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International Economic & Energy Weekly

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Synopsis

1 **Perspective—Latin American Debt: The Risks in Financial Brinksmanship**

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The international cooperation that has sustained debt negotiations between Latin American governments and their international creditors increasingly is under stress. Although the main intent of the debtors may be to prod the US Government and world bankers into pursuing new solutions to the debt problem, a showdown in key financial negotiations could precipitate a financial crisis that neither side really wants.

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3 **Latin America: Export Difficulties in the 1980s**

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The growth of Latin America's export earnings, which is critical to the region's debt servicing capabilities, has slowed considerably from a robust average annual pace of 18 percent in the 1970s to 5 percent during the 1980s. To restore rapid export expansion, we believe Latin American countries will have to take a more active role in enhancing the competitiveness of their products to compensate for the lack of vigorous OECD economic growth.

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7 **Gorbachev's Industrial Modernization Program: From Strategy to Implementation**

25X1

Gorbachev has outlined a strategy to revitalize the stagnant Soviet economy, but has yet to translate the strategy into a fully consistent plan of action. If his modernization program does not begin to show results soon, the gap between Western and Soviet technology is likely to widen during the 1990s, thus threatening the USSR's capability to match the productivity of the industrial West in critical areas.

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11 **Bolivia: Struggling for Economic Recovery**

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The economic stabilization program launched by President Paz Estenssoro last August has achieved sufficient success to persuade some foreign lenders to offer new credits. We judge, however, that the government's efforts to sustain an economic recovery will be constrained by its limited ability to attract foreign investment, boost exports, and resist inflationary wage pressures from leftist labor unions.

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15 **China: Alternative Energy Sources for Rural Development** 25X1

China's interest in developing alternative energy sources, such as solar, wind, and biogas power, stems largely from problems in supplying the growing demand for energy in rural areas. Alternative sources alone will not solve the rural energy problem, and, to minimize foreign exchange costs, however, we expect China to seek technology transfers or coproduction agreements rather than large purchases. 25X1

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International Economic & Energy Weekly

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Perspective

Latin American Debt: The Risks in Financial Brinksmanship

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The international cooperation that has sustained debt negotiations between Latin American governments and their international creditors increasingly is under stress. Since late 1985, the region's governments have taken tougher positions and are sticking to their guns longer than in the past. Although the main intent of the debtors may be to prod the US Government and world bankers into pursuing new solutions to the debt problem, a showdown in key financial negotiations could precipitate a financial crisis that neither side really wants. At a minimum, we believe that financial brinksmanship could paralyze existing mechanisms for mediating debt problems.

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Brazil, Latin America's largest debtor, started the trend when it rejected a formal agreement with the IMF as a basis for rescheduling its commercial debt last fall. It has negotiated with its private creditors without budging from this position, but the tentative agreement reached with the banks in March has yet to be ratified. Meanwhile, Brasilia took the same position with the Paris Club, although an IMF agreement is a prerequisite for opening talks. Paris Club members also want the Brazilians to become current on interest payments, but Brasilia has proposed paying only 15 percent of the overdue amount.

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Upon taking office last year, ***Peru***'s Garcia administration announced that it would not negotiate with the IMF to obtain financial assistance. It also limited debt service payments to the value of 10 percent of exports. Creditors responded by placing new financial assistance agreements on hold and reducing their trade credits. Today, Peru and its creditors are still at loggerheads.

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Talks between other Latin debtors and their creditors also have become more confrontational:

- ***Mexico*** surprised its bank advisory committee in February with an estimated $9 billion financial gap for 1986. The Mexicans backed off in the face of vehement bank opposition to extending new loans without a government commitment to economic reform. Unlike in 1982, however, Mexico City has not acceded to creditor demands and is still wrangling with the IMF over conditions for an agreement.

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- ***Venezuela*** in May invoked a contingency clause in its rescheduling accord to reopen negotiations before the agreement entered into force. The banks, however, refuse to start negotiations as long as Caracas has not made the $750 million downpayment specified in the accord. The Venezuelans, in turn, may seek $600 million in new money—without IMF conditions—to ease the drain on their reserves

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We believe that Latin American governments have become even more frustrated over a debt bind that perpetuates slow economic growth. With interest payments taking a growing share of export earnings, if they fully service their debts, the capital outflows would hold down investment and economic growth. On the other hand, refusal to make scheduled interest payments would probably lead creditors to retaliate by cutting trade and development finance, which several past econometric studies have shown also would reduce GNP growth for the rest of the decade.

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For their part, we believe that foreign creditors have toughened their positions because they are in better financial shape than at any time since the debt crisis surfaced in 1982. Press reports indicate that most banks worldwide have lowered their exposure in Latin America relative to capital and have built up loan loss reserves

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Moreover, many creditors believe that Latin American countries—including Mexico—need stronger prodding to undertake serious economic adjustments.

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In contrast to 1982 and 1983, debtors and creditors increasingly are losing patience with protracted negotiations and with the perceived unwillingness of the "other side" to agree on solutions. In the Mexican negotiations, each side may be looking to Washington to intervene to avoid a financial crisis with the view that a tougher stance will yield a more favorable compromise.

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Latin American leaders are watching Mexican developments closely. Venezuela and Chile, in particular, seem to be delaying their own negotiations, hoping to cash in on any concessions granted Mexico. If Mexico succeeds with a unilateral payments moratorium, we believe that, over time, other debtors could adopt similar tactics, making compromises harder to achieve. Under such conditions, a temporary suspension of payments could become an indefinite moratorium that leaves a pile of bad debt on the books of creditors. At that point, both debtors and creditors could pressure Washington to come up with a solution.

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Latin America: Export Difficulties in the 1980s [1]

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The growth of Latin America's export earnings, which is critical to the region's debt servicing capabilities, has slowed considerably from a robust average annual pace of 18 percent in the 1970s to 5 percent during the 1980s. In our judgment, the dramatic deceleration of Latin American exports has mainly been the result of unfavorable trends in industrialized country—especially West European and Japanese—markets, which normally absorb more than 70 percent of the region's foreign sales. Notable among those trends have been a decline in OECD growth, a rise in industrialized country protectionism, and a significant increase in the value of the dollar against the West European and Japanese currencies. Government policies in Latin America are not, on average, strongly conducive to export growth, and they have not changed significantly since the 1970s. To restore rapid export expansion, we believe Latin American countries will have to take a more active role in enhancing the competitiveness of their products to compensate for the lack of vigorous OECD economic growth.

Commodity Exporters Hardest Hit

A sluggish OECD aggregate economic growth rate of 2.3 percent over the past five years not only has dampened general demand for foreign goods in the industrialized countries, but also has indirectly set back Latin American exports by contributing to a fall in commodity prices. Indeed, slumping international prices for agricultural products, raw materials, and fuels—which together account for more than 75 percent of total Latin American exports—explain much of the decline in the growth of regional exports in the 1980s. In addition to the decline in world oil prices in the 1980s, world recession has cut short the commodity booms in the 1970s that drove up the prices of Latin American exports of bananas, coffee, copper, fishmeal, sugar, soybeans, and meat.

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The export performances in OECD markets of individual countries or groups between 1979 and 1985 have varied dramatically:

- ***Brazil*** and ***Mexico***, the region's two largest exporters, recorded major export gains in part because of their large and well-developed industrial sectors. Also, Brazil pursued aggressive export promotion policies, while Mexico benefited from large new oil finds and production increases.
- The export earnings of other major oil producers, such as ***Venezuela*** and ***Trinidad and Tobago***, either fell or rose only slightly during the 1980s as oil prices surged at the turn of the decade and later slumped.
- ***Chile*** and ***Jamaica*** experienced sharp declines in their export earnings as the prices of copper and bauxite plunged in recent years.
- The exports of major agricultural producers, including Argentina and a number of small Central American and Caribbean countries, fared poorly as prices for grain and sugar nosedived.

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Shifting Patterns of Trade With the OECD

Latin America's exports to major industrialized countries in 1984-85 averaged $77 billion, up $16 billion from the 1979-80 period. To a degree,

[1] We relied on the industrialized partners' trade returns to construct a comprehensive and reliable data series extending from 1979 through 1985 because comparable statistics generated by Latin American governments were far less complete, especially for recent years. As a result, data for Latin American exports are actually partner country imports, c.i.f. We used two-year dollar value averages for 1984-85 and 1979-80 to reduce single-year phenomena, such as the sharp increase in the international price of oil that occurred between 1978 and 1980.

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Latin America: Commodity Export Prices, 1981-85

Index: 1980=100

	1981	1982	1983	1984	1985
Bananas	107.0	99.9	114.4	98.5	101.2
Cocoa	81.7	63.8	77.6	98.4	88.8
Coffee	76.8	83.4	84.9	93.7	88.6
Fishmeal	92.7	70.1	89.7	74.0	55.5
Iron ore	90.4	96.2	88.0	84.8	83.2
Soybeans	97.4	82.5	95.1	95.2	75.8
Sugar	58.9	29.3	29.5	18.1	14.1
Wheat	111.7	91.9	79.1	73.4	65.0
Bauxite	101.8	98.1	84.5	77.6	77.3
Copper	82.9	71.9	76.8	66.0	64.7

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the disparity in imports from Latin America among individual OECD countries paralleled differences in the growth of each country's economy. For example, the United States and Japan, which recorded higher average annual GDP growth than other OECD countries during the 1980s, increased their imports from Latin America at a faster rate than did the countries of Western Europe.

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The United States considerably outperformed all other industrialized countries in expanding its purchases of Latin American goods, partly because of relative exchange rate movements and lower import barriers. The region's exports to Japan and Western Europe, particularly manufactures, were hurt by the appreciation in the early 1980s of the US dollar—to which most Latin American currencies are linked:

- Despite its modest 2.3-percent average annual GDP growth in the 1980s, the United States hiked its imports from Latin America—mostly manufactured products—7 percent per year.
- Japan, Canada, and Spain raised their imports from the region at rates varying between 3 and 6 percent per year, with particular emphasis on foodstuffs and petroleum.
- Exports to EC countries performed relatively poorly. Purchases of Latin goods by West Germany, France, and Italy each rose less than 2 percent a year (UK imports actually declined because of that country's break in trade relations with Argentina).

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Protectionism in the OECD

In contrast to the progress on trade liberalization in the 1970s, depressed growth and soaring unemployment in industrial countries in the 1980s have caused a number of governments to succumb to mounting demands at home for greater import restraints. Although tariff rates continue to impede trade flows in some instances, the World Bank notes that the more serious obstacle to Latin American exports has been the growing use of nontariff barriers (NTBs), especially in Western Europe. According to Bank analysis, by the early 1980s 22 percent of EC imports from developing countries were subject to NTBs, 10.5 percent of Japan's imports and 12.9 percent of US imports.

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Latin America: Annual Average Exports to Major OECD Countries

Million US $, c.i.f.

	Argentina	Brazil	Chile	Mexico	Venezuela	Andean	Central America	Caribbean	Total
	1984-85								
Total	**3,867**	**17,165**	**2,619**	**25,964**	**10,727**	**7,305**	**3,810**	**6,032**	**77,489**
Foodstuffs	2,019	6,658	670	1,950	120	3,063	2,761	1,381	18,622
Coffee	1	2,281	1	393	20	1,737	1,128	171	5,732
Sugar	99	192	2	51	0	117	250	510	1,221
Bananas	0	2	1	23	6	596	893	104	1,625
Beef	99	116	0	9	0	0	117	11	352
Raw materials	761	2,979	722	767	211	957	342	547	7,286
Iron ore	0	1,710	162	0	184	54	0	0	2,110
Copper	0	2	198	82	1	38	1	5	327
Bauxite	0	88	0	0	18	0	0	453	559
Fuels	271	499	2	13,537	9,559	1,943	74	2,303	28,188
Manufactures	799	6,895	1,213	9,179	774	1,283	569	1,676	22,388
Clothing, textiles	54	616	2	369	1	223	194	458	1,917
Iron, steel	109	1,066	6	219	177	39	0	121	1,737
Copper mfg.	2	45	1,009	64	0	363	0	0	1,483
Other	17	134	12	531	63	59	64	125	1,005
	1979-80								
Total	**4,145**	**10,994**	**2,951**	**13,700**	**9,730**	**7,358**	**4,465**	**7,810**	**61,153**
Foodstuffs	2,251	5,237	412	1,950	85	3,469	3,363	1,643	18,410
Coffee	0	1,946	0	525	17	2,394	1,602	228	6,712
Sugar	97	442	2	90	0	149	316	773	1,869
Bananas	0	0	0	3	0	394	766	77	1,240
Beef	269	5	0	8	0	2	271	5	560
Raw materials	911	2,632	991	693	264	1,129	481	819	7,920
Iron ore	0	1,668	236	0	256	92	0	0	2,252
Copper	0	0	148	70	0	59	3	0	280
Bauxite	0	37	0	0	0	0	0	706	743
Fuels	136	47	11	6,123	8,971	1,250	26	4,402	20,966
Manufactures	798	3,000	1,493	4,603	370	1,445	419	822	12,950
Clothing, textiles	43	431	2	303	0	195	118	185	1,277
Iron, steel	25	462	4	69	75	6	0	118	759
Copper mfg.	1	8	1,340	24	0	466	0	0	1,838
Other	49	78	44	331	40	65	176	124	907

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OECD Countries: Average Annual GDP Growth and Import Growth From Latin America, 1981-85

Percent

	GDP	Imports [a]
United States	2.3	7.0
Spain	2.2	3.0
Canada	2.2	3.2
West Germany	1.2	0.8
France	1.2	1.9
United Kingdom	1.6	−2.6
Italy	0.8	0.7
Benelux	0.6	2.6
Japan	4.3	5.7

[a] Growth derived from a 1979-80 data base.

Restraints on agricultural trade have proliferated. While the overall dollar value of Latin American agricultural exports to the OECD remained relatively constant during the 1980s, Western Europe's absorption of these commodities declined while those of the United States and Japan went up, probably in part because of tighter European import restraints. Overall, Latin American exports of beef and sugar have been hit the hardest. For example, the EC generally imposes tariffs and import quotas on both commodities. Only Barbados, Jamaica, Guyana, Trinidad and Tobago, and a few smaller countries in the region—members of an EC preference scheme largely for former colonies—were exempt

Protectionist barriers against imports of Latin American manufactures, though not as extensive as restraints on agricultural trade, have been growing more rapidly, according to the Inter-American Development Bank. Our research indicates that, although limitations on imports of manufactured products are on the rise throughout the OECD, they are more restrictive in Western Europe and Japan than in the United States. While the value of US purchases of manufactured goods originating in Latin America more than doubled since the beginning of the decade, purchases by most other industrialized countries remained at previous levels or declined.

In specific markets, Latin America has had particular difficulty expanding its sales of products that compete with OECD industries that are either labor intensive or are plagued by world overcapacity and low demand. The EC countries in the late 1970s were the leaders in urging tougher restrictions on trade in textiles and clothing during negotiations for the renewal of the Multi-Fiber Arrangement and they concluded voluntary restraint agreements (VRAs) with eight Latin American, as well as 18 other, textile exporters. Also, both the European and Japanese governments have moved to restrict imports of Latin metal products. For example, quantitative limits imposed by Tokyo on imports of copper and copper products had contributed to declining imports from Chile and Peru. In the early 1980s, EC countries took steps to restrain imports of steel—including VRAs with major Latin American and other suppliers—to protect major parts of Western Europe's steel industries.

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Outlook

In our judgment, Latin America will not be able to count on robust industrialized country economic growth to spur major increases in its regional exports as it has in the past. Most forecasters believe that OECD growth over the next few years will at best speed up slightly to the 2.5 to 3.0 percent level and that a major rebound in commodity prices is unlikely. They also indicate that it probably is unrealistic to expect industrialized countries to roll back existing import restraints in a major way at a time when domestic demand is low and their own industrial structures are threatened. Accordingly, we expect that Latin American governments and businesses will be forced to undertake significant reforms and cost-cutting measures aimed at making the region's products more competitive on world markets to enhance their export prospects. For example, Latin countries may restructure their existing array of commercial, credit, and fiscal policies to provide greater export incentives. Despite the recent depreciation of the US dollar, additional devaluations will be necessary to enhance the competitiveness of Latin American goods.

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Gorbachev's Industrial Modernization Program: From Strategy to Implementation

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Gorbachev has outlined a strategy to revitalize the stagnant Soviet economy, but has yet to translate the strategy into a fully consistent plan of action. The Gorbachev and Ryzhkov speeches at last week's party plenum and sessions of the Supreme Soviet failed to clear up many of the gaps and contradictions in published economic plans that suggest continuing debate concerning appropriate modernization policies. Delays in developing such policies could signal a rocky road for Gorbachev. If his modernization program does not begin to show results soon, the gap between Western and Soviet technology is likely to widen during the 1990s, thus threatening the USSR's capability to match the productivity of the industrial West in critical areas.

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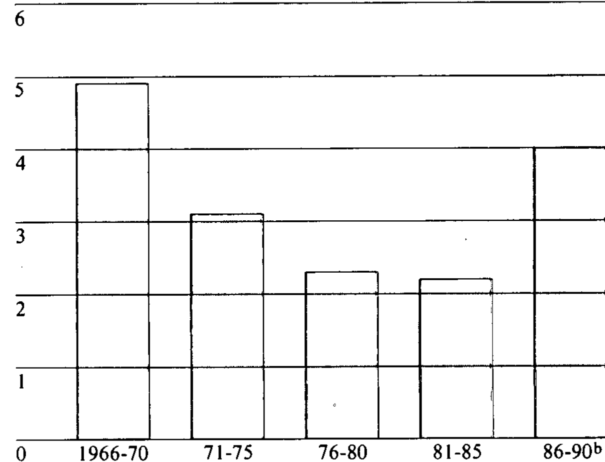
Overall Strategy

Since Gorbachev became General Secretary, official pronouncements emphasizing the importance of industrial modernization have become more urgent. In his address to the April 1985 Party Plenum, Gorbachev painted a bleak picture of the current level of Soviet technology, "S&T progress in the majority of industries is flagging . . . progressing in an evolutionary way when what is required is revolutionary change." This speech was soon followed by a special conference, held in June, to develop a strategy to deal with the issue. Since the conference, the economic plan for 1986 and the 1986-90 Five-Year Plan with guidelines to the year 2000—approved just last week by the Supreme Soviet—have set ambitious growth goals and have enshrined industrial modernization as Moscow's number-one domestic priority. Modernizing industry will require years of effort:

- Gorbachev is relying on the more efficient use of existing resources—primarily through discipline, his antialcohol campaign, less waste, and improved worker effort—to prompt an immediate growth dividend that can support future modernization. This growth dividend itself will be supported by organizational changes to "streamline" management and speed industrial innovation by bringing R&D closer to the production line.

- Modernization is to be achieved within a framework of renovating existing plants rather than building new ones. To provide the equipment to be installed in these renovated plants, the machine-building and metalworking sector (MBMW) will itself undergo rapid modernization. Investment in civilian MBMW is scheduled to grow 80 percent over the next five years, with special emphasis on the sophisticated technologies

USSR: Average Annual Growth of GNP, 1966-90[a]



[a] Estimates using 1982 sector-of-origin factor-cost weights.
[b] Projection using official Soviet plans.

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that have led modernization efforts in the West—machine tools, measuring instruments, and computers, for example.

Gorbachev clearly hopes that large investments in these technologies today will pay off in the 1990s with increasing output of high-technology equipment to spur the economy. In the meantime, he intends to achieve growth primarily by accelerating the replacement of workers in labor-intensive industries with machinery that is already in stock or can be produced quickly. The leadership has declared that such increases in productivity will account for two-thirds of the planned increase in economic output during the period 1986-90. 25X1

Missing Links

Despite the more urgent rhetoric, Gorbachev's policies are, by and large, repeats or extensions of past ideas. Renovating plants instead of building new ones has been a high priority for more than 15 years. Organizational changes to speed technological change by bringing R&D closer to the production line have been tried in various forms since 1965. Even the Gorbachevian call for a "scientific-technological" revolution was a main Brezhnev theme. What is new about the current program is the vigor with which it is being pushed. Gorbachev has made impressive gains in replacing bureaucratic deadwood with younger, handpicked allies that may enable him to more successfully implement the current brew of old policies than did his predecessors.

On the other hand, bureaucratic resistance remains strong and was identified by Gorbachev at last week's plenum as a major obstacle to industrial modernization. Moreover, analysis of published economic plans and the speeches of the leadership suggest questionable linkages and, in some cases, contradictions that may reflect political divisions within the leadership and tensions between industrial modernization and other economic priorities:

- Output targets for steel and nonferrous metals seem too low to support the high rate of growth—7.4 percent per year—planned for machinery output.
- Plans for long-term growth rely largely on a retooled machine-building sector—by 1990 about 60 percent of the present stock of machinery is to be "new"—but the ambitious machine-building output goals for 1986-90 do not seem to allow the necessary downtime for enterprises to install new equipment and learn to use it.
- The plans imply that Siberia will continue to be developed on a priority basis, while, at the same time, resources for new construction will be cut back drastically throughout the economy. Just to continue development of Siberia's natural resources (especially energy) will require massive infusions of capital and labor in contrast to a growth strategy based on renovation.
- The five-year plan goals for savings of energy, metals, and other materials far exceed the low level of savings realized during 1981-85. The long leadtimes necessary to design and produce more efficient equipment make it highly unlikely that substantial savings could be realized in this decade. 25X1

Roadblocks to Modernization

Ridding the economic program of inconsistencies and contradictions will not, by itself, spell smooth sailing for industrial modernization. Indeed, Gorbachev's high expectations for MBMW raise doubt about the feasibility of his ambitious modernization goals. For his strategy to succeed, the civilian MBMW sector must be able to efficiently absorb a very large amount of investment—an 80-percent increase over 1981-85 levels—in a very short time. Moreover, it must change the structure and mix of its output to a degree unparalleled in post–World War II Soviet history. This is a difficult task for an industry accustomed to producing large lots of a small variety of equipment for use in plants being constructed under highly standardized designs. Indeed, the increased pressure to accelerate output of producer durables may prompt machine builders to sacrifice innovation for cosmetic change and reproduce the same output mix that has prevailed for years—only faster and in a more slipshod manner. 25X1

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Furthermore:

- The age and condition of plants in Soviet industry bring into question the feasibility of trying to modernize through renovation. Many facilities in the European USSR are so old that they would have to be gutted to house more sophisticated machinery.

- Planned renovation projects probably exceed the capabilities of the chronically poor-performing Soviet construction industry.

- Reallocation of investment to civilian machine building and energy may squeeze other vital sectors—especially metals and transportation—risking production bottlenecks.

- Exogenous constraints—labor shortages and rising raw material costs—will remain severe.

- Hard currency constraints and Soviet problems in using foreign technology will limit the potential contribution of imports.

It is also doubtful that the S&T revolution that Gorbachev envisions will result in large quantities of modern equipment coming off Soviet production lines in the 1990s. Creating and efficiently using advanced machinery is something the Soviet system has never done well. Today, the development of sophisticated automated technologies is a rapidly changing and high-risk business: the pace of improvements in high-technology products and production processes in the West is increasing rapidly, largely because of the free flow of information and competitive pressures in Western market economies. In the Soviet economy, where performance is judged by achievement of annual quantifiable goals and rewards are predetermined by central authorities, the rapid creation and widespread assimilation of sophisticated technologies—let alone product improvements—may be incompatible with any system of management and rewards that the Gorbachev regime is willing and politically able to implement. The relative successes of the Soviet defense industries in the past have resulted primarily from their priority access to scarce high-quality resources and the willingness of the regime to ignore the high cost of success—a condition that cannot be applied economywide.

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Prospects

Gorbachev clearly hopes that the economic dividend from his dynamic management style and no-nonsense approach will provide the breathing space necessary to work out the details of industrial modernization. We believe, over the next few years, that vigorous leadership and mobilization of effort will probably provide this economic dividend—even if industrial modernization gets off to a slow start. Nonetheless, continuing bureaucratic resistance and exogenous factors—bad weather and electricity shortages caused by the Chernobyl' nuclear disaster, for example—could make the achievement of this economic dividend difficult.

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In either case, Gorbachev is under considerable pressure to work out the flaws in his modernization strategy as quickly as possible. The military appears to have bought into the General Secretary's program to modernize the civilian economy—at least for the time being—out of the belief that defense will be a major long-term beneficiary. Because of large investments in defense facilities over the last decade, the military is well positioned to accommodate a shift in resources to civilian machine building over the next couple of years. If Gorbachev tries to curb defense demands for machine building much longer, however, the military could become restless while waiting for the spillover from improvements in the civilian technological base. If this occurs, and Gorbachev reacts by cutting resources to civilian machine building, the pace of modernization is likely to trail off, leading to an even wider East-West technology gap in the 1990s and making it more difficult for Moscow to match Western productivity gains in both the defense and civilian economies.

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Bolivia: Struggling for Economic Recovery

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The economic stabilization program launched by President Paz Estenssoro last August to strengthen the private sector and improve external accounts has achieved sufficient success to persuade some foreign lenders to offer new credits. La Paz has obtained a standby loan from the IMF and has initiated rescheduling talks with the Paris Club and commercial banks. We judge, however, that the government's efforts to sustain an economic recovery will be constrained by its limited ability to attract foreign investment, boost exports, and resist inflationary wage pressures from leftist labor unions.

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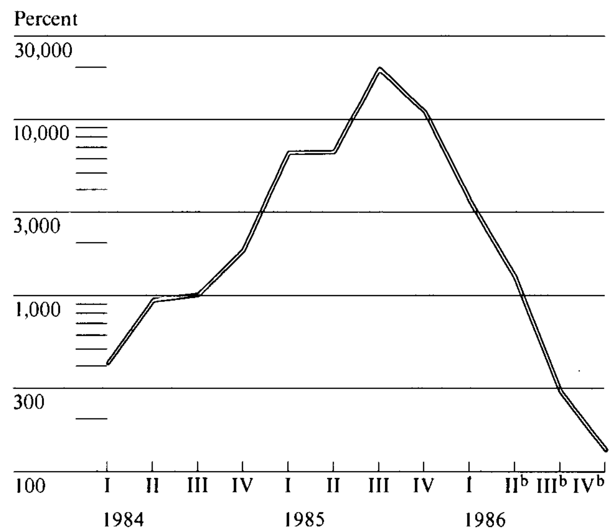
Halting the Economic Tailspin

When Paz Estenssoro took office in August 1985, the economy was in chaos. Public finances, which had been deteriorating steadily since 1982, reached a new low in 1985 when the Central Bank was forced to print money to finance the public sector, according to the IMF. Inflation was soaring at an annual rate of more than 20,000 percent in September 1985; the official exchange rate was pegged at 67,000 pesos per dollar, while the parallel rate pushed past 1 million; and arrears on the public external debt totaled more than $700 million. In addition, per capita income had fallen by about 30 percent over the past 10 years. Almost immediately, Paz Estenssoro instituted an economic program designed to stabilize the economy and to restore government control over the operations of the Treasury, the Central Bank, and state enterprises.

Although La Paz expected these measures to produce a modest recovery in the short run, hopes were dashed when the prices of key exports declined. In October, world prices for tin fell below domestic production costs, forcing several mines to close. Natural gas, which in recent years has eclipsed tin as Bolivia's largest export earner, also declined in

Bolivia: Consumer Price Increase, 1984-86 [a]



[a] Quarterly data annualized.
[b] Estimated.

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price. We estimate that export earnings will drop 10 percent and unemployment will rise by 450,000 this year. In addition, flooding around Lake Titicaca over the past eight months has left over 83,000 homeless and destroyed 12,000 hectares of crops, according to the US Embassy.

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To overcome the financial crisis, La Paz approached the IMF last year to discuss arranging its first standby loan since 1980. The bungling economic policies and payment defaults of previous administrations had dried up Bolivia's international sources of credit. Because of his domestic popularity and de facto majority in Congress, Paz Estenssoro was able to break with Bolivia's past refusal to

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Paz Estenssoro's New Economic Program

Paz Estenssoro announced his new economic plan, designed to strengthen the private sector and invigorate foreign trade, in August 1985. The plan took effect in September when he froze public-sector wages for 10 months, removed price and exchange controls, and halted runaway growth of the money supply. The program produced striking improvements, according to the US Embassy: inflation dropped from an annualized rate of 23,447 percent in September to 1,900 percent in April, the peso has stabilized in both official and parallel markets, and the government has begun to receive revenues from state enterprises.

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The government also enacted a series of administrative measures intended to strengthen the economy over the longer term. La Paz prepared its first federal budget in five years, a major step toward regaining control of the economy and providing the statistics needed to receive foreign aid and loans. It audited its Central Bank, and, according to the US Embassy, brought charges of graft against 93 former officials. Finally, it passed a comprehensive tax reform, a crucial step—Bolivia's tax revenues have amounted to less than 1 percent of GDP, the lowest share in the world. Taxes will be easier to collect and enforce and are expected eventually to equal 10 percent of GDP per year, according to the US Embassy.

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The last major step of the new economic plan is to streamline the public sector. Paz Estenssoro aims to eliminate up to 200,000 excess government positions and to decentralize large state enterprises. Enactment of this step is currently on hold, awaiting the inflow of funds from the IMF and other sources to be used for severance payments to those laid off.

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Bolivia: Financing Needs, 1986 [a] *Million US $*

Capital requirements	**1,293**
Imports of goods	609
Interest on external debt	267
Other factor payments	105
Amortization	312
Multilateral	63
Bilateral	164
Commercial banks	85
Sources	**1,293**
Exports	561
Direct foreign investment	25
Use of reserves	51
Transfers and other net service payments	4
Other capital flows (net)	62
Rescheduling (estimated)	344
Capital inflows	246
World Bank/IDA	42
IDB	66
Other multilateral	45
Bilateral	93

[a] World Bank projections.

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deal with the Fund. Standby negotiations with the IMF, originally expected to be completed by the end of January, hit a snag, however, when the economic program lost momentum. Partly in response to these developments, Paz Estenssoro reshuffled his Cabinet and directed his new ministers to revive the program. The government was able to hold prices steady in February and March, and the exchange rate stabilized. In April, Congress passed a major tax reform that the IMF deemed essential, and, in late May, La Paz and the IMF agreed on a plan to raise domestic energy prices.

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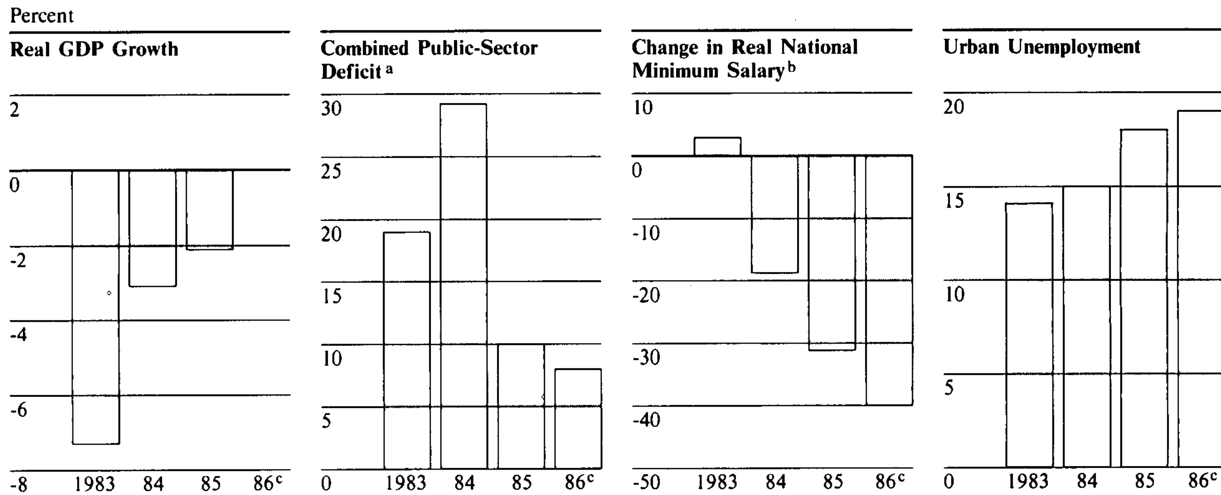
Bolivia: Economic Indicators, 1983-86



[a] As a share of GDP.
[b] First instituted in November 1982.
[c] Estimated.

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The IMF Standby and Other Financial Inflows

Approval of the $55 million standby loan on 19 June will trigger the release of project loans and aid from the World Bank and foreign governments. According to the World Bank, if Bolivia covers its external financing needs of $1.3 billion this year, it can avoid a further erosion of GDP. Formal talks with the Paris Club to reschedule some $1 billion in loans and loan guarantees took place on 24-25 June. La Paz hopes to reschedule an additional $870 million in non–Paris Club debt on similar terms and to obtain up to $143 million in new loans and aid from Paris Club lenders, according to the US Embassy. Bolivia has already met once with its commercial bank lenders, and talks will begin in earnest this summer. The banks, according to the US Embassy, have proposed to roll over Bolivia's entire commercial debt of $670 million in exchange for an $85 million cash payment this year; privately, bankers have indicated to the Embassy that they would accept $10 million. 25X1

Bolivian efforts to comply with the requirements of an IMF program are likely to be haphazard, at best. For example, demands on the federal coffers will increase this summer when La Paz removes the public-sector wage freeze and makes severance payments of an estimated $50 million to recently dismissed government employees. We believe that La Paz will find it politically difficult to deny demands for larger-than-targeted wage hikes, worsening its chances of keeping its fiscal deficit below the IMF target of 6.4 percent of GDP. In addition, the hikes in wages and domestic energy prices may rekindle inflation. 25X1

Limited potential to attract foreign investment and boost exports will hamper efforts to sustain an economic recovery. Although Paz Estenssoro's stabilization program has produced some impressive

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

	1984	1985	1986 [a]
Current account	**−129**	**−281**	**−416**
Trade balance	232	69	−48
Exports, f.o.b.	724	621	561
Imports, c.i.f.	−492	−552	−609
Services and transfers	−361	−350	−368
Net interest	−334	−317	−267
Capital account	**−163**	**−103**	**21**
Financial gap	**−292**	**−384**	**−395**
Change in official reserves	148	30	−51

[a] Estimated.

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results, Bolivia's record as an impoverished, unstable, and unpredictable nation continues to discourage foreign investment. At least for the near term, La Paz will rely solely on foreign aid to restructure and modernize its mining and hydrocarbons industries. It will also continue to look for new export markets for these products and has already approached Brazil, Peru, and Chile.

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Political Challenges to the Adjustment Program

We believe that the government has, at best, an even chance of meeting its economic goals and moving toward a long-term economic recovery. The Communist-dominated labor unions, historically a disruptive force in Bolivian politics, represent the majority of workers. Although the union movement is currently divided, worsening economic conditions, shrinking real wages, or rising taxes could lead to large-scale work stoppages and violence. Should labor agitation provoke major social unrest, the Bolivian military would most likely move to restore order, possibly intervening once again in the political process. If labor unrest or military pressure force Bolivia to seriously compromise its economic program or agreements with foreign lenders, disbursements of IMF funds and foreign aid would be delayed. With imports already cut to the bone and export performance weak, La Paz would be unable again to service its foreign debt, bringing Bolivia back to the brink of economic chaos.

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China: Alternative Energy Sources for Rural Development?

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China's interest in developing alternative energy sources, such as solar, wind, and biogas power, stems largely from problems in supplying the growing demand for energy in rural areas. Much of this growth in energy demand stems from the economic reforms implemented since 1978 to stimulate rural development. Traditional sources of energy (firewood, crop waste) are already overused, and, although China has progressed in rural development of commercial energy sources—including small local coal mines and hydrostations—many rural areas lack these resources. Although alternative sources alone will not solve the rural energy problem, they can play a major role where other resources are inadequate or impractical. Beijing is particularly interested in harnessing China's considerable solar and wind potential, and has talked with US, Swedish, and Japanese companies about acquiring appropriate technologies. To minimize foreign exchange costs, however, we expect China to seek technology transfers or coproduction agreements rather than large purchases.

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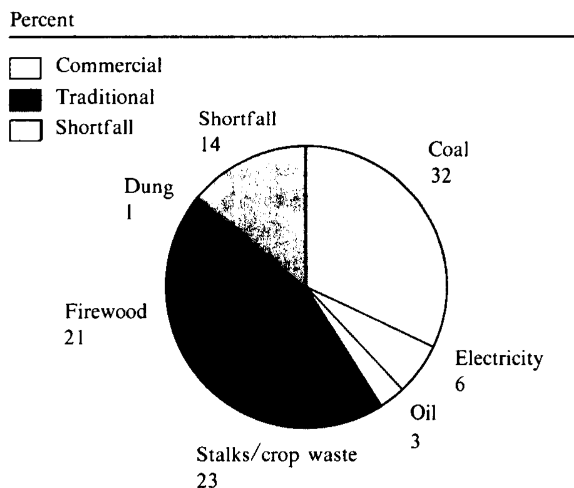
China: Rural Energy Demand, 1983[a]



Total demand = 490 million metric tons of coal equivalent

[a] Includes both household and industrial demand.

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The Rural Energy Problem

China's peasants, which comprise 80 percent of a population of more than 1 billion, have long depended on crop wastes and firewood for fuel. As the population has grown, these sources have been increasingly diverted from use as fertilizer, animal fodder, and building materials. In addition, as Chinese officials have acknowledged, widespread deforestation has brought about severe soil erosion.

To stem the growth in consumption of traditional fuels, China in the 1960s and 1970s tried to develop rural sources of commercial energy—locally run coal mines and hydropower stations—that would be more efficient and not tax national networks that supply urban areas. Beijing also tried to protect and replenish forested areas and promoted the use of innovative energy sources, such as biogas pits that use human and animal wastes to provide methane for rural cooking and heating.

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By 1984, coal had become the largest source of energy in the countryside, and small hydrostations with a capacity of less than 12 megawatts (MW) accounted for one-third of China's hydropower capacity. Even so, traditional fuels still accounted for one-half of overall energy supplies and 90 percent of rural household consumption. Deforestation remained a serious problem, and, although biogas use enjoyed some success, it provided less than 1 percent of rural energy needs.

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Rural Energy Resources: Status and Plans

Firewood/Crop Wastes. *China is trying to improve the efficiency of biomass energy consumption; currently, only about 10 percent of its potential energy is being extracted. In 1984, Beijing began a campaign to promote the use of more efficient wood-burning stoves in peasant households. According to the Chinese press, the new stoves use only one-half as much firewood as the old models. About 25 million peasant households have replaced their stoves in the last two years. Beijing hopes to have the new stoves in 100 million peasant households by 1990, saving the firewood equivalent of 33 million tons of coal per year.*

Local Coal Mines. *The sharp rise in China's local coal production actually led to a lower free market price in 1985, although by press accounts it was still four times the state price. These mines produce coal quickly by exploiting the largest veins, but make later extraction of the remaining coal much more costly. Even so, Beijing expects local mines of all sizes to supply about two-thirds of rural coal demand by the end of the 1980s.*

Small Hydrostations. *Small hydrostations provide 8,500 megawatts (MW) of China's 24,000 MW of hydropower capacity. They produce about 25 billion kilowatt-hours of electricity per year, 42 percent of total rural consumption of electricity. China hopes to at least double small hydropower capacity by the year 2000, with consumers paying all costs. Small hydropower installations are limited mostly to the south and southwest, where there is hydropower potential.*

Wind Power. *China claims to have wind potential that in Inner Mongolia alone totals 540,000 MW, nearly equal to China's entire hydropower potential but much more difficult to exploit. China produces about 10,000 wind generators per year, mostly in 50- and 100-watt sizes, compared with US generators in the 300- to 1,000-kilowatt range. China's windpower devices, moreover, have serious quality problems, and most, apparently, have had to be given away.*

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Solar. *China claims it has large areas that are among the world's most suitable for solar power. Press reports to date, however, indicate that China has used solar power for little more than solar cookers in Gansu and for greenhouses in Tibet.*

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Biogas. *China now estimates that it has 4.5 million biogas pits, supplying energy for 20 million people, and hopes to double the number by 1990. Methane pits work best in warmer regions but generally provide only a supplemental source of fuel for heating and cooking.*

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Geothermal. *China's practical sites for developing geothermal resources are limited. Most geothermal sites lie in remote mountainous areas such as Tibet, where China has built a 7-MW power plant at Yangbajing, now being expanded to 22 MW. A 3-MW generator has been ordered from Japan and is scheduled for operation by February 1987. A geothermally heated greeenhouse covering about 5 hectares is under construction, which is intended to become a key supply of vegetables for Lhasa.*

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Leadership Interest in Alternative Energy Sources

According to Embassy reporting, the State Council in 1984 created a special committee—the Rural Energy Leading Group—to assess energy problems. Vice Premier Li Peng, an energy expert, heads the group. Other participants include representatives from the State Planning Commission, the State Science and Technology Commission, and the China Rural Development Research Center. Although our information is sketchy, conversations between Chinese officials and Western businessmen suggest that this group is behind the current interest in alternative energy sources.

Press reports indicate that some provincial governments have also set up rural energy groups, and Beijing apparently has authorized them to deal directly with foreign governments; for example, Denmark has signed a memorandum of understanding with Tibet to provide feasibility studies on wind-powered generators. Most contacts with foreigners, however, have been initiated by the national-level leading group.

These additions to rural energy supplies were offset by economic reforms in the countryside that since 1978 have accelerated growth in rural energy demand. Higher peasant incomes from private plots and sideline occupations have increased demand for fuels for heating and cooking and for electricity to power newly available consumer goods, such as televisions, refrigerators, and washing machines.

More important, policies to develop township industry have created a rapidly growing rural industrial sector whose demand for coal, oil, and power outstrips the growth in rural supplies. According to the Chinese press, rural industry is not only growing rapidly, but also is concentrated in energy-intensive industries such as machine building and cement. Furthermore, much of the present capital stock of rural industry consists of older machinery and equipment salvaged from urban factories under renovation. Beijing claims this equipment is incredibly wasteful; compared with urban factories, for example, township metallurgical enterprises reportedly consume three and a half times as much energy per unit of output.

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Beijing estimates that the annual shortfall currently facing rural industry and households is 80 million metric tons of coal equivalent, which is twice the electric power shortfall facing China's urban industry. Furthermore, Beijing estimates—and we agree—that, despite its best efforts, the rural shortfall by the year 2000 could reach 200 million tons of coal equivalent, and traditional and commercial energy sources would satisfy only 72 percent of demand compared with the current 84 percent.

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Addressing the Problem

To supplement their efforts with biogas, the Chinese are pursuing the use of solar, wind, and geothermal installations. Chinese officials are seeking international cooperation in developing technologies that are easy to use and maintain, that are practical to build and use on a scale suitable for rural operation, and that China can learn to manufacture and eventually export.

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China has approached the US Government on bilateral cooperation in windpowered generators and in the construction of a model village using renewable energy sources. Both projects would use mainly existing technologies and could provide ready—though small—sales for US firms. The Chinese, however, expect firms to provide free goods and technology before they agree to purchase equipment or know-how, which may dampen the interest of some firms.

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China is also considering Swedish windpowered generator technology and Japanese proposals for the development of solar-generated electricity (photovoltaic, or PV). PV equipment, at present, is

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prohibitively expensive, but Japanese suppliers claim costs will drop to acceptable levels by the 1990s. Japan hopes its cooperation with China will provide opportunities to experiment with and perfect its solar energy technology.

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Outlook

We believe alternative energy sources will take time to develop but can provide power in many rural areas that lack access to coal, hydropower, or electric power grids. They will at best, however, offset a fraction of expected rural shortfalls nationwide by the end of the century; China will continue to rely on conventional commercial and traditional energy sources.

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We believe the United States and Sweden have an edge in China's alternative energy market for the next few years because their windpowered technologies are already commercially feasible. Japan could capture a share of the market, however, if it is able to develop solar energy at a competitive cost. In any case, the market is likely to be small; budget and foreign exchange restraints will probably limit China's purchases to prototypes and technology transfer agreements.

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Briefs

Energy

Spot Oil Price Developments

Spot oil prices have been slowly falling over the past four weeks. Key North Sea and US crudes are selling for $11.45 and $14.05 per barrel, respectively, and the world average price has dropped approximately 70 cents in a month to $14.34 per barrel. OPEC production remains high and, without agreement at this week's meeting to reduce output, prices will remain weak. A large volume of Middle Eastern oil, still on the water, is due to arrive in markets in late June, and the need to aggressively market the crude also will keep downward pressure on prices for at least the next few months. [ ] 25X1

Italian Difficulties in Cutting Libyan Oil Ties

Italian officials say Rome is willing to reduce oil imports from Libya further if other West European countries do so, but is likely to have great difficulties. Italy reportedly already has ceased purchasing Libyan crude on the spot market and failed to renew a 25,000-b/d contract that expired this month. Rome still depends on Libya for about 15 percent of its total oil needs, according to the US Embassy, and currently imports about 300,000 b/d from Libya. This figure is higher than it was last year, in part because Tripoli recently resumed paying with oil some of the $800 million it owes to Italian companies. Both Prime Minister Craxi and Foreign Minister Andreotti have said that the debt payments of about 60,000 b/d, as well as another 60,000 b/d the state-owned oil company receives from its interest in a Libyan oilfield, cannot be eliminated. Therefore, cutback efforts probably will center on contracts for more than 90,000 b/d held by Montedison, the huge chemicals conglomerate, and 60,000 b/d purchased by the Tamoil refinery, in which Libya has a 70-percent interest. Although alternative suppliers are available, Montedison would lose the concessionary rates Libya offers, would have to pay higher transportation costs, and would have to make minor adjustments to equipment at the refinery—altogether increasing costs by about $1.85 per barrel. Montedison is controlled by several of the country's politically powerful leading industrialists, however, and company officials have said that they see no reason to break off profitable economic relations with Libya. Rome also can do little to sever Tamoil's Libyan ties. If the government could persuade Montedison to purchase oil elsewhere, Italy's dependence on Libyan crude would be reduced by almost one-half. [ ] 25X1

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More Brazilian Oil and Gas Discoveries

New discoveries in the Campos Basin increase Brazil's chances of becoming self-sufficient in oil and gas by the mid-1990s. Initial exploration indicates the discoveries could triple Brazil's oil reserves to over 6 billion barrels and nearly triple gas reserves to 242 billion cubic meters. The new discoveries are located in deep water, but the Brazilian national oil company does not believe this will hinder development. These new discoveries probably will provide significant quantities of oil and gas in three to four years. If additional drilling confirms the new oil discoveries, Brazil's reserves would approach those of Norway. Continued exploration in the Campos Basin and other offshore areas is likely to result in more discoveries, and Brazilian oil reserves might eventually equal those of the entire North Sea.

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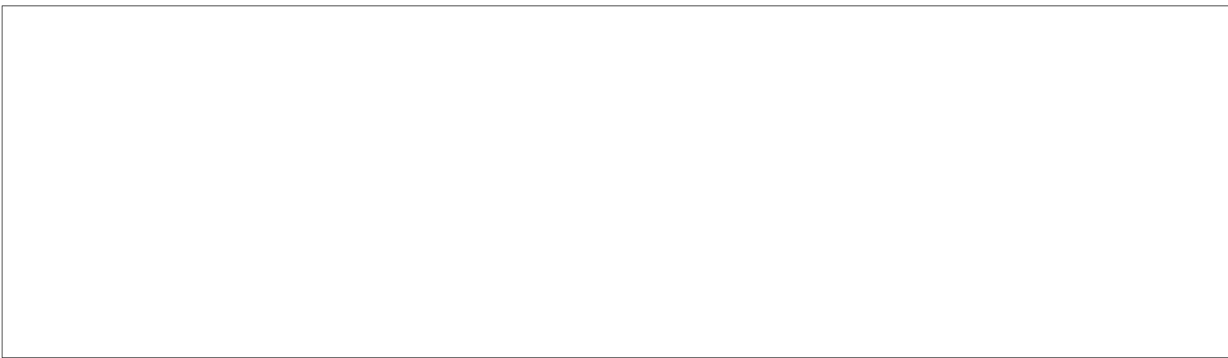

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International Finance

Dropoff in IMF/IBRD Net Lending

The two major multilateral financial institutions may become negative net lenders to LDCs. On the basis of IMF data, we estimate that the Fund will take in about $1 billion more from LDCs than it lends out during 1986 as repayments on 1982-84 lending begin to mount. We expect a similar net inflow of IMF credits during 1987. Meanwhile, the IBRD projects that its net transfers—disbursements less repayments of principal and interest—will be close to zero for the Bank's current fiscal year ending 30 June, continuing a downward trend begun in 1984. World Bank officials claim that this is only cyclical, although the IBRD has drawn criticism from some financial observers for not doing more to assist LDCs in a period when commercial bank lending has fallen sharply. In our judgment, the installation of new World Bank President Barber Conable—who has publicly stated his desire to expand the IBRD's role, particularly as a key element of the Baker Initiative—should lead to a resurgence of new loans to LDCs over the next few years.

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The Gambia's New IMF Package

The Gambia has obtained a 15-month IMF standby arrangement worth $15.5 million. The US Embassy reports that the program will require Banjul to raise its tax on rice and to match Senegalese prices for peanut and petroleum products in an effort to reduce illegal cross-border trade. According to open sources, The Gambia also will lay off another 1,500 civil servants, in addition to the 3,000 fired last October, as part of a four-year austerity program. In addition, the government reportedly has agreed to recruit foreign economic advisers to assist the President and the Central Bank. These long-overdue reforms carry significant political risks to President Jawara's already vulnerable government, which already weathered one coup attempt in 1981 and faces the threat of intervention by its larger neighbor Senegal.

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International Trade

Japan Monitoring Trade Problems

The Japanese press reports the Trade Ministry is developing an export surveillance system to alert policymakers to new areas of trade friction. The system, to be in place by September, will monitor export statistics, the economic condition of affected industries in Japan's trading partners, and prospects for foreign restrictions on Japanese exports. If a product is determined to be sensitive, the Trade Ministry reportedly intends to advise exporters to slow sales. Aware that Japan's trade surplus is likely to grow throughout 1986, officials and top business leaders are increasingly concerned about restrictive trade legislation in the United States and the EC. The head of Japan's most influential business organization, for example, recently floated a proposal for "managed trade" between Japan and the United States. Implementation of the proposed surveillance system is uncertain. Moreover, the Trade Ministry would probably face strong opposition from the business community if it tried to use the procedure to impose formal export restrictions.

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Global and Regional Developments

Possible Chinese Launch of Indonesian Satellite

China is claiming Indonesia has asked it to launch the Palapa B-2P communications satellite by 1988. Following the US shuttle loss, Indonesia approached the West European Arianespace and was offered a launch slot in 1988. The subsequent failure of an Ariane launcher, however, has made Arianespace's schedule uncertain. The US and Arianespace setbacks may have led Jakarta to believe that neither could launch the Palapa before the presidential election scheduled for 1988. The Palapa B-2P is intended to replace an older satellite to ensure continued internal communications. The Indonesian ruling party is counting on the use of communications satellites to broadcast its political campaign messages. The Chinese have offered commercial launch services but have successfully placed only two satellites in geosynchronous orbit, and Indonesia's alleged request suggests desperation.

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Reserve Position of Major Debtors

Many of the 15 major debtors will improve their reserves-to-import ratio for the current year—based on lower estimated imports for 1986—despite a projected decline in their reserves. Official import estimates, however, may understate actual needs. The Latin and Asian debtors continue to show comfortable reserve levels, but the African countries have little or no reserve cushion to sustain needed imports. To sustain their reserve levels, Latin American countries have the highest debt/GNP ratio of the three regions, followed closely by Africa. Major shifts in reserve levels have occurred only in Argentina and Nigeria.

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Key LDC Debtors: Foreign Exchange Reserves

	Reserves [a] *(billion US $)*		Reserves-to-Import Ratio, 1986 [b] *(number of months)*
	1985	1986	
Total	**45.9**	**43.9**	
Argentina	3.1 [c]	2.5 [d]	7
Bolivia	0.2	0.2 [d]	4
Brazil	10.6	11.0 [d]	9
Chile	2.4	2.2	8
Colombia	1.6	1.5	7
Ecuador	0.7	0.7	5
Ivory Coast	NEGL	NEGL	... [e]
Mexico	4.9	5.0	5 [d]
Morocco	0.1	0.1	... [e]
Nigeria	1.7	0.5 [d]	1
Peru	1.8	1.9	10
Philippines	0.6	0.7	3
South Korea	7.7	7.3	3
Uruguay	0.2	0.3	5
Venezuela [f]	10.3	10.0	19

[a] Total reserves minus gold; IMF data for the first quarter 1986.
[b] Projected.
[c] CIA fourth-quarter estimate.
[d] CIA first-quarter estimate.
[e] Less than half a month.
[f] Reserves in Central Bank only.

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National Developments

Developed Countries

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Canadian Province To Open Securities Industry to Foreign Firms

Ontario is proposing to reduce barriers to foreign and domestic financial institutions' and other businesses' participation in its securities industry, which accounts for 75 to 80 percent of Canadian stock market trading. The province plans to raise the limit on foreign dealers' ownership of Canadian securities firms from 10 to 30 percent, allow foreign full-service firms to enter the market, and permit foreign and domestic banks and other companies to own up to 30 percent of a Canadian securities firm. To meet its 1 January 1987 target, Ontario must not only change its own regulations, but also persuade the federal government to alter national legislation affecting the banking and insurance industries. Opposition from the House of Commons Finance Committee probably will delay implementation of Ontario's proposal.

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Japanese Economic Slowdown Revives Austerity Debate

Japan's real GNP fell 0.5 percent in the January-March quarter—the first quarterly drop in 11 years—largely because of the deflationary effects of the strong yen. Export volume dropped almost 5 percent from the previous quarter, capital investment in the manufacturing sector slowed, and unemployment—while low compared with that in other industrial countries—now stands at a record 2.9 percent. The bad economic news was generally anticipated, however, and should have little impact on legislative elections next month. The current slowdown is nonetheless strengthening the arguments of those favoring temporary economic stimulus. Influential business leaders and politicians in the ruling party are increasingly calling for a major public works program. The influential Administration Reform Council, which supports Tokyo's fiscal austerity, laid the groundwork for such a move in its final report this month by recognizing the need for "flexible" measures in "emergencies." Whatever the composition of the Diet after elections, another quarter of near-zero growth would move the government closer to declaring an economic emergency and adopting an expansionary budget.

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Japanese Semiconductor Firms Cut Planned Investment

According to press reports, Japanese semiconductor producers plan to reduce plant and equipment investment by an average of 30 percent for the fiscal year that began in April. Although we believe that uncertainty over the world semiconductor market's recovery and Japan's current semiconductor overcapacity will keep investment low, Japanese manufacturers may be overstating the drop to avoid US criticism that heavy investment will depress semiconductor prices and thus aggravate trade friction. The US Embassy indicates that Japanese semiconductor firms are increasing research and development spending, some of which might be used to upgrade production equipment. Japanese companies, moreover, still appear to believe heavy investment is necessary to stay competitive.

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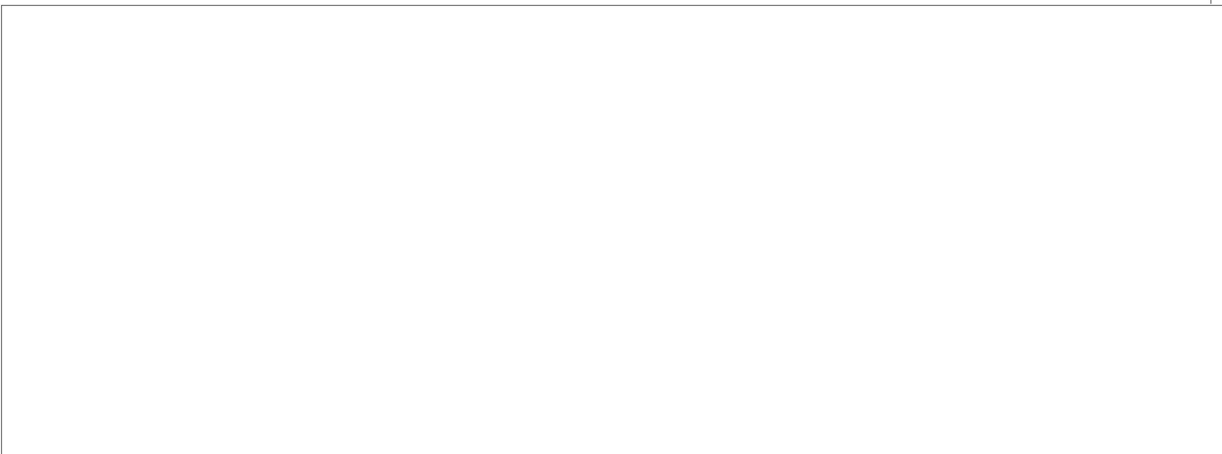

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Projected Shifts in British Labor Market

A recent study of future manpower needs in Britain points to a continued shift into service industries and small businesses. Based on interviews with 3,000 employers, the Institute of Manpower Studies concludes that between now and 1990 the sharpest fall in employment will occur in the heavy engineering, energy, manufacturing, and construction industries. Jobs will grow most rapidly in financial and business services, leisure industries, and commerce. In occupational terms, demand will be strongest for managers, skilled craftsmen, engineers, and scientists, while unskilled workers face a bleak future. With these findings in hand, many groups, including Conservative supporters of Prime Minister Thatcher, are pressing the government to expand and improve training programs both for young people entering the job market and for the long-term unemployed—many of whom have no marketable skills. Critics claim that existing programs do not meet employers' needs and pale in comparison with the more rigorous, skill-specific training provided by competitors such as Japan, West Germany, and France.

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Bonn To Unveil 1989-91 Tax Cuts

Details of major tax cuts for 1989 and 1991 reportedly will be unveiled this year and introduced in parliament right after the January election. According to a West German newsletter that often accurately reports insider information, the cuts will total at least $22 billion and be introduced in roughly equal installments. About one-half of the $22 billion would be financed by cuts in subsidies and by an increase in the VAT. A $3.4 billion tax cut already is scheduled for 1988, and a $4.3 billion cut took effect last January. Although Bonn started talking about major tax reform last year, it has kept the timing vague. The reported timing would be intended to achieve maximum political impact, while defusing international calls for West German reflation.

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Spain Pushing Joint High-Tech Projects

The Spanish National Telephone Company (Telefonica) and Corning Glass have set up a joint venture that will provide Spain with its first optical fiber manufacturing facility. Scheduled to come on stream in mid-1988, the plant will further Madrid's ambitious telecommunications program, which envisions the construction of an optical fiber communications network. The project is part of the government's reindustrialization effort, and is one of several deals between Telefonica and leading multinationals aimed at securing foreign technology, capital, and managerial expertise. Other ventures have been concluded with AT&T for custom-made microchips, Fujitsu for computer equipment, and Hewlett-Packard for computer-aided design plotters. Foreign firms have become increasingly confident of Spain's economic and political stability—particularly since its entry into the EC and the reaffirmation of its NATO ties.

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Greek Officials Admit External Target Unobtainable

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Athens's current account deficit target of $1.7 billion for this year is unobtainable and that the deficit is likely to be closer to $2.5 billion. additional measures will be necessary to prevent a further deterioration of the Greek economy, but are unlikely before the October municipal elections. These measures may include further import restrictions. Greece's foreign exchange reserves have been falling steadily this year, and a banking source has told the US Embassy that reserves at the end of May were $320-360 million—less than two weeks' worth of imports. A further decline of foreign exchange reserves could force Athens to seek additional assistance from the EC. At a minimum, Greece will be required to continue to pay high margins on future borrowings to retain access to foreign credit.

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Less Developed Countries

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Libyan Black-Market Activity Increasing

Libyans are increasingly turning to a flourishing black market as food and goods supplies dwindle. [ ] obtaining goods and services now depends on who you know, how much you are willing to pay, and how long you will stand in line. Most products, however, are not available in Tripoli from government-run stores, and store managers hoard goods for friends or those willing to pay nearly double official prices. So far, the government has tolerated such activity. Moreover, a true black market has evolved to satisfy a growing demand for drugs, alcohol, foreign currency, auto spare parts, and cigarettes. [ ] Although the current shortages are not critical—starvation is not a problem—domestic disgruntlement with the regime's economic and foreign policies is undoubtedly increasing. [ ]

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Tunisian Structural Adjustment Program Defined

Tunis has unveiled new austerity measures aimed at trimming domestic demand, redressing mounting financial imbalances, and promoting exports that have sagged as a result of the weak oil market and a severe drought this year. According to the US Embassy, investment will be trimmed by $170 million this year and domestic prices raised by almost 6 percent to help curb import growth. Moreover, the government may devalue the dinar by 15 percent to stimulate tourism and manufactured goods exports that account for 60 percent of foreign exchange earnings. Even with planned cuts in domestic spending, Tunis probably still faces a financing gap of $500 million this year, which the government hopes to fill through foreign borrowing. The debt service ratio, however, is near 30 percent, and reserves cover less than two weeks of imports. While the measures are designed to minimize the impact on the neediest, disgruntlement over unemployment and the government's intransigent position on wages is sure to rise. [ ]

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Economic Conditions in Afghan Countryside

The Afghan conflict has resulted in high inflation and labor shortages in the agricultural regions of the country, according to a recent traveler to the area. While government subsidies and price controls have kept inflation at about 25 percent annually in Kabul, in provinces such as Qandahar it has averaged about 200 percent over the last two to three years. The exodus of refugees has also caused severe labor shortages in various regions. Unskilled day laborers in Qandahar now earn about 500 afghanis per day, approximately $3.70 at the bazaar exchange rate—compared to 50 afghanis per day, about $1.20, in 1977. The labor shortage has cut critical maintenance of the country's traditional irrigation systems. There has also been a shift from labor-intensive cash crops, such as cotton and sugar beets, to food crops, such as wheat, according to a separate source. To reverse this trend, which is hurting the regime's ability to earn hard currency, Kabul has introduced large subsidies for cotton and sugar beet production, but, to date, has had little success. [ ]

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Bhutto's Proposed Economic Policies for Pakistan

Benazir Bhutto, head of the opposition Pakistan People's Party (PPP), announced a "people's budget" during a visit to Lahore last week. Several of her budget proposals are likely to alienate important sources of support for her election bid. The budget calls for a one-third or $666 million reduction in defense spending that would anger the military, a group whose tolerance she needs. Businessmen are uneasy about her call for an almost doubling of the minimum wage; the textile industry, Pakistan's largest, would be severely affected by such a move. The proposed measures will probably cost Bhutto needed financial support from the business community while a proposed agricultural tax will antagonize Pakistan's powerful landowners. At the same time, there are indications that support for Bhutto among workers and peasants is causing the Junejo government to reconsider some policies, including using some of the windfall gains from lower oil prices for a new national employment fund.

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Intergovernmental Group Pledges Indonesian Aid

Foreign aid donors pledged $2.5 billion in new development assistance for the fiscal year that began 1 April at last week's annual coordinating session in The Hague. Although it is an increase of $100 million over 1985, the amount is much less than hoped for by Jakarta—net financial requirements for the year might balloon to $5 billion, compared with just over $2 billion in each of the previous two years. Aid donors, however, beset by their own budget problems, were reluctant to substantially increase development assistance. This has already forced Jakarta to dip into an estimated $2.5 billion in unused credit lines and will encourage the government to seek new sources of capital in the private market. The result will probably be a major increase this year in the country's debt service burden, which totaled nearly $6 billion in 1985.

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Communist

Soviets Scrap Plans for Chemical Complex

Soviet officials have notified Western contractors bidding for a new $1 billion olefins complex at Budennovsk that the project has been canceled for financial reasons. The complex was to have supplied a variety of plastics for consumer, industrial, and, possibly, military use. Moscow now plans to revamp an existing facility at Budennovsk and to install a linear, low-density polyethylene plant there using Western technology. Another chemical project under negotiation with Western firms—a polyester fiber complex near Ufa—is still hanging on, albeit in reduced form. Although the feedstock plant will be the same size as originally designed, polyester fiber capacity will be halved. Hard currency constraints caused by the decline in oil prices probably are responsible for the cutbacks in planned purchases of Western chemical technology and equipment. Moscow will find it difficult to meet the goals of the "chemicalization" program without these facilities.

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China Reacts to Hong Kong's Antinuclear Power Movement

Beijing is reacting cautiously to the increasingly vocal opposition in Hong Kong to the construction of the Daya Bay Nuclear Power Plant, about 50 kilometers north of the territory in Guangdong Province. The opposition, which claims to have gathered 80,000 signatures, is attempting to force the local utility, China Light and Power Co., Ltd., to withdraw from the joint venture and to pressure the Hong Kong Government to cancel its agreement to purchase 75 percent of the plant's electricity.

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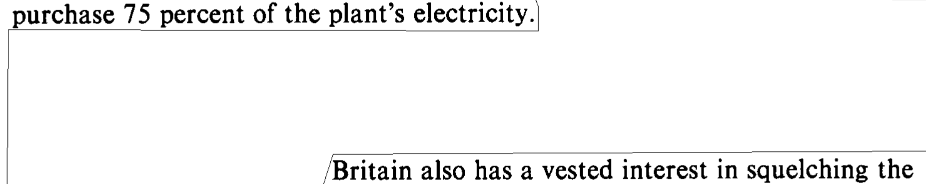

Britain also has a vested interest in squelching the protests because it is providing the plant's turbines. Nonetheless, the antinuclear movement will be seriously hampered by Hong Kong's traditional apolitical climate and the lack of democracy.

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New Chinese Rail Line

China plans to add some 240 kilometers to the single-track, Harbin-Longzhen railway, extending the line to Aihui on the Sino-Soviet border in northern Heilongjiang Province. The line will be built along the route of a previous line destroyed 40 years ago by the Japanese. The Chinese probably will attempt to complete this rail crossing quickly to facilitate expanding Sino-Soviet border trade. The two existing rail crossings, Manzhouli and Suifenhe, handled approximately $30 million in border trade last year. Chinese grain sales and log purchases accounted for much of the trade.

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Beijing Forms Telecommunications Enterprise Groups

The Ministry of Posts and Telecommunications (MPT) has organized four enterprise association groups designed to promote interenterprise cooperation in an effort to increase efficiency and the level of technology in the telecommunications industry. Although the individual enterprises retain some autonomy in planning joint projects, organizing production, and marketing, the central ministry maintains ultimate control through its sponsorship of the associations and its position as China's major purchaser of telecommunications services and equipment. According to the Chinese press, the MPT's established groups—which include microwave and television communications—have bid on 11 international telecommunications projects and have won four of the bids. The microwave communications group has also been particularly successful in securing domestic projects. The MPT plans to set up six more enterprise groups by the end of June.

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