued foreign exchange constraint. Over the long run, however, Communist countries will probably become more important economic partners for South Korea. In our judgment, future trends in economic relations will be molded by several factors, including:

- ***Erosion of Japan's Market Share.*** South Korea is emerging as a competitor to Japan in a number of export sectors. If Korean firms displace even 10 percent of Japan's exports to China and the Soviet Union, Communist–South Korean trade would double. Beijing, in particular, has been vocal about its large trade deficits with Japan and is looking to South Korean sources for capital and consumer goods.

25X1

- ***Communist Energy Development.*** Seoul's longstanding policy of energy diversification increases the attractiveness of coal and oil imports from Communist countries, particularly as China aggressively develops its energy resources.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

South Korea: Trade With the Soviet Union and Eastern Europe, 1979-85

Million US $

	1979	1980	1981	1982	1983	1984	1985
Total trade	**46.9**	**38.6**	**37.6**	**43.9**	**64.9**	**94.0**	**114.9**
Exports	8.0	18.3	19.4	18.8	30.2	24.1	50.8
Soviet Union	1.0	2.4	1.5	1.0	0.8	3.5	13.6
East Germany	0	0.9	5.2	4.5	1.4	4.7	7.3
Yugoslavia	0.4	0.5	1.5	1.0	0	2.0	3.6
Poland	2.1	4.5	0.4	1.8	23.0	9.5	18.2
Czechoslovakia	2.8	7.3	3.5	2.3	1.5	1.2	3.0
Hungary	0.1	1.2	3.4	5.3	1.1	0.6	4.2
Romania	0.2	0.9	2.4	2.3	1.7	1.4	0.5
Bulgaria	1.4	0.6	1.5	0.6	0.7	1.2	0.4
Imports	38.9	20.3	18.2	25.2	34.7	69.9	64.1
Soviet Union	6.3	9.7	9.9	16.5	22.1	41.5	33.6
East Germany	1.8	0.3	0.2	0.8	1.5	1.6	2.0
Yugoslavia	3.9	4.8	3.0	1.9	0	5.6	0.4
Poland	1.3	2.3	2.7	2.0	4.4	7.2	8.6
Czechoslovakia	8.4	2.0	0.7	1.4	1.5	4.9	3.7
Hungary	3.4	0.6	1.2	1.0	0.6	4.5	4.4
Romania	13.6	0.6	0.4	1.4	3.4	2.5	7.8
Bulgaria	0.2	0	0.1	0.2	1.2	2.1	3.6

25X1

- ***Scarce Foreign Exchange.*** Falling energy prices are depressing Soviet and Chinese hard currency earnings. South Korean businesses—with Seoul's encouragement—stepped up purchases from China last year to keep trade relatively balanced and to appear to respond to Beijing's foreign exchange concerns. In addition, South Korea's general trading companies are willing to strike barter deals.

Notwithstanding the factors that favor increased bilateral trade and investment, the politics on the Korean issue will continue to affect trade growth. We have seen some evidence that Beijing, at least, is becoming less sensitive to P'yongyang's objections to economic contact with the South. Burgeoning trade through Hong Kong last spring, for example, drew protests from North Korea, but Beijing made no moves to clamp down as it had in 1982. Nonetheless, with North Korean–Soviet ties improving and China seeking to maintain what leverage it has in North Korea, we believe both Moscow and Beijing will manage the relationship with Seoul carefully.

25X1

Trade through third countries will allow maneuvering room, but it also discourages trade growth by adding a costly cut to middlemen in each transaction. We would expect progress on the dialogue between North and South Korea to further open the channel for direct contacts. The North-South talks are addressing an agreement for economic cooperation, and an accord would help Communist countries justify direct commercial deals with the South.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

South Korean Communist Trade Ties: A Thin Facade

South Korea's trade with Communist countries is still cloaked behind third-country middlemen, but the cover is wearing thin. No Communist country recognizes Seoul, and China officially bans trade with South Korea. Sino–South Korean trade through Hong Kong is one of the world's worst kept secrets, and Western and Asian press exposes of "clandestine" trade and investment are commonplace. The majority of manufactured goods traded between South Korea and China passes through Hong Kong and, to a lesser extent, Japan. Bulk commodities, such as coal, cotton, and corn are often shipped directly from Chinese to South Korean ports

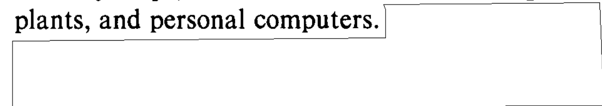
25X1

Implications for the United States

US firms and farmers have already been hurt by growing South Korean trade with the Communist world. We estimate China sold $200 million worth of corn, soybean meal, and cotton last year to South Korea—a traditional US market. While the Communist countries pose a limited threat to US agricultural sales, coal from China and the Soviet Union—along with Soviet timber—also could displace US exports to South Korea.

25X1

South Korea's rapid climb up the technology ladder in manufacturing, machine tools, and microelectronics also raises technology transfer concerns. We expect South Korea to be increasingly viewed by the Soviet Bloc and China as a potential source of proscribed technology. Rapidly growing commercial contacts are increasing the possibility of illegal trade deals. Of particular concern are advanced microelectronics, such as 256K and 1-megabit memory chips, semiconductor manufacturing plants, and personal computers.



25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

North Korea's Approach to the West

25X1

Faced with chronic shortages in its economy and a failure to secure increased support from its Communist trading partners, P'yongyang has begun to look to the West for equipment and technology to modernize its industry. For nearly two years P'yongyang has been engaged in a round of contract negotiations with Western firms and a campaign to acquire Western financing for imports. North Korea also has adopted a joint venture law in the hope of attracting Western investment. So far, however, this flurry of activity has yielded few payoffs because of North Korea's abysmal repayment record during a similar turn to the West in the mid-1970s.

25X1

The North Falls Behind

Just as South Korea has been expanding trade with Communist countries over the past two years, North Korea has attempted to increase imports and financing from the West. While Seoul's motives have been largely political, North Korea's approach to the West has been driven primarily by economic and technological concerns. In economic terms, the North continues to fall further behind its southern rival. Recurrent shortages, ranging from energy to rail cars, have long created serious production and transportation bottlenecks. Moreover, Kim Chong-il, Kim Il-song's son and designated heir, who is credited by P'yongyang with running the domestic economy, almost certainly hopes that Western technology will provide some economic successes to add legitimacy to his father's succession plan.

The Shopping List

North Korea has put together an extensive list of industrial equipment it hopes to acquire from the West. The North has also put out feelers for equipment to produce consumer goods, including clothing and textiles, and is planning to seek Western help in developing tourist facilities. The North Koreans are approaching firms in Western Europe and Japan as potential sources.

25X1

25X1

North Korean Shopping List

Included among the items in which the North reportedly has expressed interest is equipment for:

- *Exploration and exploitation of offshore and onshore oil.*
- *Two coal-fired power plants that will use low-grade coal and have a generating capacity of 500,000 megawatts (about $275 million).*
- *Coal liquefaction gas plant ($30 million).*
- *Coal mining.*
- *Aluminum refinery ($280 million).*
- *A 3-million-metric-ton-a-year steel plant.*
- *Plant to produce magnesite, magnesia clinker, and firebricks.*
- *Integrated-circuit production plant ($5 million).*
- *Plant to produce fiber optics.*
- *Plants to produce telephone equipment.*
- *Paper plant ($25 million).*
- *Production of clothing, toiletries, shoes, foodstuffs, furniture, and kitchen appliances.*
- *The manufacture of agricultural machinery, such as combines and rice planting machines.*
- *An international airport in P'yongyang (total package to cost about $80-120 million).*

25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Given North Korea's limited financial resources, the shopping list is far too ambitious. We estimate that the value of the Western equipment and technology P'yongyang hopes to line up for its next seven-year plan period (1987-93) exceeds $1 billion. This would almost double the current annual level of plant and equipment imports—reminiscent of P'yongyang's disastrous buying spree that ran up massive debts in the mid-1970s. Even some of the individual projects may be too costly for the North. Nonetheless, if P'yongyang judiciously trims its import program to a realistic level, the economy would benefit from an infusion of Western technology. For example, a focus on power projects and a paring back of other items on the shopping list—such as the large steel plant—could be affordable and would help alleviate energy and transportation shortages that seriously hamper industrial production.

Reportedly, only a few of the many contracts North Korea is negotiating with Western firms have been concluded, In the first half of 1985, North Korea signed contracts with Japanese firms for mining equipment valued at $19 million and a rolling machinery plant costing $2 million. In April 1985 the North signed a $7 million contract with a Danish firm for equipment for a prefabricated construction materials plant.

Limited Export Potential

P'yongyang's policy of self-reliance has severely hampered the development of North Korean export industries. Exports are encouraged only as a means of covering essential imports, not as a means of providing employment as in the South. Exports to the developed West—which consist largely of nonferrous metals, iron and steel sheet, foodstuffs, and gold—have on average risen little in value terms over the 1976-80 level. The North's nonmilitary finished goods are in general of such poor quality that even its Communist trading partners are reluctant to accept them. Given the production shortfalls we expect will plague the economy for some time to come, the North Koreans will remain hard pressed to supply their domestic needs while trying to raise exports to both its Communist and non-Communist partners.

25X1

The Search for Financing

P'yongyang continues to search for credits to finance the machinery and equipment it hopes to import. Its bad repayment record, however, has made it a poor credit risk:

- North Korea has approximately $1 billion in debts to the West, nearly all of which were originally incurred during the mid-1970s.
- North Korea has also failed to repay short-term borrowing.
- The leadership remains unwilling to cut back on hard currency imports to pay off its obligations; we estimate a cut in imports of more than 50 percent would be needed to meet annual principal and interest payments.

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Joint Ventures

P'yongyang's passage of a joint venture [2] law in September 1984 was probably designed to get around its hard currency shortages and Western reluctance to extend credits. The law—patterned after a similar program in China—obstensibly opens the way for direct Western participation in funding and operating companies in North Korea. It is not clear, however, how much control P'yongyang will be willing to share with Western firms.

Despite the North's high hopes for the joint venture law, only seven deals—all involved with services rather than production—have been concluded since late 1984.

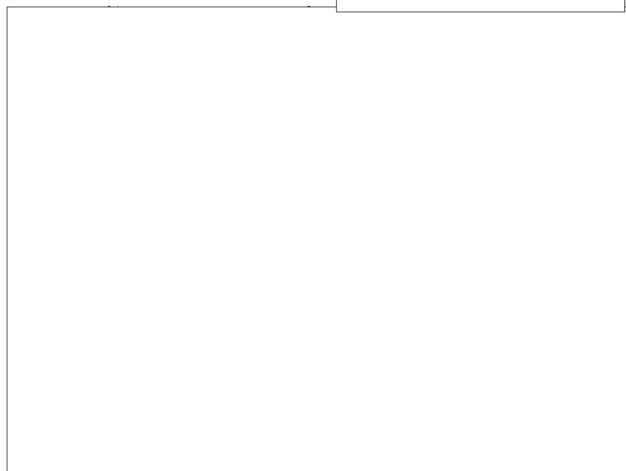
[2] The North Koreans have used the term joint venture rather loosely. For example, P'yongyang has cited an agreement with West German firms for the construction of a cement plant as a joint venture, but the arrangement may in fact be an outright equipment purchase from the Germans. Even if the West Germans agreed to take some of the product as partial payment, this would be a compensation rather than a joint venture arrangement.

Joint Ventures

The Nagwon Department Store. *This joint venture between Asahi Sansa (formerly Asahi Shoji Company, Ltd.) of Tokyo and the Mangyong Trade Corporation of North Korea was formed in January 1985. The main branch of the store is in P'yongyang, and 31 branches are planned for major North Korean cities.*

25X1

25X1



25X1

The Hotel in P'yongyang. *Shortly after passing its joint venture law in September 1984, North Korea concluded an agreement with a French firm, Camenon Barnaul, to build a 45-story hotel in P'yongyang. In early 1985 the government announced that the foundation work was complete and construction was progressing as scheduled. By December 1985, however, although ground had been broken, apparently no work was under way. It is possible that North Korea's failure to make good on debt repayments to France cast a pall on the French firm's willingness to continue with the hotel. Representatives of Camenon Barnaul were in P'yongyang in early March, presumably to discuss the contract.*

25X1

25X1

25X1

25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

progress of the few joint ventures under way suggests Western firms are encountering a variety of difficulties, which will continue to dissuade other foreign investors.

25X1

25X1

Outlook

We believe that North Korea—with its lack of creditworthiness and poor export potential—will be unable to obtain most of the items on its shopping list. Moreover, Western partners clearly are dissatisfied with the joint ventures they have entered so far. Given the Kims' history of tight central authority and "on-the-spot guidance," P'yongyang will be unlikely to change their views. North Korea's Communist economic partners will probably offer little relief. Neither Moscow nor Beijing, to which P'yongyang also owes large sums, appears willing to extend the large volume of credits that would be required for North Korea to substantially increase its imports. Without large infusions of foreign capital—together with dramatic changes in P'yongyang's approach to economic management—the North Korean economy probably will continue to plod along, falling farther behind that of the South.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Summit Issues: Big Six Budget Deficit Trends

25X1

Big Six efforts to trim budget deficits have had mixed success during the 1980s. The governments that have doggedly pursued deficit reduction as their chief economic priority have succeeded; Japan and West Germany are close to budget balance. The United Kingdom, despite recent slippage, has also made considerable progress, but primarily as a result of privatization, not expenditure restraint. In contrast, budget deficits are on the rise in the other three countries. Because of the size of the Japanese and West German economies, however, the net budget position of the Six had a slight deflationary impact on Big Six economic growth in 1985. For FY 1986, most Big Six governments plan budget tightening and, if they succeed in implementing more austere budgets, we expect fiscal policy to have a negative or, at most, neutral impact on growth.

25X1

Recent Trends

Despite recent efforts to contain budget deficits that grew markedly during the 1970s, the Big Six countries as a group have shown only little progress toward deficit reduction in the 1980s. The average central government deficit as a share of GNP for the Big Six has remained in the 3.3- to 4.7-percent range since 1978. This aggregate figure masks widely disparate country performances, as fiscal austerity in West Germany and Japan has been offset by higher deficits elsewhere:

- ***West Germany*** and ***Japan*** have pursued fiscal austerity with a vengeance and are on the way to achieving budget balance.

- The ***United Kingdom*** has reduced its deficit as a share of GNP by 2 percentage points during the 1980s, although its deficit last year was only slightly below the six-nation average.

- The Socialist government in ***France*** enacted highly expansionary budgets after its election in 1981, and, although the government switched to fiscal austerity two years later, Paris has failed to make significant inroads on the deficit.

- ***Italy***'s chronic budget deficits have grown to 15 percent of GNP despite attempts by successive governments to bring the budget under control.

- ***Canada*** has experienced a major deterioration in its budget position due to the 1981/82 recession, reductions in some taxes, and a continued failure to reduce expenditures.

25X1

Expenditures, Revenue, and Debt

West Germany and Japan have closed their deficits chiefly through spending restraint, without resorting to major tax increases. As a share of GNP, central government expenditures have been declining lately in both countries. London's sales of public assets—which are counted as negative spending—have helped hold the line on expenditure growth during the 1980s, but revenues have not risen fast enough to close the government deficit. Spending jumps in France and Italy during the early 1980s exceeded revenue growth. In Canada central government expenditures have risen as a percentage of GNP, while revenues have remained fairly flat.

25X1

Central government debt as a share of GNP has continued to climb in all Big Six countries, although recent trends suggest it is leveling off in West Germany and Japan. The growth in government debt poses a major problem for deficit reduction programs, because debt service is a nondiscretionary expenditure.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Big Six: Central Government Budget Balances, as a Share of GNP [a]

Percent

	1979	1980	1981	1982	1983	1984	1985
	Nominal						
Big Six	−3.8	−3.3	−3.9	−4.2	−4.7	−4.0	−3.6
Japan	−3.4	−3.0	−2.6	−2.4	−2.4	−1.6	−1.3
West Germany	−2.0	−1.8	−2.3	−1.9	−2.0	−1.5	−0.8
France	−1.5	NEGL	−2.7	−3.1	−3.1	−3.2	−3.7
United Kingdom	−5.2	−4.7	−4.1	−2.8	−4.8	−3.2	−3.3
Italy	−11.2	−10.9	−13.4	−15.6	−16.6	−15.7	−15.0
Canada	−3.9	−3.4	−2.8	−6.3	−7.0	−7.2	−7.3
	High-Employment, Inflation-Adjusted						
Big Six	−0.6	0.1	−0.1	0.1	0.2	0.1	0.3
Japan	−1.1	−0.6	0.1	0.6	0.9	1.7	2.2
West Germany	−0.7	−0.4	−0.6	0.5	0.6	1.0	1.7
France	0.4	2.1	−0.5	−0.7	−0.9	−0.4	−0.7
United Kingdom	−1.2	1.2	0.6	0.9	−1.6	NEGL	0.1
Italy	−1.2	3.4	−2.0	−3.1	−1.0	−4.4	−4.5
Canada	0.8	2.8	2.9	0.9	−2.3	−3.7	−3.9

[a] Cash basis.

25X1

Impact of Fiscal Policy

During 1979-85, Big Six government budget balances—when calculated on a high-employment, inflation-adjusted basis (HEIA)—had a slight deflationary effect on growth. The average HEIA balance has shifted from a small deficit to a small surplus, but the balance has fluctuated around zero in intervening years. The shift has been dramatic in Japan and West Germany, however. Japan ran an HEIA surplus equivalent to 2.2 percent of GNP last year, while that of West Germany grew to 1.7 percent. Canadian fiscal policy, which was relatively tight in the early 1980s, has turned markedly expansionist in recent years, and Italian fiscal policy is more lax. Fiscal policy has been slightly expansionist in France, and slightly restrictive in the United Kingdom.

Outlook for 1986

Budget programs announced for 1986—if successfully implemented—suggest some narrowing in intercountry disparities. West Germany and Japan will continue tightening, while other Big Six governments plan to trim or at least stabilize their deficits:

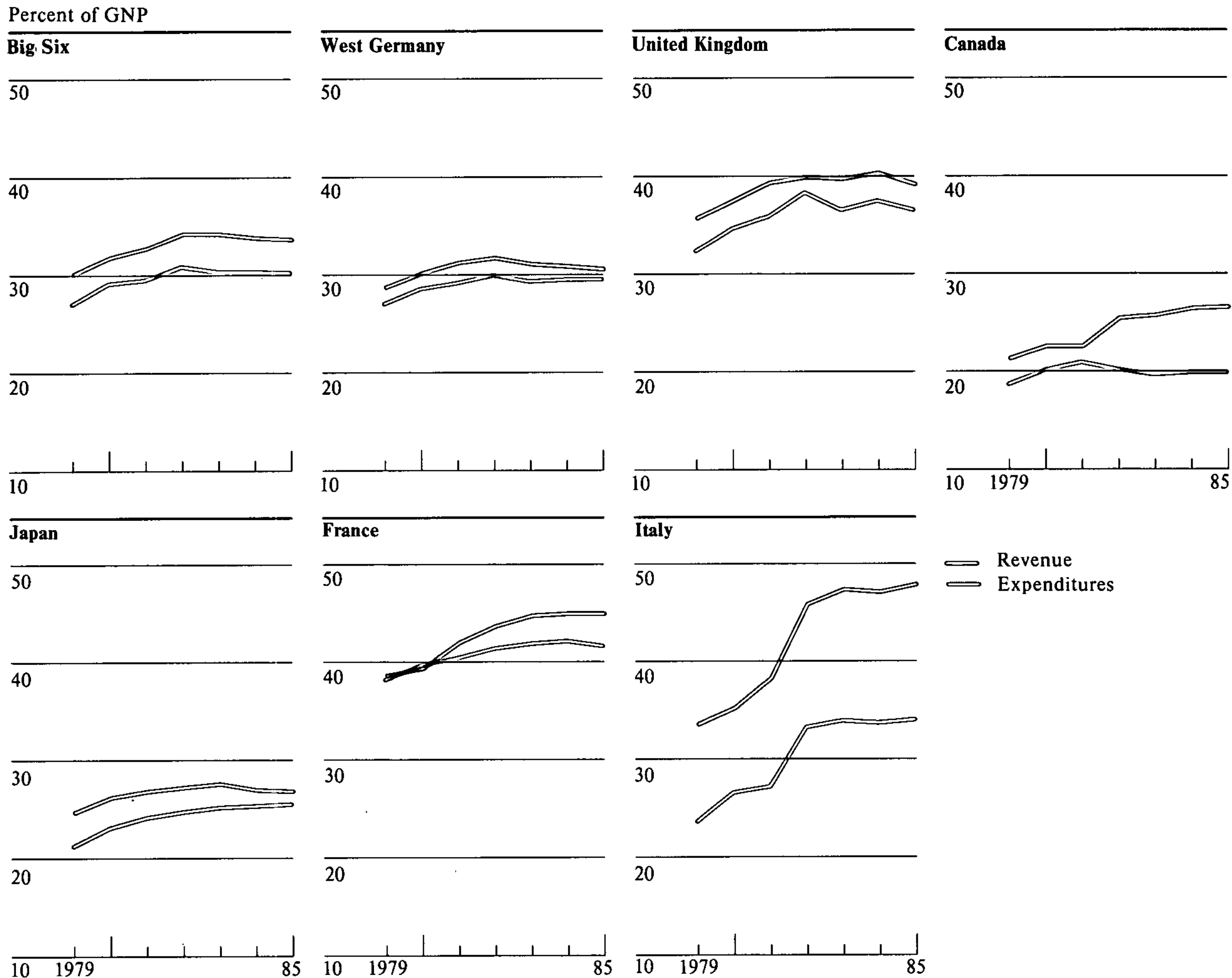
- ***Japan*** is adhering to fiscal restraint, although recent yen appreciation has lowered growth prospects. The FY 1986 budget cuts administrative and investment spending to keep total discretionary expenditure within last year's level. The modest spending increases planned for the separate public works budget will have little impact on this year's deficit.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Big Six: Central Government Revenues and Expenditures, 1979-85



25X1

308735 4-86

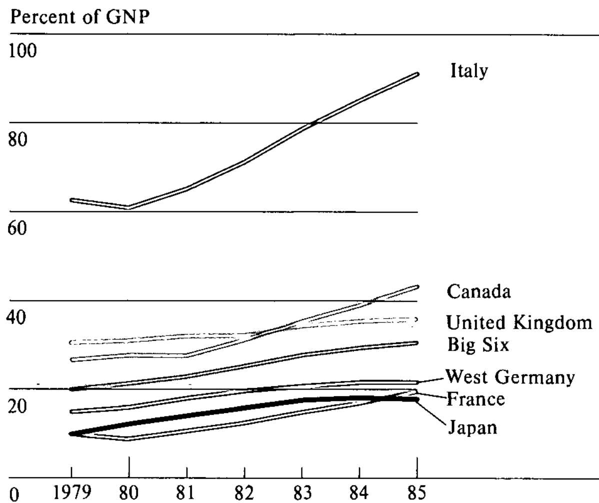
- ***West Germany*** continues its fiscal consolidation program into 1986, with budget expenditures expected to rise only 2 percent over last year's level. Deficit reduction is proceeding faster than foreseen in Bonn's medium-term financial plan, due in part to extraordinary profits from central bank operations. This year's tax cuts will barely compensate for past fiscal drag, and Bonn is resisting suggestions to move up tax cuts scheduled for 1988.

- ***Italy***'s 1986 budget reduces the deficit as a share of GNP by about 1 percentage point below last year's level. The package, however, leaves undetermined $4 billion in spending cuts, making achievement of the deficit goal almost impossible. Reduced central government transfers to the regional and local governments will be offset by new local taxes.

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Big Six: Central Government Debt, 1979-85



308734 4-86

- ***Canada*** has announced a FY 1986 budget aimed at trimming the government deficit by $3.3 billion next year. The reduction will be implemented by a combination of tax increases and spending cuts.

- ***France*** aims to hold this year's central government deficit constant as a share of GNP. The 1986 budget plans an increase in noninterest expenditures of only 2.8 percent, but cuts in personal taxes and increased debt service charges should preclude any reduction in government indebtedness.

- The ***United Kingdom*** intends to lower public-sector borrowing as a share of GNP this year through higher direct tax receipts and increased public asset sales. General government spending will be frozen in real terms. London cites reduced oil tax revenue as a rationale for lower-than-promised income tax cuts.

Calculating HEIA Budget Balances

To derive high-employment budget balances, we estimated an aggregate production function for each country. Combining this equation with the actual levels of capital stock and the labor force yields measures of potential GNP. The highest percentage of potential GNP obtained over the time period is defined as the high-employment level for purposes of determining high-employment balances. Using simulations of a reduced form of our Linked Policy Impact Model (LPIM), actual budget deficits were adjusted to the levels that would have been obtained under high-employment conditions. This methodology does not rely on arbitrarily set levels of full employment that vary between business cycles.

25X1

We then adjusted these calculated budget balances for inflation by reducing the deficit—or increasing the surplus—by an amount that leaves the real level of government debt—including bonds and central bank money—unchanged. Budgets that increase the level of government debt by exactly the current inflation rate are considered to be balanced on an inflation-adjusted basis. An inflation-adjusted budget shows a surplus if it decreases the real level of government debt; it shows a deficit if it increases the real debt level.

25X1

25X1

If budget plans are implemented, the average Big Six deficit would decline by 0.5 to 1 percentage point as a share of GNP. We estimate that fiscal policy will have a negative, or at best neutral, impact on growth in 1986.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

USSR: Facing the Dilemma of Hard Currency Shortages

25X1

Declining oil earnings took a heavy toll on the USSR's hard currency position in 1985 and will do so again this year. Moscow's current financial standing remains strong, however, offering the Soviets some leeway in the short term. Moscow is unlikely to resort to massive borrowing, however, and instead will cut imports to make up for most of the earnings decline. Over the longer term, General Secretary Gorbachev will need to formulate a more coherent import plan than is now apparent—and probably even ease up on the Soviets' conservative approach to borrowing—if he hopes to both maintain needed imports of agricultural products and intermediate goods and keep his modernization program on track.

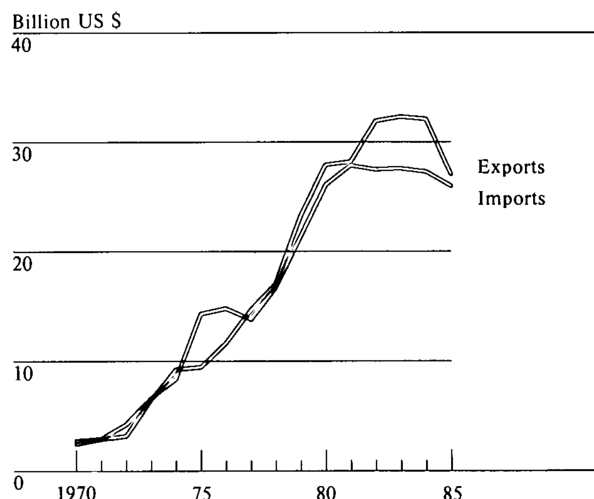
25X1

Temporizing in 1985

Moscow's hard currency trade surplus dropped from $4.8 billion in 1984 to about $1 billion in 1985, largely as a result of declining export earnings. Preliminary Soviet trade data indicate that hard currency exports declined by 15 percent to $27 billion, the lowest level since 1979. Falling oil prices and sluggish domestic oil production led to a 20-percent reduction in oil export revenues. Available data further suggest a similar percentage decline in Soviet arms exports while exports of most other commodities remained near the 1984 level.

Moscow countered the export decline by stepping up borrowing. The fall in imports was limited to an estimated 5 percent, with most of the reduction coming in the second half of last year. According to Western financial statistics, Soviet debt to Western banks increased by $5 billion by the end of September. In addition to taking advantage of short-term borrowing, the Soviets also used their strong credit rating to raise about $2.5 billion in medium- and long-term syndicated loans at favorable interest rates and repayment periods. Moscow also requested some Western firms to arrange for supplier

USSR: Hard Currency Imports and Exports, 1970-85



25X1

308751 4-86

credits or deferred payments for Soviet purchases. In addition, gold sales reached approximately 180 metric tons, compared with less than 100 tons in each of the previous two years, earning Moscow about $1.8 billion.

25X1
25X1

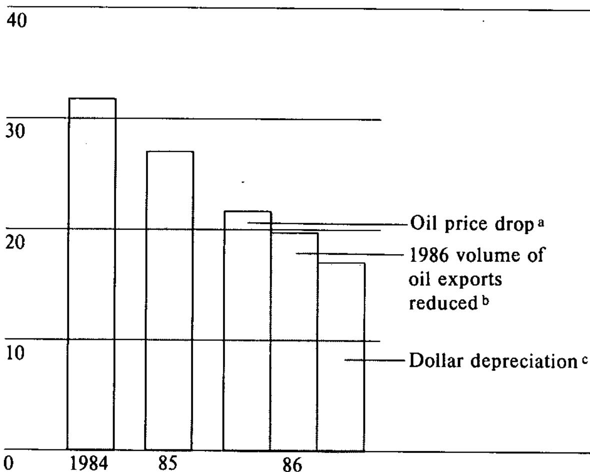
The sharp reversal of Moscow's hard currency position appears to have taken Soviet planners by surprise. Soviet officials, in fact, may have initially viewed the export shortfalls last year as a temporary event resulting from lagging oil production and severe winter weather. Trade officials continued to negotiate and sign major contracts with Western firms throughout the summer and early fall for projects to be constructed during the 1986-90 plan. The failure to come to grips with the

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

problem sooner may also have been due to some confusion in the Soviet bureaucracy, resulting from the appointment of a new Gosplan chairman and foreign trade minister.

USSR: Impact of Oil Price, Oil Volume, and Dollar Decline on Hard Currency Exports



[a] Assumes price drops to $15 a barrel.
[b] In addition to price drop, this assumes oil export volume declines by 300,000 b/d.
[c] Additional impact of a 20-percent depreciation of the dollar, assuming 70 percent of imports are in nondollar currencies.

308752 4-86

25X1

Deteriorating Export Earnings in 1986

Reduced world oil prices and continued problems in oil production are likely to push Soviet hard currency exports in 1986 down even further than in 1985—earnings could fall by as much as $7 billion. The bulk of this drop would result from sustained low oil prices of about $17 per barrel or less, affecting Soviet earnings from gas as well. Oil production problems will probably limit Moscow's ability to boost oil export volume: at best, oil production will remain at the current rate of 12 million b/d and could drop to 11.6 million b/d by the end of the year.

25X1

Moscow must also contend with a sharp erosion in its buying power caused by the continuing fall of the US dollar. Roughly two-thirds of Soviet exports are priced in US dollars, while about 70 percent of Soviet purchases are made in other hard currencies. Assuming a 20-percent drop this year in the value of the US dollar against the market basket of currencies used to finance Soviet imports, Soviet export earnings would buy about 15 percent less this year than in 1985.

25X1

25X1

Coping With Revenue Declines

Because of Moscow's currently comfortable financial position, Soviet planners have several options available to help offset falling oil earnings in 1986:

- Soviet assets in Western banks currently amount to $10 billion, and Moscow could probably draw down these assets by as much as $2 billion without seriously jeopardizing its liquidity position.
- The USSR's excellent credit rating among Western creditors offers the possibility of increased borrowing at favorable rates. For example, Moscow could easily raise another $1-2 billion in syndicated borrowings this year. The Soviets may also push for lower interest rates and longer repayment terms.
- The USSR—with an estimated 2,800 tons of gold in reserve and annual production of 340 tons—could increase annual sales to 300 tons without disrupting the market. Perhaps up to an additional 150 tons could be sold discreetly through futures markets and nontraditional buyers. Sales of 300 to 450 tons in 1986 would raise roughly $3-5 billion.

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

- Moscow also could try to boost other nonenergy exports such as diamonds, chemicals, nonferrous metals, and wood products, by offering below-market prices or countertrade arrangements.

Because of uncertainties over the duration of this earnings decline beyond 1986, the Soviet leadership will probably approach these options with caution. In particular, Moscow is unlikely to repeat last year's strategy of heavy borrowing to limit the fall in import capacity. Other than expanded gold sales, the USSR's options offer little potential to counter declining oil revenues, given the generally weak market for Soviet goods, including arms.

Mounting evidence indicates that Soviet planners are in the process of adjusting the 1986 import program to reflect reduced Soviet earnings. Soviet officials have stated that imports would be cut to match declines in earnings. Since late last year, Soviet purchasing activity has slowed noticeably.

The decision to cut hard currency expenditures appears to be affecting all types of purchases:

- According to the US Embassy, the Soviets have scaled back plans for two petrochemical complexes and an agrochemical plant.

Japanese officials reported to the US Embassy in Moscow that cutbacks in purchases of consumer goods such as clothing and textiles appeared to be in the offing.

25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1

Beyond 1986

We believe Moscow faces a high probability that real imports will remain severely depressed for the rest of the decade. Prospects for hard currency earnings are extremely poor as long as oil prices remain low. Reductions that are likely to occur in Soviet oil production could depress export earnings further. In addition, growth in nonenergy exports—especially arms—shows little promise because low oil prices will hurt the economies of Moscow's major Middle Eastern arms clients. Moreover, the poor quality of Soviet manufactures will limit their export potential in the West.

The recent import cuts, especially those involving large projects scheduled for the 1986-90 plan, may reflect a recognition by the leadership of the long-term nature of the hard currency problem. The cutbacks, in addition to dealing with the immediate scarcity of hard currency, will also allow time for a

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

more coherent import strategy to be put into place. Such a strategy must weigh the costs of large import cuts on Gorbachev's modernization program and consumer welfare.

25X1

Allocating the available hard currency among competing domestic users will present the Soviet leadership with difficult choices. Machinery and equipment imports will probably bear the brunt of import cutbacks. While some cuts in imports of spare parts and intermediate goods such as chemicals and specialty steels are probable, large, sustained cuts could slow or even temporarily halt production in some enterprises. In addition, drastic cuts in agricultural imports could jeopardize efforts to improve consumer welfare.

25X1

The import pattern that will emerge over the next 12 to 18 months may bear little resemblance to the established priorities of recent years. Rather than apportioning the blow among existing claimants for hard currency allocations, the leadership will have to formulate new priorities for the various sectors of the economy. Coping with reduced imports, moreover, may force Gorbachev and his lieutenants to attempt even bolder domestic initiatives to further improve the management of Soviet resources and trading practices.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Pakistan: On a Foreign Payments Tightrope [1]

25X1

We judge Pakistan will face serious foreign payments problems despite recent agreement on a $4 billion, six-year US economic and military aid package. Pakistan's external financial position will probably stabilize this year, but Pakistani exports are likely to face increased competition and lower world commodity prices over the next few years. In addition, declining remittances also are likely to widen the current account deficit. When foreign payments problems occur—possibly as early as next year—Pakistan will try to lay the blame on the United States, push Washington to write off the military debt and provide more commodity aid, and seek IMF assistance. We believe the financially strapped Junejo regime will probably face increased political activism from groups such as students, labor, and small farmers, who were neglected during the martial law years.

25X1

Dodging a Financial Bullet

Expansionary economic policies, a steady decline in worker remittances, and a disastrous cotton crop two years ago, however, precipitated a serious foreign exchange crisis last summer.[2] Rather than curb imports or slash government spending, Islamabad financed the rapidly growing current account deficits by drawing down reserves. From a high of $2 billion in December 1983, liquid reserves plummeted to roughly $325 million in mid-August 1985—equivalent to about 3 weeks' imports.

25X1

Since then, President Zia's luck and creative financial maneuvering have enabled Pakistan to more than double foreign exchange reserves, avoid going to the IMF, and finance much of the public deficit:

- Export earnings, primarily raw cotton and cotton-based manufactures, increased more than 18 percent in value terms while imports dropped about 1 percent compared with the first half of FY 1985,[3] according to US Embassy reporting.
- An improved US dollar exchange rate, better banking procedures, and savings carried back by returning workers stimulated a near 6-percent rise in remittance earnings.
- Since August 1985, sales of Special National Fund Bonds (SNFB) tapped the nation's vast reserves of "black money," netting more than $1 billion and the introduction of Foreign Exchange Certificates (FEBC) has probably added more than $500 million to Pakistan's foreign exchange reserves.[4]

25X1

To help cover its current account deficits, Islamabad has required large infusions of foreign aid. Since FY 1980, Pakistan has received on average more than $1 billion a year in project and commodity assistance from the United States and multilateral donors. Islamabad recently agreed to a US assistance program of $4 billion—less than its

25X1

[2] Pakistan has been able to sustain a more than 6-percent real average annual growth since FY 1977. Our analysis shows, however, that for every 1-percent increase in GDP, import growth increased by more than 1 percent. As a result, the trade balance deteriorated even though the domestic economy performed well.

25X1

[3] The Pakistani fiscal year runs from July 1 to June 30.

25X1

[4] SNFBs are special one-time bearer bonds that allow Pakistanis to launder their "hidden assets" and avoid tax investigations. FEBCs are foreign currency certificates of deposit that pay high interest, are cashable in foreign currencies, and guarantee purchaser confidentially.

25X1

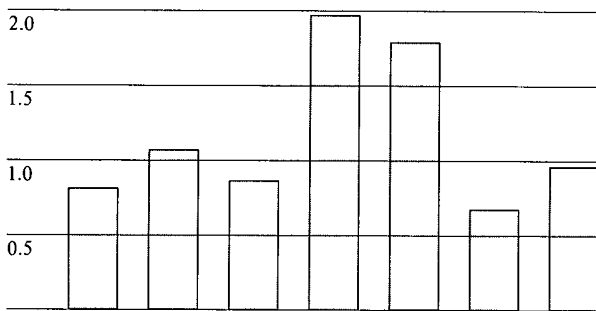
25X1

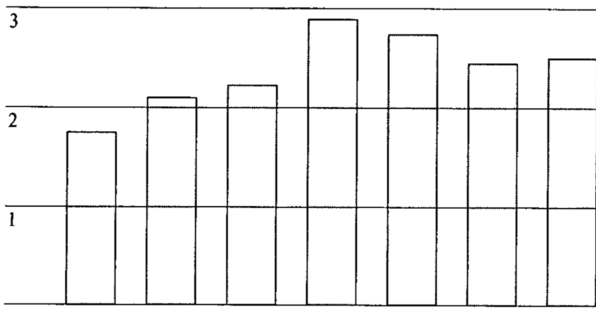
Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

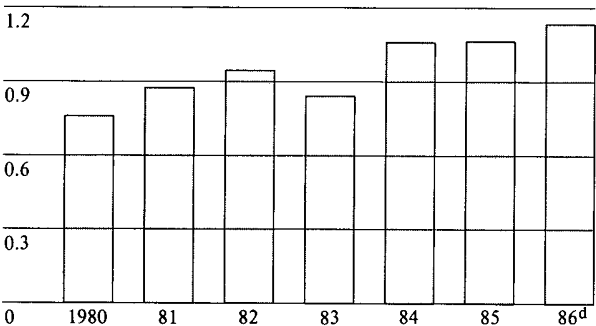
Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Pakistan: Economic Indicators, 1980-86[a]

Billion US $







[a] Data are for fiscal years ending on 30 June of the stated year.
[b] Liquid foreign exchange reserves at end of fiscal years.
[c] Including interest, amortization, and FMS.
[d] Estimated.

308737 4-86

original $6.5 billion request. The new package is weighted more toward economic aid and offers concessional military assistance in contrast to the current $3.2 billion program for FY 1982–FY 1987. The Pakistanis argued that even greater concessionality and an increase over the current aid package was essential to bolster their fledgling democracy, assuage domestic critics, and ease the country's growing debt burden, according to US Embassy reporting.

25X1

Structural Weakness

Pakistan let its economic foundation weaken while it was "buying" political stability with imports (including military purchases) and subsidies. With government investment stagnating, irrigation works, roads, and energy facilities fell into disrepair. Over the next few years, Pakistan's dilapidated economic infrastructure is likely to impede efforts to narrow chronic current account and budget deficits by hampering agricultural and industrial growth:

- Agriculture is the most promising sector of the economy, but over the years underfunding of Pakistan's irrigation, agricultural research, and extension service has led to low yields and erratic production.

- Although industrial production has grown rapidly over the past few years, this has not translated into increased exports. High import duties have sheltered producers from international competition and hampered export competitiveness.

- Over the past few years, chronic energy shortages, particularly electrical power, have required increasing energy imports, disrupted production, and raised costs.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Pakistan: Balance of Payments, 1981-86 [a]

Million US $

	1981	1982	1983	1984	1985	1986 [b]
Trade balance	−2,765	−3,450	−2,989	−3,324	−3,462	−3,201
Exports (f.o.b.)	2,798	2,319	2,627	2,669	2,475	2,945
Imports (f.o.b.)	5,563	5,769	5,616	5,993	5,937	6,146
Services balance	1,639	1,677	2,274	2,020	1,624	1,675
Of which:						
Interest payments	357	453	421	477	461	429
Remittances	2,097	2,224	2,886	2,737	2,446	2,500
Private transfers	135	663	157	307	187	219
Current account	**−991**	**−1,110**	**−558**	**−997**	**−1,651**	**−1,307**
Government transfers	276	416	325	309	379	772
Long-term capital (net)	563	612	1,057	431	290	150
IMF	315	345	413			
Gross aid disbursements	680	676	976	925	850	778
Amortization (principal) payments	516	492	420	555	537	582
FMS payments [c]				28	66	124
Other private	84	83	88	89	43	78
Other	443	−116	287	79	−105	672
Change in reserves	**291**	**−198**	**1,111**	**−178**	**−1,087**	**287**

[a] Data are for fiscal years ending 30 June of the stated year.
[b] Estimated.
[c] Includes principal and interest payments.

25X1

Balance-of-Payments Scenarios

We envision growing foreign payments problems over the next five years. Pakistan is likely to face growing competition and lower prices for its commodity-based exports. Although lower world oil prices will help stabilize Pakistan's energy import bill, it will also reduce remittance earnings from workers in the Gulf states. Moreover, repayments to the IMF, to Washington on the Foreign Military Sales (FMS) debt, and to other lenders will raise Pakistan's debt service burden.

25X1

A Worse Case. Prospects for matching the export growth of the last five years are dim because Pakistan's major exports—rice, cotton, and textiles—face glutted markets, domestic production uncertainties, and stiff international competition. Prime Minister Junejo's new civilian government might be inclined to allow imports to grow in order to appease consumers and develop a domestic constituency. A drop in export growth on the order of 2 percentage points, an increase in import growth of

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

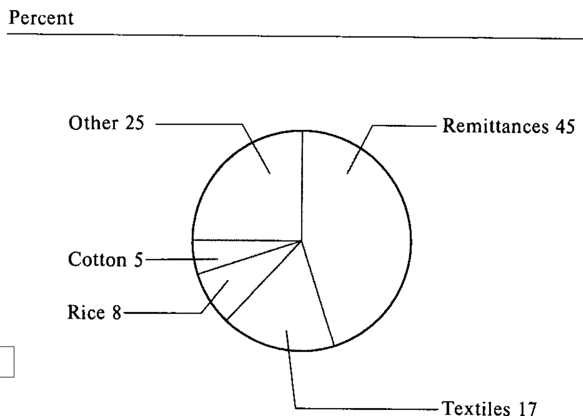
Remittance Woes

Falling world oil prices and a slowdown in Gulf economic activity threaten to undermine Pakistan's major foreign exchange earner—worker remittances. Even though remittances have dropped nearly 15 percent since FY 1983, they still account for nearly 50 percent of Pakistan's foreign exchange earnings. Because the majority of remittances come from manual workers in the Middle East, they are particularly vulnerable to economic downturns. [redacted] *nearly two-thirds of the remittance income goes toward living expenses—mostly in rural areas—with the remainder flowing into land and housing.* [redacted]

1 percentage point, and a sharp falloff in remittance earnings would result in a financial gap of about $5 billion in FY 1991, compared with roughly $2 billion in FY 1986. [redacted]

A Better Case. Because it will be difficult for Pakistan to increase its exports, we believe Islamabad will have few options other than to cut back on imports to hold down trade deficits. Consumer goods and some raw materials—an estimated 30 percent of total imports in FY 1985—would be targeted for cuts. By cutting its import growth rate by 2 percentage points and maintaining an export growth rate of roughly 4 percent with remittance earnings declining at a 2-percent annual rate, Pakistan could contain its current account deficit to slightly over $2 billion in FY 1991. Even then, the financial gap would reach $3.5 billion. [redacted]

Pakistan: Average Foreign Exchange Earnings, 1978-85[a]



[a] Data are for fiscal years 1978-85.

[redacted]

308736 4-86

25X1

Outlook

Over the next few years, the new civilian government is unlikely to experience the kinds of fortuitous economic developments that Zia experienced during the period of martial law. Even under the better case scenario, foreign exchange shortages will be a serious problem. Total capital inflows from US aid, the IMF, and the World Bank are unlikely to increase much from the current $1.6 billion annual level. Therefore, we believe that an austerity program considerably more stringent than the better case scenario would have to be implemented sometime before the 1990 elections. [redacted]

Stringent austerity measures, however, are likely to provide populist politicians the opportunity to develop a powerful constituency among disenfranchised groups such as students, farmers, and labor. Effective protests from these elements are likely to develop slowly, because political party organization atrophied during martial law. If repatriation of Pakistani migrant workers occurs rapidly, the already glutted domestic labor market will be unable to absorb the influx, increasing the possibility of widespread political unrest. [redacted]

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

As Pakistan's foreign payments situation deteriorates, we expect Islamabad to blame the United States for providing inadequate aid while, at the same time, increasing pressure on Washington to provide more help. At a minimum, Islamabad will press the United States to intervene with the IMF for less restrictive targets on currency devaluation, tax reform, and subsidy reductions, in return for a standby agreement. They are also likely to request rescheduling on outstanding FMS obligations and the conversion of new disbursements to grants.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Briefs

Energy

Iran May Increase Oil Production

The need for revenue probably will prompt Iran to increase oil production by early summer. Oil Minister Aqazadeh announced during the recent OPEC conference that, if the group failed to reach agreement to reduce output, Iran would increase its production. 25X1 25X1

Iran 25X1 probably will restrict exports for several more weeks as it continues to press OPEC—particularly Saudi Arabia and Kuwait—for production cuts. Iran has the capacity to increase exports by about 800,000 b/d within a few months, if it can find buyers and if Iraqi attacks do not damage export facilities further. 25X1

Malaysia Maintaining Oil Output

Kuala Lumpur announced last week that it would continue to produce 510,000 b/d of oil at its current price of about $16.45 per barrel despite the recent OPEC request to cut output. At the March meeting in Geneva, OPEC asked the five non-OPEC observers—Malaysia, Egypt, Mexico, Oman, and Angola, whose production equals roughly one-fourth of OPEC's 18 million b/d—to cut output by up to 20 percent although Britain and Norway—the other major non-OPEC producers—continued to ignore such requests. In a show of support for market stabilization, Malaysia temporarily cut production by 40,000 b/d to about 410,000 b/d last summer but restored output to about 440,000 b/d within a few months. We believe that the loss of as much as $1 billion in annual revenues from recent oil price declines will adversely affect the country's development plans, making Kuala Lumpur unwilling to incur further production cuts. Malaysia, however, probably could not increase oil production much further now without damaging the ultimate recovery potential of its fields. 25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Effect of Sanctions on Libyan Oil Industry

As of mid-March, there were no impediments to oil company operations resulting from the US sanctions. [redacted] 25X1 [redacted] 25X1 US-origin oilfield and pipeline equipment can be purchased easily in Western Europe from third parties because there is no control over end user certification. Western oil industry workers—mostly Canadians, Britons, West Germans, and Austrians—have taken the place of those US oil workers who have left permanently. Moreover, many US nationals have reportedly returned to Libya after leaving for Malta at the end of January 1986. [redacted] 25X1 the main problems in the Libyan oil industry are a result of falling oil prices, which could reduce Libyan oil revenues to only $6 billion this year—down from $11 billion in 1985. Reduced revenues are causing cutbacks to maintenance and development plans. Libya should be able to maintain its current production of about 1 million b/d over the next few years without major expenditures for exploration and production because of its significant excess production capacity. [redacted] 25X1

Spain Requests Algerian Gas Price Reduction

Spain is pressing Algeria to reduce the price of liquid natural gas (LNG). Madrid wants to bring the price of imported LNG in line with the state-administered domestic gas price, which is tied to the price of oil. The price differential has led to huge losses for ENAGAS, the state-owned natural gas firm, requiring large government subsidies. Moreover, ENAGAS's shaky financial situation has slowed its efforts to expand pipelines and develop other infrastructure projects that could generate sufficient demand for the growing supply of LNG. Current demand is well below supply, and under a 1985 agreement Spain is committed to double its LNG imports from Algeria by 1992. Madrid probably will not risk a termination of the contract, because Algeria supplies about two-thirds of Spain's natural gas consumption. Moreover, in light of the dispute with Morocco over two Spanish enclaves and the government's desire to maintain balanced relations with North Africa, Madrid is unlikely to risk a major confrontation with Algiers. [redacted] 25X1

International Finance

Nigeria's Unresolved Debt Problems

Nigeria's reported agreement last week with commercial creditors in London on a 90-day debt moratorium will not offset the decline in oil export earnings, and the press reports that Lagos will request a similar standstill from official creditors this month. Lagos obtained preliminary approval to roll over principal payments through June in the talks with bankers—who hold about 40 percent of Nigeria's $19 billion external debt. The request followed President Babangida's announcement last January that debt service would be limited to 30 percent of export earnings. According to US Embassy estimates, Nigeria's 1986 debt obligations total $5.4 billion, roughly three-fourths of projected export revenues of $7 billion. [redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Bolivia's Negotiations With the IMF

The Paz Estenssoro government hopes to conclude a $57 million IMF standby agreement by mid-May to lay the groundwork for commercial bank debt rescheduling, release aid from other sources, and assist domestic recovery. In return, according to the US Embassy, La Paz pledges to reduce its fiscal deficit from 13 to 5.8 percent of GDP, hold inflation to 85 percent in 1986, and limit foreign exchange reserve losses to $20 million. Once the agreement is in place, Bolivia plans to approach foreign commercial banks to begin negotiations on rescheduling $850 million in commercial debt.

25X1

Thai Financial Jitters

The probable collapse of a Thai conglomerate is intensifying concern among the financial community in Bangkok and may cause some foreign bankers to reassess their exposure in Thailand, according to the US Embassy. About $70 million in loans from large Thai and foreign banks—including at least two US banks—reportedly would be at risk should Paul Sitthi-Amnuay Enterprises (PSA) go bust. Although the group's collapse probably would not seriously destabilize Thailand's financial system, the PSA debacle has renewed concerns over the quality of assets held by the Thai banking sector, which was shaken by the failure of several finance companies two years ago. As a result, Bangkok is likely to further tighten its regulation of financial markets and may give the Central Bank more powers to intervene.

25X1

International Trade

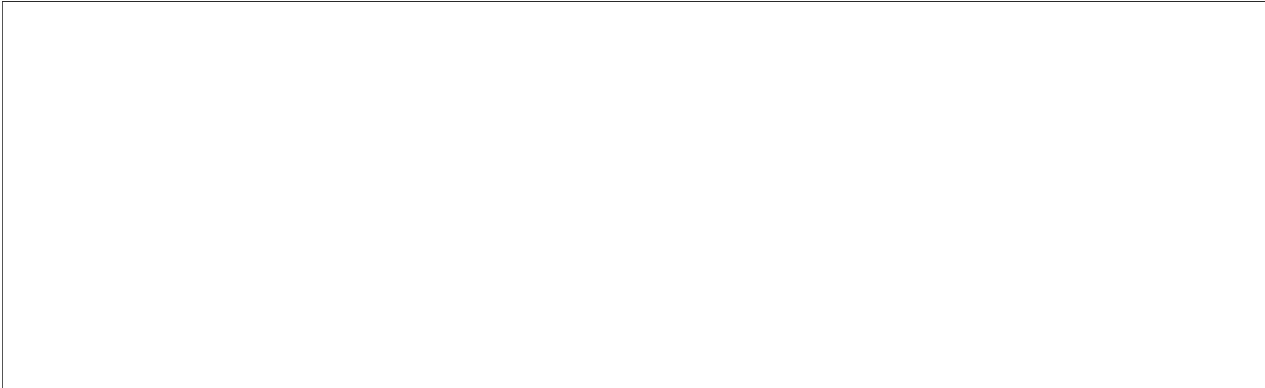
US Textiles Talks With Hong Kong

According to US Consulate General reporting, Hong Kong remains skeptical and uncompromising on the US request for a "standstill" on textile exports. During recent bilateral discussions, Hong Kong criticized the United States for reopening negotiations and changing rules of origin. It was also critical of US attempts to allow poorer LDCs to increase textile exports, at the expense of "middle income" exporters, such as itself, and not at the expense of OECD textile exporters such as the EC. Hong Kong implied that there are "connections" between US–Hong Kong bilateral discussions, the Multifiber Arrangement negotiations, and the new GATT round. According to Consulate reports, Hong Kong's uncompromising attitude may be dictated by a desire to maximize its concessions from the United States, and to see how bilateral negotiations with other major Asian suppliers progress. Hong Kong's negotiators know Washington is under pressure to curb imports from the "Big Three"—Hong Kong, South Korea, and Taiwan. Nonetheless, Hong Kong was careful not to close the door to further discussions, which could take place in April.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5



25X1

Global and Regional Developments

Per Capita GDP Slump of Key LDC Debtors Continues

Continuing the trend of the last five years, per capita real GDP in the key LDC debtors is projected to fall again this year. During 1981-85, Nigeria, Venezuela, and Argentina registered declines of 17 to 22 percent. Brazil and Mexico experienced downturns of only about 3 to 4 percent. During 1986, Brazil will be the major bright spot with a 1.7-percent gain—considerably less than last year's remarkable performance, however. Mexico, Venezuela, and Nigeria, hard hit by sagging oil prices, are expected to post the steepest declines.

25X1

Key LDC Debtors: Real Per Capita GDP Growth, 1981-86 [a]

Percent

	1981	1982	1983	1984	1985	Total 1981-85	1986 [b]
Total	**−2.1**	**−3.3**	**−5.5**	**0**	**0.9**	**−9.7**	**−1.5**
Argentina	−7.8	−6.3	1.4	0.4	−5.3	−16.8	−1.5
Brazil	−3.7	−1.3	−5.3	2.2	5.9	−2.6	1.7
Chile	3.8	−15.6	−2.3	4.1	0.3	−10.6	0.2
Mexico	5.1	−3.1	−7.6	1.0	1.2	−3.8	−5.2
Nigeria	−6.1	−5.1	−5.4	−3.9	−3.8	−22.0	−5.5
Peru	0.4	−1.7	−14.1	2.0	−0.7	−14.1	−0.6
Philippines	0.4	−0.6	−1.2	−6.8	−6.1	−13.8	−0.5
Venezuela	−3.3	−2.2	−8.2	−3.8	−3.1	−19.1	−2.7

[a] Data based on 1984 US dollars.
[b] Projected.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Japanese Businessmen Consider Investment in the Caribbean

According to the US Embassy, last month a Japanese delegation visited several Caribbean countries and made a positive assessment of the investment potential in the region. This is due in part to tax incentives available under the Caribbean Basin Initiative and the region's proximity to the US market. We believe Japanese companies will increase investment in Jamaica because of past private-sector economic cooperation. Access to the US market will remain an important stimulus, especially if trade tensions worsen between Japan and the United States. Elsewhere in the region, however, we believe investment will be delayed for at least the next year or two because of concerns about labor relations and the quality of labor and materials. In Trinidad and Tobago, for example, companies operating there stressed labor problems—including absentee rates of up to 30 percent—in talks with Japanese businessmen.

25X1

EC-GCC Petrochemical Talks

Representatives from the EC and the Gulf Cooperation Council (GCC) will meet in Riyadh next week to discuss their dispute over GCC petrochemical exports. The GCC countries are seeking a much more open market for their petrochemicals in the Community, but EC members—especially France and Netherlands—are opposed. The EC reportedly is hinting it will propose a solution that will involve the United States and Japan, but it has failed to present specifics. Although the two sides are still far apart on the issue, the EC may again make small concessions to facilitate slightly higher Saudi petrochemical sales.

25X1

Saudi Arabia Supplies Oil to Sudan

According to the US Embassy in Khartoum, Saudi Arabia has agreed to provide, gratis, 2.9 million barrels of crude oil to Sudan. Sudanese petroleum officials have confirmed that the first consignment of 365,000 barrels has already reached Port Sudan. The Saudi deliveries will cover most of Sudan's petroleum requirements through June and will help eliminate the threat of crippling fuel shortages during the critical period following the April elections as well as free Khartoum from short-term dependence on Libyan crude. Libya has provided, over the past six months, 2.2 million barrels of crude to Sudan, but promises of future deliveries have remained vague and contingent upon future political cooperation with Tripoli.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

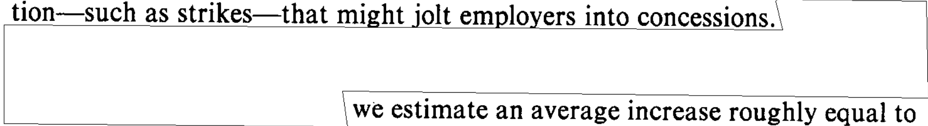
National Developments

Developed Countries

25X1

Substantial Japanese Wage Hike Unlikely

Although Tokyo's economic stimulus package due for release in early April may recommend higher wages and fewer hours, this year's national wage negotiations *(shunto)*—traditionally concluded for the major unions during the second week of April—will probably yield meager increases. The business sector is determined to keep the wage hikes modest, insisting they be linked to productivity, while the rank and file appear unwilling to support the kind of action—such as strikes—that might jolt employers into concessions.



25X6

we estimate an average increase roughly equal to last year's 4 to 5.5 percent, which would do little to boost domestic demand. Wage hikes in some depressed industries may even be less. For example the US Embassy reports the steelworkers union has agreed to a 3-percent raise, while two unions in the troubled shipbuilding industry are not even seeking increases this year.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Japan Promoting Its Aircraft Industry

MITI recently introduced into the Diet a revision of the 1958 Aircraft Industrial Promotion Act to establish a fund for the development phase of international joint ventures. Funding would come from low-interest Japan Development Bank loans, private capital subscriptions, loan guarantees, and government subsidies. Japan's aircraft industry has been hampered by ballooning development costs, fierce international competition, and a small domestic market. [redacted] 25X1 25X1 the Japanese industry is far too small to gain more than 10 percent of the world market. Moreover, the policy change probably reflects Tokyo's recognition that the Japanese aircraft industry would not be able to manufacture large jet aircraft independently. [redacted] 25X1

West Germany Resuming Modest Denationalization

Bonn will sell portions of three nationalized companies this year in its next cautious step toward reducing the government role in the economy. In June, Bonn will sell 40 percent of VIAG, the large energy, chemicals, and aluminum firm. In June and September, respectively, Bonn will substantially increase the capital of Prakla-Seismos, a major gas and oil exploration firm, and IVG, an industrial holding company, and offer about 45 percent of the new stock to the public. In addition, the federal railway will reduce its 100-percent holdings in a bank and a transport firm to 25 percent. [redacted] 25X1 Bonn's only previous denationalization involved reducing its stake in the Veba energy conglomerate from 44 percent to 25 percent in 1983. Finance Minister Stoltenberg's much more ambitious 1982 privatization program encountered unexpected strong political opposition, most notably from Minister President Strauss of Bavaria, where a number of the privatization candidates are headquartered. [redacted] 25X1

Another Danish Austerity Package

Denmark has announced the second austerity package in four months in an effort to curb the current account deficit, but the measures are unlikely to be successful. The measures, which raise taxes on energy, a variety of consumer and durable goods, and share transfers, narrowly passed parliament on 21 April. The current account deficit reached $2.7 billion in 1985, 30 percent higher than the government had expected. The government felt compelled to implement the package because of a more-than-doubling of the seasonally adjusted trade deficit for the three months ending in January compared with the same period a year ago, and probably because of a significant decline in foreign exchange reserves in February. Furthermore, a published study showed that Denmark's export competitiveness deteriorated in the second half of 1985. Nonetheless, the higher taxes will only partially offset the stimulus to import demand from rising real incomes, falling interest rates, rising employment, and lower oil prices. [redacted] 25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Less Developed Countries

25X1

Nicaraguan Port Construction

Expanded port facilities at El Bluff could be operational next year. Work is progressing for a berthing area capable of accommodating 20,000-ton ships. The roughly $100 million project, undertaken primarily with Bulgarian—and to a lesser extent Soviet and Dutch—assistance will give Nicaragua its first Caribbean deepwater port and direct access to the Atlantic. It will save the regime some $10 million annually in transportation costs. Currently, large merchant ships from Europe must go through the Panama Canal and use the Pacific coast harbor of Corinto, the country's only deepwater port. The project also will improve Nicaragua's ability to unload arms shipments arriving at El Bluff.

25X1

Ethiopia Agrees to Agriculture Reforms

Ethiopia has told the EC it would initiate agricultural reforms in exchange for additional development assistance, according to the US Embassy. The reforms reportedly include lower state quotas for sales by peasant associations and collectivized farms, the removal of restrictions on interregional grain trade, and an adjustment of official prices. Addis Ababa probably consented to the changes because of continued declines in agricultural productivity and living standards and the refusal of major donors to commit funds to agricultural projects without policy reform. In addition, Moscow reportedly has encouraged Chairman Mengistu to improve agricultural performance before proceeding fully with collectivization. The new measures, if effectively implemented, could help reverse the decline in Ethiopian agricultural production but would take several years to close the food gap. We believe the Ethiopian leadership probably views these reforms as a temporary measure and will pursue collectivization as soon as the current crisis eases.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Communist

Lack of Progress on Sino-US Investment Treaty

Recent reporting from the US Embassy indicates that negotiations for a Sino-US Bilateral Investment Treaty (BIT) continue to be stymied by Chinese reluctance to concede on three points: protecting foreign investors from future changes in Chinese domestic law, guaranteeing full value compensation for expropriation, and delineating what disputes may be settled through international arbitration. We believe the Chinese are in no hurry to sign the BIT because the lack of a treaty apparently has not slowed investment—US firms are major investors in China. Furthermore, about 20 nations have either signed or are negotiating with China investment treaties that lack these guarantees.

25X1

China Adopts Controversial Mining Law

China's National People's Congress adopted a controversial law in March that, as of 1 October, requires individuals and collectives that mine coal, gold, iron ore, and other minerals to obtain a license and pay an unspecified resource exploitation tax. It also requires reclamation work and prohibits unsafe mines. The law will mainly affect China's 61,000 small-scale coal mines, which produced 243 million metric tons of coal last year, over 28 percent of China's total output. Small-scale mining has grown rapidly in China since 1983 when Beijing began allowing peasants to set up local mining operations. Complaints have surfaced in the coal industry, however, that these mines have caused environmental damage and overlapped larger state mines. Although significant mine closures are unlikely because many rural areas have become dependent on these small-scale mines for much of their coal supply, the law provides several mechanisms to shut down more mines if Beijing chooses.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

25X1
Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Page Denied

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5

Declassified in Part - Sanitized Copy Approved for Release 2011/12/12 : CIA-RDP88-00798R000300100005-5