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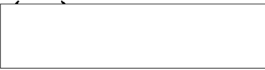
International Economic & Energy Weekly



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Synopsis

1 **Perspective—GATT: Outlook for the Ministerial and a New Trade Round**

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Substantial disagreements over agriculture and the treatment of new issues—services, intellectual property rights (IPR), and investment—portend difficult negotiations once the new GATT round of multilateral trade negotiations gets under way.

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3 **Agriculture in the New GATT Round**

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Liberalizing agricultural trade will be one of the most contentious issues in the coming GATT round. Nonetheless, there is some potential for success, particularly as increased budget costs of the CAP strain EC unity.

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7 **New Issues in the GATT Round: Intellectual Property and International Investment**

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The inclusion of intellectual property rights (IPRs) and investment issues in the GATT, both US initiatives, are two controversial subjects that will be addressed at the GATT Ministerial beginning in mid-September in Punta del Este. Although there is support from many GATT members to discuss both problems, hardline opposition from a number of LDCs—particularly in the investment area—threatens to hinder progress on negotiations.

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11 **Non-OPEC Oil Producers: Limited Prospects for Reductions in Output**

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Despite commitments from several non-OPEC oil producers, proposed cutbacks are likely to reduce ouput far less than what OPEC is hoping for. Moreover, we believe total non-OPEC production will probably rise during the remainder of the year.

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19 **El Salvador: Private-Sector Uneasiness**

Relations between President Duarte and the private sector in El Salvador have been marked by mutual distrust, strong ideological differences, and conflict over economic policy. The adversarial relationship between Duarte and the business community shows no signs of abating, and the poor economic prospects suggested by this standoff will probably force the government to remain heavily dependent on US economic assistance to generate even small levels of economic growth.

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Perspective

GATT: Outlook for the Ministerial and a New Trade Round

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Substantial disagreements over agriculture and the treatment of new issues—services, intellectual property rights (IPR), and investment—portend difficult negotiations once the new GATT round of multilateral trade negotiations gets under way. Before the launching of the the new round at the 15 September GATT Ministerial in Punta del Este, Uruguay, the trade ministers from the 92 member countries must iron out disagreements over a draft agenda for the negotiations—something that the Preparatory Committee (Prepcom), after seven months of discussions, was unable to do. GATT members believe there has been a severe deterioration in the trade environment since the Tokyo Round (1973-79) and question whether GATT's structure and enforcement abilities adequately meet today's needs. Developing countries have been particularly critical of actions that they say restrict access to developed country markets—such as the extension of the Multi-Fiber Arrangement—and claim the US Farm Bill and Washington's recent decision to expand wheat subsidies puts their commodity exports at a competitive disadvantage.

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The GATT Prepcom proposed an ambitious agenda for the negotiations. Key proposals include:
- Preventing new protectionist measures and rolling back existing trade barriers.
- Strengthening GATT's ability to resolve trade disputes.
- Reviewing the codes negotiated in the Tokyo Round, such as import licensing and government procurement.
- Bringing agriculture and textiles into the GATT system.
- Expanding GATT coverage into the areas of trade in services, IPR, and foreign investment.

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Although the LDCs support the new round, many argue that the agenda is overloaded and that previous commitments should be met before GATT is expanded to cover new issues. Their negotiating priorities are to improve regulations governing trade in agriculture, to focus on tropical and natural resource products, and to enhance the special treatment for LDCs that minimizes their obligations to adhere to GATT rules. Most LDCs are extremely wary of the new issues, although some plan not to block their inclusion on the agenda in the hope of getting better treatment for LDC priority issues. The developing countries' main fear is that developed countries will seek to link increased liberalization in goods trade to an agreement reducing LDC barriers to developed country services, such as banking or telecommunications. We believe many LDCs probably will not participate in negotiations if such linkage is attempted.

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Developed countries want the new round primarily to improve the functioning of the GATT system; strengthen requirements authorizing temporary import restraints; increase the adherence to GATT rules by the more advanced LDCs, and expand GATT to cover services, IPR, and investment. Even though there are few international standards and growing protectionism in these new areas, several developed countries would prefer to limit negotiations until they are studied further.

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Before the new round is launched, a final agenda must be distilled from the three drafts that the Prepcom forwarded to the Ministers. One is a compromise text negotiated among 48 developed and developing country members, but differences remain on textiles, the three new issues, and agriculture. On the last item, the French blocked consensus at the last minute, objecting to language on export subsidies. The second draft agenda is supported by 10 hardline LDCs, led by Brazil, and excludes investment, services, and IPR. Its sponsors believe that GATT has no competence to handle these issues. In an attempt to forge a compromise, Argentina, a cosponsor of the second draft, has drafted a third agenda that is similar to Brazil's but includes services. According to Embassy reporting, Brazil, India, and the EC have been meeting informally to discuss services and may propose at the Ministerial that there be separate meetings for services and goods—the United States wants both negotiated together.

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Most countries are optimistic that a new round will be successfully launched and are working informally to resolve differences before the Ministerial. EC members are attempting to pressure the French to drop their objections to direct references to agricultural subsidies. The GATT services group has been unable to reach an agreement but will have a final meeting on 29 August to formulate their recommendations for presentation in Punta del Este. Although Brazil and India are not likely to agree to linking negotiations of goods and services. They have not even considered IPR or investment. Given the heavy and controversial agenda proposed, the new round could easily drag on beyond the four years allotted, with members relying on bilateral negotiations to resolve acute trade disputes.

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Agriculture in the New GATT Round

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Liberalizing agricultural trade will be one of the most contentious issues in the coming GATT round. Most GATT members support the inclusion of agriculture in the new round, and many developing countries claim that, unless agriculture is given top priority, they will have little interest in negotiations. The major stumblingblock, the European Community (EC), with France as the driving force, will resist major commitments that will force changes in its Common Agricultural Policy (CAP). As a result, agricultural discussions in the GATT negotiations are likely to be highly politicized and drawn out. Nonetheless, there is some potential for success, particularly as increased budget costs of the CAP strain EC unity.

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Rising Agricultural Protectionism

Since the Tokyo Round ended in 1979, overproduction and burdensome stocks in many agricultural commodities have made export competition more intense. Moreover, the transition of former LDC importers such as Brazil to agricultural exporters has driven developed countries toward greater agricultural trade protectionism:

- ***Import barriers***—including tariffs, quotas, health restrictions and other nontariff trade barriers (NTBs)—are employed by developed countries to protect their domestic farmers, cutting off market access for the LDCs' burgeoning exports.

- ***Export subsidies*** such as Canadian grain freight subsidies, the EC's favorable credit terms, and US payment-in-kind bonuses have provoked complaints from exporters such as Australia, New Zealand, and Thailand that subsidies are driving down already low commodity prices.

- ***Domestic agricultural subsidies*** in the form of income supports and guaranteed minimum prices encourage overproduction because they are seldom tied to actual market conditions. Negotiations in this area will likely be the most highly charged, because farm support programs have strong social and political ramifications.

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GATT Provisions for Agriculture

GATT has traditionally recognized the "special characteristics" of agriculture by applying its rules more leniently than on industrial goods. Specifically, import quotas may be applied by member countries to:
- *Prevent or relieve food shortages.*
- *Enforce domestic marketing or production control programs, or remove temporary surpluses.*
- *Apply standards for classification, grading, or marketing of commodities.*

In addition, export subsidies may be used to support primary products if they do not give more than an "equitable" world market share in the product to the exporting country. These special provisions for agriculture have historically been interpreted by GATT members such as the EC to allow domestic supports and export programs to protect their farmers from the uncertainty and aggressive competition of world markets. More recently, these provisions have been cited to justify the expanded use of restrictive measures to protect agricultural sectors.

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Preparatory Committee Goals

In preparing a draft agenda for trade liberalization in agriculture, the Preparatory Committee (Prepcom) based its deliberations on recommendations of the Committee on Trade in Agriculture (CTA) adopted by GATT in 1984. A majority of GATT Prepcom delegations—with the EC dissenting—has proposed a final draft on agricultural trade that calls for:
- Minimum levels of market access for all agricultural products.

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Nonsubsidizers Join Forces

Self-proclaimed agricultural nonsubsidizers—led by Canada, Australia, and Thailand—are in the midst of a series of strategy sessions designed to jointly combat the trade-damaging effects of subsidies and protectionist policies. A meeting last month in Phatthaya, Thailand, achieved a show of solidarity and strong commitment for reform among the 12 participants:

Argentina	*Chile*	*New Zealand*
Australia	*Hungary*	*Philippines*
Brazil	*Indonesia*	*Thailand*
Canada	*Malaysia*	*Uruguay*

A conference of the same countries to be held in Cairns, Australia, on 26-27 August will probably press for stronger language on subsidies, in light of the failure of the Prepcom to achieve an acceptable text on agriculture and the recent US decision to subsidize wheat sales to the USSR. According to Embassy reports, Canberra plans to assemble a solid group of trade ministers who will insist on strong language at Punta del Este. Though the 12 countries do not share negotiating strategies for agriculture and other topics in the new round, they agree that, if a strong pledge for agricultural reform cannot be achieved, they may question the value of participating.

- A phase out of agricultural export subsidies within an agreed time frame.
- Minimal NTBs on trade in agriculture.
- Adjustment of national policies to facilitate full integration of the agricultural sector with GATT rules.
- Special and differential treatment for agriculture of developing countries.

Negotiating Positions of Key Players

EC members agree on the need to proceed cautiously on agriculture to avoid further attacks on the CAP. The EC, therefore, wants agriculture discussions confined to the CTA in order to limit concessions. However, there is growing pressure within the EC for CAP reform and a negotiated halt to the budget-crippling grain export subsidy war—the EC spends almost three-fourths of its budget on agriculture, and in 1986 expects an increase in the budget shortfall of almost $1 billion stemming from increased subsidies. Within the EC, France remains the hardline member, with West Germany more flexible and the United Kingdom acting as mediator in its current role as Commission president. The EC's grain market-sharing proposal met strong resistance at the recent Grain Exporters' Summit in Vancouver but could be revived as a transitional mechanism while export subsidies are being phased out over several years.

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France blocked EC endorsement of the majority Prepcom draft by refusing to accept the strong language on agricultural export subsidies that are integral to EC farm policy.

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according to Embassy reports, France has said it will not let disagreement over agriculture block the launching of the new round, and other Community members are optimistic that compromise language will be worked out before or during the GATT Ministerial.

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Japan probably will continue to maintain a low profile in the negotiations. Tokyo's agricultural policy supports farm incomes through quantitative restrictions, subsidies, and heavily restricted access to domestic markets. Since 1983, Japan has made a start at liberalization, decreasing its overall farm support 10 percent and reducing its direct export subsidies 25 percent. The Nakasone administration, however, probably believes that agricultural spending cuts have reached politically acceptable limits, according to press and Embassy reporting. Therefore, Japan will probably resist LDC and developed country agricultural exporters' attempts to liberalize access to this lucrative market.

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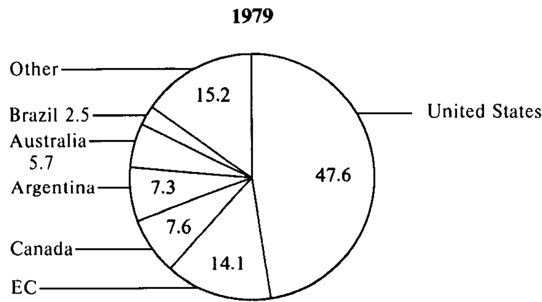
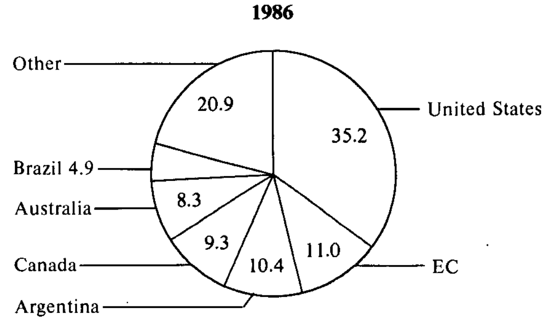
Selected GATT Members: Agricultural Export Market Share, 1979 and 1986[a]

Percent



Total=267.0 million metric tons



Total=264.2 million metric tons

[a]Exports of wheat, coarse grains, and oil seeds and products.

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Canada, Australia, and ***New Zealand*** claim that EC and US subsidies have forced down their export levels, especially for wheat and dairy products. Australia has been the most vocal supporter of agricultural negotiations in the new round and has adamantly called for a timetable on elimination of agricultural export subsidies. EC subsidies have cost Canberra over $600 million per year in export earnings due to lower world grain prices. In addition, the US decision to extend wheat export subsidies to the USSR has provoked strong protests from Ottawa and Canberra.

LDCs—especially Thailand—believe that, unless the Prepcom draft declaration contains strong language for the liberalization of agricultural trade, the negotiations will accomplish little. Argentina and Chile have declared that the protection of agriculture in the industrialized nations has led to large distortions in international markets and has constrained the ability of developing countries to compete in world markets or maintain food self-sufficiency. Many LDCs are seeking broader market access to Japan and the EC for their expanding agricultural exports. They also are calling for a thorough overhaul of trade subsidies to ensure that the subsidy war among grain exporters does not continue to harm the trade interests of smaller exporting nations. Bangkok, for example, has accused Washington of unfairly subsidizing US rice exports, depriving Thailand of at least $60 million a year in foreign exchange earnings.

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Outlook and Implications

Better market access and greater discipline in export competition are the primary goals for participants in upcoming GATT talks on agriculture. Some members—such as the EC and Argentina—feel agricultural issues should be confined to the CTA, while ASEAN and other members want discussion to cut across the subsidies, quantitative restrictions, and

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tariffs committees. This broader treatment would presumably foster more broad-based solutions to structural problems in agriculture, as opposed to the bilateral fixes a contained discussion might encourage.

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GATT progress in agriculture will be closely followed by both importers and exporters because of the increasing politicization of grain trade. Progress on agricultural liberalization is likely to be slow at best, given the conflicts between domestic pressures for farm protection and international demands for freer trade. On the other hand, glutted agricultural markets and the aggressive export provisions of the new US Farm Bill could put cracks in the EC unity on protecting the CAP. In the end, mounting budgetary burdens from increased subsidy costs may eventually provide the necessary momentum for reform.

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New Issues in the GATT Round: Intellectual Property and International Investment

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The inclusion of intellectual property rights (IPRs) and investment issues in the GATT, both US initiatives, are two controversial subjects that will be addressed at the GATT Ministerial beginning in mid-September in Punta del Este. Although there is support from many GATT members to discuss both problems, hardline opposition from a number of LDCs—particularly in the investment area—threatens to hinder progress on negotiations.

Intellectual Property

Trade in counterfeit products—those that infringe on patents, copyrights, and trademarks—has become a serious problem in international trade affecting both developed and developing countries and involving a wide range of goods. Counterfeit goods account for approximately 3 to 9 percent of world trade—upward of $170 billion—each year, according to an industry group. Many GATT contracting parties have experienced substantial economic losses as a result of this illicit trade:

- ***United States.*** The infringement of IPRs costs US companies as much as $20 billion in sales annually, resulting in a loss of up to 750,000 jobs, according to US Government and other studies.
- ***United Kingdom.*** British automobile spare-part manufacturers lost more than $200 million in exports, according to an EC study.
- ***Switzerland.*** According to the Swiss watch industry, there are as many as 10 million fake Swiss watches produced and sold each year, resulting in losses estimated as high as $500 million.
- ***West Africa.*** Cocoa farmers lost about $20 million worth of their 1984 crop as a result of ineffective counterfeit fungicide

To reduce these problems, some members propose that trade-related aspects of IPRs should be addressed in the GATT. An agreement on intellectual property is aimed at reducing trade in counterfeit goods, raising the minimum standard of protection required under certain international IPR conventions, and strengthening protection for the products of new technologies such as semiconductors and biotechnology. To date, most discussions have centered around international trade in counterfeit trademarked items.

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Patents and Copyrights

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An agreement to improve protection of patented and copyrighted works would attempt to lengthen patent terms, increase the patent protection for such goods as chemicals and pharmaceutical compounds, and extend copyright protection to computer software. In addition, it would create a dispute settlement mechanism to litigate contentious bilateral issues. This multilateral approach would supplement bilateral efforts by the United States to improve protection in these areas. So far, however, there has been little discussion or agreement among GATT members to focus on patents and copyrights in the new round until an agreement on trademarks is worked out.

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A Code for Trademarks

A code governing trade in counterfeit trademarked goods would seek to eliminate the economic incentive to trade in products carrying fake trademarks while minimizing obstacles to legitimate trade. The code would provide governments with a standardized means of either denying entry to counterfeit products—giving customs' authorities the power to seize goods—or creating a judicial mechanism through which such products can be taken out of the marketplace.

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While countries could establish their own laws regulating the importation of counterfeit trademarked goods, there are several benefits derived from multilateral action:

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- Coordinated international measures would increase the chances that trade in counterfeit products will be reduced.

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- A GATT code would facilitate action in third countries against the importation of counterfeit goods that could displace the legitimate exports of other countries.
- An internationally agreed upon mechanism to regulate the importation of suspect goods would prevent the proliferation of dissimilar national laws that could create nontariff barriers.

There is broad support among most developed countries—particularly from nations such as Switzerland, France, and Japan whose firms rely heavily on brand name and trademark recognition—to conclude an anticounterfeiting code. A small group of developing countries led by Brazil and India, however, oppose the inclusion of a trademark code—as well as a code for patents and copyrights—in the GATT. They claim that:

- The GATT is not the appropriate forum because it lacks the technical expertise and authority to deal with IPRs. Instead, the hardliners claim that the issue should be addressed by the UN-based World Intellectual Property Rights Organization—a forum that does not have an effective dispute settlement mechanism.

- There is a danger that procedures and sanctions directed against imports of counterfeit goods could be applied to imports of genuine goods.

- The problem is not sufficiently grave to warrant GATT attention at a time when there are other more pressing issues such as reducing existing trade barriers.

International Investment

GATT members have expressed only lukewarm support for negotiating removal of investment restrictions under the New Round despite the potentially distortive effect of such measures on the world economy. Incentives or disincentives created by these policies shift investment and therefore trade flows between countries. The United States seeks an agreement within the GATT for greater discipline on these practices, thereby making foreign direct investment decisions more responsive to market forces.

Trade-Related Investment Issues. Many governments offer a variety of incentives to lure foreign investors to their country. Inducements typically involve tax breaks, although protective tariffs, export rebates, and cash grants are also offered. Such practices can determine where a company chooses to invest, altering natural trade and capital flows. In fact, developing countries would benefit by not having to provide costly concessions to attract foreign direct investment.

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Another aspect of this issue that is likely to come up at the GATT Ministerial is whether to negotiate an agreement eliminating investment performance requirements. Many governments use these requirements to enhance the benefits they receive from foreign direct investment:

- Local content requirements can force foreign investors to purchase raw materials in country, or employ a specified number of nationals. By requiring foreign investors to purchase host country goods, less expensive imports are displaced.

- Export performance requirements obligate investors to export a certain share of their output. For example, Taiwan recently granted Toyota the right to build an automobile plant in Taiwan subject to the requirement that from 12.5 percent initially to as much as 50 percent of its automobile production in the late 1990s be exported. Such requirements artificially raise the quantity of affected goods in world markets—having the same effect as an export subsidy.

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Broader Investment Issues. Few nations automatically allow foreigners to invest in their country, and many would probably oppose a GATT agreement as an infringement of their sovereign right to control foreign investment. Two major issues are the right of establishment—limitations on foreigners setting up a business—and lack of national treatment—whereby governments provide a less favorable environment for foreign-owned firms than for domestic ones. Restrictions on the right of establishment or discriminatory treatment of foreign firms reduce opportunities for technology transfer, employment, and exports, as well

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Foreign Views on Including Investment Issues in the GATT

Supports/Agrees With US Position	*Agrees in Principle*	*No Objection/ Possible Support*
France	*European Community*	*Canada*
Japan	*Italy*	*Finland*
Spain	*New Zealand*	*Indonesia*
Switzerland	*West Germany*	*Thailand*
Togo	*Norway*	*South Korea*
	Sweden	*Tunisia*
		Ghana
		Uruguay

Noncommittal	*Opposes US Position*
Australia	*Argentina*
Denmark	*Brazil*
Iceland	*India*
United Kingdom	*Egypt*
Malaysia	*Yugoslavia*
Pakistan	*Cuba*
Singapore	*Colombia*

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as limit host country firms' ability to compete internationally. For example, Brasilia's practice of closing its computer industry to foreign investors undoubtedly dulls the competitiveness of Brazilian firms that produce products requiring the input of advanced computer technology.

Country Positions. Most OECD governments cautiously support the US initiative to include investment issues in the new GATT round. The EC Commission believes a system of protection for investment is needed but not necessarily under the GATT. Many OECD governments—including Bonn and London—are concerned that hostile reaction toward investment by the developing nations will adversely affect new round negotiations covering services trade, a more important issue to developed countries. Moreover, they fear that discussing investment issues in the GATT will overload an already crowded agenda. Most LDCs, while not supporting the inclusion of trade-related investment issues in the GATT, appear willing to accept their inclusion as the price LDCs must pay for concessions on other agenda items. No LDC government, however, appears willing to accept the inclusion of broader investment issues.

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Outlook

Despite opposition from certain LDCs, GATT members will most likely agree to conclude work on an anticounterfeiting code for trademarks. In the patents and copyrights areas, the course of future negotiations is less clear. Few countries support such action at this time, preferring to see the final agreement on trademarks before committing to undertake measures concerning copyrights and patents.

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On the investment issue, there is a moderate chance that the contracting parties will agree in Punta del Este and in future negotiations to increase discipline over trade-related investment measures. The developing countries are likely to balk, however, at attempts to include broader investment issues. In addition to opposition from the LDCs, most OECD governments are reluctant to include on any GATT agenda investment issues that are not trade related. In fact, the EC is probably willing to drop the investment issue entirely from new round negotiations.

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Non-OPEC Oil Producers: Limited Prospects for Reductions in Output

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Several non-OPEC oil producers have reasserted their commitments to join OPEC's effort to restrain output and boost oil prices, but voluntary cutbacks are likely to reduce output far less than what OPEC is hoping for. Moreover, we believe total non-OPEC production will probably rise during the remainder of the year as increases in exports from the North Sea, Australia, and net Communist exports will more than offset any voluntary reductions in output from other non-OPEC producers. As a result, price stability will continue to depend on OPEC's willingness to restrain output.

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Non-OPEC Oil Production, 1986 *Million b/d*

	Available Capacity	Production II Quarter	Production IV Quarter [a]	IV Quarter Change [a]
Total	**27.8**	**26.6**	**27.1**	**0.5**
Mexico	3.0	2.8	2.8	0
Egypt	0.9	0.8	0.8	0
Angola	0.3	0.3	0.3	0
Malaysia	0.51	0.51	0.46	−0.05
Oman	0.55	0.55	0.50	−0.05
Brunei	0.18	0.18	0.17	−0.01
North Sea	4.0	3.4	3.8	0.4
United States	10.7	10.5	10.5	0
Canada	1.8	1.8	1.8	0
Australia	0.6	0.5	0.6	0.1
Net Communist Exports	1.6	1.6	1.7	0.1
Other	3.7	3.7	3.7	0

[a] Projected.

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Recent Developments

OPEC has not abandoned its effort to gain production restraint from non-OPEC producers. Indeed, Saudi Oil Minister Yamani specified a cut in non-OPEC production as a condition of the quota agreement and conveyed this to the oil-producing countries that had offered to cut their output earlier this year. 25X1 Angola, Egypt, Mexico, Brunei, Malaysia, and Oman recently indicated they will implement the cuts they had promised. Norway reaffirmed that it may reconsider its oil policy now that OPEC has decided to cut output. 25X1

Nonmembers might have renewed incentive to cooperate with OPEC in the near future, having experienced the consequences of a price war. Few producers had the capacity to raise production to offset the effects of lower prices, and they all would benefit substantially from a rebound to about $15 per barrel. Even the poorer producers such as Mexico probably will take steps to at least appear as if they are doing their part to restrain output. 25X1

Constraints to Cooperation

The non-OPEC producers face a number of constraints to cooperating with OPEC that will probably limit the amount of production actually reduced:

- The major non-OPEC producers are also large oil consumers, and most of their production is used to fulfill domestic needs, leaving only modest amounts available for export. Non-OPEC production is currently averaging roughly 26.6 million b/d, but net exports are running only about 6.5 million b/d.

- Total non-OPEC production is already roughly 1.2 million b/d below capacity, and producers are probably unwilling to go much lower. Marketing problems for Mexico and Egypt have kept combined oil output about 300,000 b/d below capacity. Seasonal maintenance, especially in the UK North Sea, are reportedly responsible for another 600,000 b/d decline in output. We estimate only about 200,000

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Positions of Non-OPEC Producers

Cooperating Nations	
Mexico	*Mexico has reiterated its "offer" to cut exports to 1.35 million b/d. This spring exports fell to 1.1 million b/d because of marketing problems, but have rebounded since then to about 1.4. Mexico earlier this year set its export target at 1.35 million b/d.* 25X1
Egypt	*Production has been declining since January to roughly 600,000 b/d in July due to pricing problems. Promised only to keep output below 900,000 b/d. Imposed a production cap of 860,000 b/d for FY 1986/87 to prevent the overworking of older fields.* 25X1
Angola	*Indicated in June that it would be prepared to cut its crude oil output from its current level of 300,000 b/d, but no amount was specified.* 25X1
Malaysia	*Following OPEC's decision, Malaysia announced it would reduce output by 10 percent, but only if prices increase "significantly." This implies a potential production cut of 50,000 b/d from its current level of 510,000 b/d.* 25X1
Oman	*Agreed in May to reduce production by 50,000-100,000 b/d. Has since increased production by 50,000 b/d to 550,000 b/d but may cut back by some amount now that OPEC has reached an agreement.* 25X1
Brunei	*Reportedly agreed in May to reduce output by 10,000 b/d from its production level of 180,000 b/d.* 25X1
Noncooperating Nations	
Norway	*Announced it will decide whether to cooperate with OPEC by 1 September. Indicated in June it would not alter current production but might slow down the rate of production growth as a form of cooperation.* 25X1
United Kingdom	*Refuses to take measures that would help raise prices but probably would not oppose independent actions by companies regarding production volumes that would serve this purpose.* 25X1
Canada	*Refuses to cooperate with OPEC. Has seen some shut-in of high-cost production but, overall, not much change in output.* 25X1
Australia	*Production fell by about 120,000 b/d this summer because of oil-worker strikes and a high tax structure that made some production for export uneconomic.* 25X1
China	*Will try to keep exports at 600,000 b/d to earn needed hard currency.* 25X1
USSR	*Facing a substantial deterioration in hard currency earnings and an improved production situation, Moscow could raise exports by roughly 100,000 b/d during the rest of the year.* 25X1

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b/d of output, mostly in the United States and Canada, has been shut in because oil prices fell below operating costs.

- Producers have divergent interests and no formal mechanism for communication or coordination. The countries are a disparate group that range from LDCs that depend heavily on oil for revenue to industrial nations with larger, more diversified economies.
- Growing financial difficulties and budget deficits are making it politically difficult for governments to agree to production cuts when there are no guarantees that all other oil producers will follow suit.
- Technical factors limit additional output cuts. For example, certain fields in Norway—particularly Statfjord—produce associated gas, all of which is sold under long-term contract.
- The North Sea producers—members of the International Energy Agency—are particularly susceptible to strong pressure from the United States, which advocates a hands-off policy in the oil market.

Cooperation Will Be Limited

In our judgment, combined voluntary cutbacks by several nonmembers will probably reduce output by only a maximum of 100,000 b/d this year. Cuts by smaller producers such as Malaysia and Oman will be token gestures to OPEC. Mexico said it would hold its exports to 1.4 million b/d for 1986—a 10-percent reduction from last year. Exports for the first half of 1986 were only 1.3 million b/d, but Mexico could keep sales during the second half at 1.4 million b/d and still honor its commitment to OPEC. Egypt will base its "cutbacks" on already planned reductions in output for 1986—reductions from current production are unlikely. Promises of cooperation from others such as Angola and China were probably lipservice, in our view, and are unlikely to translate into significant decreases in output.

We expect increases in output from other non-OPEC producers, however, will more than offset voluntary production cuts, causing total non-OPEC production to rise by as much as 500,000 b/d over the coming months. Following completion of summer maintenance programs, UK production is expected to rise by at least 300,000 b/d in the next month or two. Also, a recent tax revision in Australia has triggered a resumption of exports of about 100,000 b/d, and the USSR has steadily increased exports in recent weeks.

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Consequently, changes in nonmember production will fall far short of OPEC's expectations and are unlikely to affect price movements significantly this year. The burden of price stability will remain on OPEC, although it is unclear at this point how these circumstances will affect OPEC's discipline. If another price war should ensue, Saudi Arabia might believe that non-OPEC producers have not learned their lesson and attempt to keep prices at very low levels for a prolonged period.

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If OPEC Reneges

OPEC's recent agreement is tentative and could rapidly collapse if members cheat on their quotas. The Saudis would probably renew the market share fight and force prices down again if violations occurred. Kuwait and Indonesia made explicit that their participation in the new accord was contingent on strict adherence to quotas and that cheating by any member would absolve them of quota obligations. If OPEC members were to participate in the struggle for market share and attempt to force their remaining capacity onto the market, oil prices could fall to about $5 per barrel. Under these circumstances, some industry analysts believe that oil prices could remain below $10 per barrel for two years before market forces lead to a rebound.

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If the OPEC agreement collapses, nonmembers would probably remove any production restraint and join the price war. Should prices erode and approach $5 per barrel, additional output in high-cost areas such as the United States and some production in the North Sea and Canada would be significantly affected for the first time. During the first year or so, however, the additional loss of non-OPEC supply—even at prices

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around $5 per barrel—would be relatively small, perhaps about 500,000 to 1 million b/d. In the North Sea, for example, only about 500,000 b/d of UK production would be unprofitable at $5 per barrel, but much of this would probably be produced anyway. Also, shutting in production would entail considerable costs, which might induce operators to continue producing despite short-term losses.

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El Salvador: Private-Sector Uneasiness

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Relations between President Duarte and the private sector in El Salvador have been marked by mutual distrust, strong ideological differences, and conflict over economic policy. Even though private-sector cooperation is essential to revitalize El Salvador's economy, Duarte has continued to concentrate on improving the economic and social conditions of the lower classes and has largely ignored the needs of the business community. As a result, businessmen have remained unwilling to increase investment or expand production. The adversarial relationship between Duarte and the business community shows no signs of abating, and the poor economic prospects suggested by this standoff will probably force the government to remain heavily dependent on US economic assistance to generate even small levels of economic growth.

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Poor Business Climate

The differences between Duarte and the private sector date to 1980 when Duarte, as head of a civilian-military junta, spearheaded reforms aimed at redistributing wealth and breaking the private sector's control over the economy. The major initiatives—agrarian reform and nationalization of export industries and the banking system—robbed the private sector of both political and economic power. Even though Duarte has not enacted major reforms since his election as President in 1984, he believes that Salvadoran businessmen and the upper class should bear most of the sacrifices necessary to achieve a socially equitable economic recovery.

Duarte's opposition to the private sector has hurt the economy. The political and economic fallout from the 1980 reforms—coupled with the continuing insurgency, slack regional trade, and low prices for agricultural export crops—has led to depressed levels of investment and reduced both agricultural and industrial production. Gross fixed private investment is roughly equivalent to what it was in 1971, and less than half the 1978 peak. The industrial sector is operating under 70 percent of capacity, according to the World Bank, while the 1985/86 coffee harvest may be the lowest in 20 years, according to the US Embassy.

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El Salvador: Gross Fixed Private Domestic Investment, 1970-85

	Investment *(million US $)*	Annual Change in Investment *(percent)*	Investment as a Share GDP *(percent)*
1970	195.6	NA	8.1
1971	209.3	7.0	8.3
1972	272.0	30.0	10.2
1973	245.7	−9.7	8.8
1974	281.0	14.4	9.4
1975	320.3	14.0	10.2
1976	355.1	10.9	10.9
1977	430.8	21.3	12.5
1978	495.3	15.0	13.5
1979	371.2	−25.1	10.3
1980	189.4	−49.0	5.7
1981	161.3	−14.8	5.3
1982	151.0	−6.4	5.3
1983	164.0	8.6	5.7
1984	186.0	13.4	6.3
1985	202.7	9.0	6.8

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Businessmen remain concerned about their inability to influence economic decision making and fear that Duarte will attempt to increase the state's control over the economy. Low business confidence is aggravated by cumbersome bureaucratic procedures and mismanagement. Embassy reporting provides numerous instances where the lengthy and difficult process of

[1] This article summarizes a forthcoming research paper.

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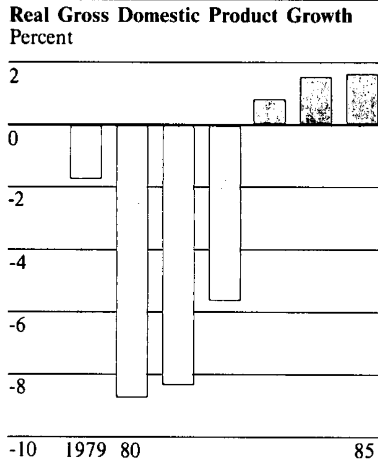
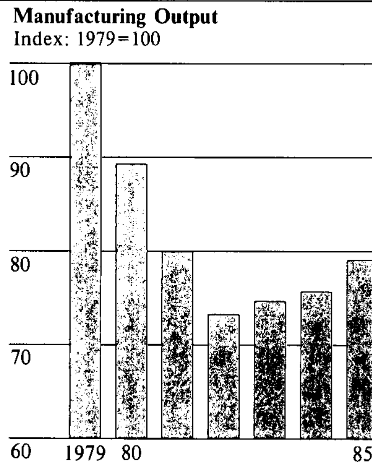
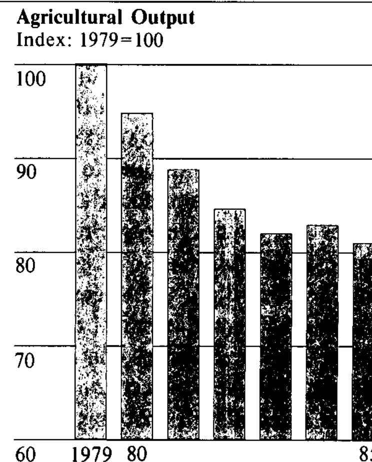
El Salvador: Economic Indicators, 1979-85

Note scale change







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getting foreign exchange has cost business sales. Businessmen correctly perceive that the government has virtually ignored major macroeconomic problems such as the need to earn foreign exchange by stimulating exports.

Nonetheless, strong backing from the United States and the Salvadoran military has bolstered Duarte's position vis-a-vis the private sector. The President's ability to control policy is also enhanced by his party's control of the National Assembly. Embassy reporting indicates that the Salvadoran business community realizes that US military and economic aid has accelerated the downward trend in political violence, substantially improved the counterinsurgency effort, and raised El Salvador's international image. As a result, the serious problem of capital flight—which reached over $1 billion during the peak of violence in 1981-82—appears to be stemmed.

Despite the improvement in the security situation, however, progress in subduing the insurgency has been gradual and costly. Moreover, the guerrillas increasingly have focused on economic sabotage in an effort to offset the superiority of the armed forces and highlight the vulnerability of the government. As a result, the domestic climate has remained tenuous and strongly unfavorable to either domestic or foreign investment.

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Efforts at Accommodation Fall Short

Many in the government appear to recognize that the cooperation of the private sector—which produces roughly 70 percent of GDP—is essential for stable, long-term economic growth. Duarte is being pressured by members of his own party to be more conciliatory. In particular, Minister of Planning Chavez, who hopes to be the next president, has attempted to establish cordial relations with the business community.

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Duarte could ease tensions with the private sector, both by providing economic incentives and by modifying the way he deals with the business community, but his options are constrained by his need to be responsive to his constituents—particularly labor and peasant groups. Embassy reporting indicates that the President's concerns about the potential for leftist labor agitation and his desire to strengthen his support among democratic unions caused him to soften his January austerity program by maintaining price controls and subsidies and including some salary increases. Many of the reforms that would be most effective in boosting private-sector confidence and improving economic prospects—such as additional devaluations—would impact negatively on the lower classes and therefore tend to be rejected out of hand by Duarte.

Private-sector leaders have initiated dialogue with the government on several occasions in an effort to improve relations, and several business groups have given Duarte proposals for revitalizing the economy. The US Embassy reports that some moderate businessmen have made efforts to improve communication, but they feel their suggestions have been ignored. Further complicating matters, a hardline minority continues to foment opposition to the Duarte government. For example, the January announcement of the austerity package precipitated efforts by rightist businessmen to mobilize public protests and form a broad-based opposition front to demand revisions in the program. These efforts so far have failed, however, due to lack of broad private-sector support, financial difficulties, and distrust of rightist intentions by labor groups.

Reconciliation Unlikely

Relations between the private sector and the government are unlikely to improve significantly in the next two years, making the prospects for sustained economic recovery poor. Despite the importance of the private sector, we expect that President Duarte will continue to lean toward satisfying popular demands at the expense of measures to restore business confidence. For its part, the business community probably will remain unwilling to boost investment or contribute to the revival of the economy without some signs of conciliation from the government.

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In our judgment, the private sector will not abandon its cautious attitude or be able to significantly alter the government's agenda. The country's seven major business organizations lack the unity or political clout to influence policy. Moreover, we believe that the reelection earlier this year of moderates to lead major private-sector groups indicates little desire on the part of most businessmen to challenge the government. Rather, the business community will continue to work for a set of fair, mutually agreeable ground rules.

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As a result of the continuing stalemate in private-sector relations, we expect economic growth to languish at 1 to 3 percent this year—well short of the level necessary to reverse the slide in real per capita income that started in 1980. In addition, we foresee no end to a reliance on agriculture for export earnings, as the business community will remain unwilling to move toward production of nontraditional exports without incentives from the government.

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Without increased private-sector involvement in the economy, El Salvador's economic dependence on US aid may increase. In our judgment, Duarte believes he can rely on US economic aid to see him through hard times without making the politically risky reforms essential to restoring the economy or boosting private-sector confidence. Duarte is unlikely to implement conditions attached to US aid that call for increased private-sector-government cooperation if he believes they would weaken his popular support. Salvadoran businessmen, on the other hand, are likely to increase pressure on the United States to force Duarte to accommodate their interests.

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Briefs

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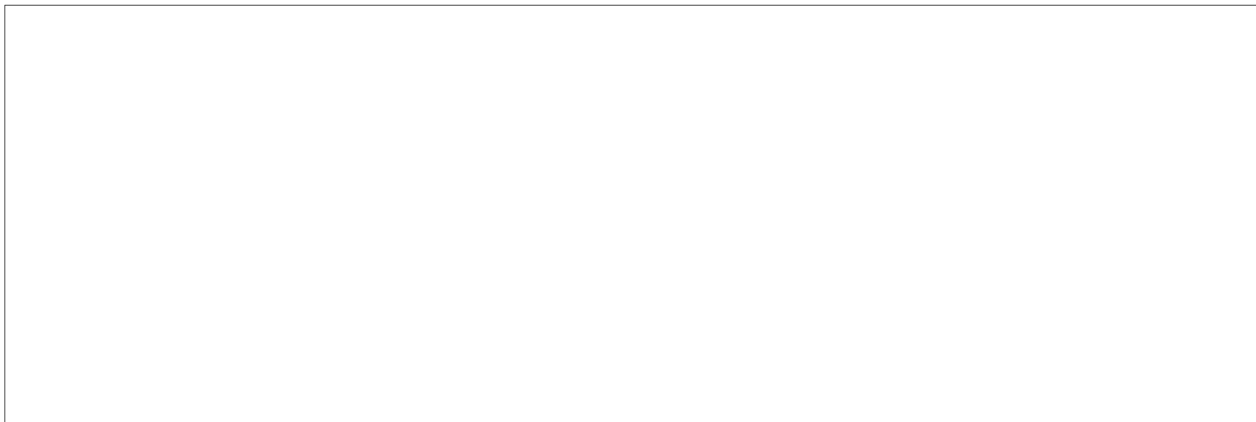
Energy



UK North Sea Oil Exploration To Fall

British oil companies will sharply cut North Sea exploration in second-half 1986 because of the continued slump in oil prices. The UK Offshore Operators' Association reports that, by yearend, exploration could fall by as much as 40 percent from 1985 levels. Flagging activity is already evident with only 41 of 111 available drilling rigs in use over the past two months, a period when drilling usually picks up due to calmer seas. Exploration activity is unlikely to pick up even if oil prices rebound somewhat because oil companies have already slashed North Sea exploration budgets—formulated with the assumption of oil prices of $15 to $18 per barrel—by as much as 50 percent. Industry officials now estimate that oil prices would have to rise to a sustained level of at least $18 per barrel before it would be profitable to increase exploration. 25X1

Libyan Oil Industry Reorganization

Libya is reorganizing its oil industry following the 30 June withdrawal of US companies. 25X1 all assets and operations of US oil companies will be incorporated into the Sirte Oil Company, whose activities will be overseen by Mansur Muhummad Bin Niran of the Libyan National Oil Company. Assuming the reorganization is completed, Sirte will be producing over 50 percent of Libya's total production of about 1.1 million b/d. The former Sirte Oil Company was producing about 100,000 b/d, but production has slipped in recent months due to a lack of oilfield investment. 25X1 Sirte has indefinitely suspended all new foreign oil equipment purchases because of Libya's financial crisis. If Libya continues to neglect capital and operating expenditures for its oil industry, Libya will be unable to maintain its productive capacity at its current estimated level of 1.6 million b/d. 25X1

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International Finance

Reaction to Mexican Debt Agreement

Several Latin American countries are positioning themselves to take advantage of the innovative financial package recently put together by the IMF for Mexico. Failure by these governments to obtain comparable terms tied to the prices of key export commodities or to economic growth might provoke them to adopt confrontational tactics. For some, the commitment to large new loans for Mexico will raise expectations of substantial new credit infusions:

- ***Argentina*** has delayed its talks with the Fund in an effort to obtain equal treatment. Argentine Government officials recently noted that weak agricultural prices are analogous to lower oil prices, according to the US Embassy. President Alfonsin also has told the press that Argentina will request a sizable reduction in interest payments because of the price-depressing effect of US-subsidized wheat sales to the USSR.

- Although ***Venezuelan*** officials have not yet commented publicly on the Mexican agreement, Finance Minister Azpurua told the US Ambassador in June that Caracas was examining ways to link debt service to oil prices. Venezuela, which relies on oil for 90 percent of its exports, will begin talks with foreign bankers this fall to renegotiate terms on its rescheduling agreement.

- In his state-of-the-nation address on Sunday, ***Ecuadorean*** President Febres-Cordero said that Quito would seek more favorable terms on its foreign debt if oil prices do not rebound soon. Up to this point, Ecuador has cooperated fully with creditors.

- ***Brazil's*** Finance Minister Funaro told the press in late July that Brazil needed to cut its net debt payments to 2.5 percent of GDP next year to support a planned 7-percent growth rate.

25X1

- President Garcia of ***Peru*** is probably taking credit in private for the favorable terms won by Mexico, suggesting that this vindicates Lima's hardline debt policies. Garcia recently announced an indefinite extension of his unilateral limit on Peru's debt service, placed new limits on foreign remittances, and paid only part of the country's arrears to the IMF.

25X1

IMF Sanctions Against Peru

The IMF publicly declared Peru ineligible to draw on Fund resources last week when Lima failed to clear about $160 million in arrearages. Peru has paid $35 million, and, according to official statements, the government was resigned to being declared ineligible. Peru probably will not declare a total debt moratorium because the government still hopes to receive continued loans from the World Bank and the Inter-American Development Bank, as well as bilateral credits from some OECD governments. The IMF declaration places new credits from the development banks in jeopardy, but it should not affect loans currently being processed. President Garcia has used the occasion to reiterate his assertion that developing countries should only be expected to service their debts in accordance with their ability to pay.

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Venezuela Scraps Plan To Assume Private Foreign Debt

The Lusinchi administation has scrapped plans to assume most of the government-approved private foreign debt. Passed by Congress last month, the scheme was intended to provide balance-of-payments relief and to raise revenues to cover next year's fiscal deficit by forcing large private-sector debtors to purchase 15-year, dollar-denominated government bonds to settle accounts with foreign creditors. Although foreign banks favored a government assumption of the private-sector debt, they strongly opposed the below-market interest rate the bonds would carry. In reaction, banks refused to open negotiations to reschedule the public debt—some, reportedly, cut trade credit lines. According to the Embassy, the government now plans to require large private debtors to secure a five-year grace period on principal repayments from their foreign creditors before being granted access to preferential-rate dollars at the Central Bank. To cover the 1987 fiscal deficit—a projected 8 percent of GDP—the administration may allow the Central Bank to increase significantly its holdings of Treasury debt. Some Venezuelan analysts, however, have expressed concern that such a move would be inflationary. The private debt fiasco has increased tensions with banks, has fueled opposition criticism of Lusinchi's economic management and, in our judgment, is likely to further depress investor confidence—making chances of economic recovery before 1988 even more remote.

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Soviet LDC Debt Collection Problems

The fall in world prices of oil and other raw materials is making it difficult for a number of Third World countries to meet their hard currency payments to the USSR, adding to Moscow's own foreign exchange problems. Estimated Libyan backpayments have grown to as much as $1.2 billion over the past year. Many clients, including Angola and Iraq, have requested debt rescheduling. Some, such as Syria and Nicaragua, have requested loans. Third World countries owe the USSR approximately $25 billion, mostly for military purchases. About $10 billion is owed by countries that Moscow knows will not be able to repay—for example, Ethiopia, Mozambique, and South Yemen. In some cases Moscow has been increasingly willing to accept goods—especially oil—in lieu of cash repayments. The USSR currently has such arrangements with a number of LDCs, including Libya, Iraq, and Peru. The recent extension of Soviet credit to Algeria allows for half the repayment to be in industrial products. Moscow, however, is unlikely to press too hard on the debt issue for economic as well as more obvious political and military reasons. The LDCs represent Moscow's major Western outlet for exports of manufactured goods and provide the Soviets with $3-4 billion per year even after credits and payment reschedulings are taken into account.

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Seychelles' Foreign Exchange Crisis

According to US Embassy sources, Seychelles is suffering a critical foreign exchange shortage that could adversely affect President Rene's political prospects over the medium term. Although receipts from tourism, the main source of foreign exchange, have been rising since 1983 to a record $47 million last year, local banks and businessmen are having great difficulty in obtaining hard currency from the Central Bank for new letters of credit or existing ones already approved.

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The government is in arrears to the African Development Bank, Air France, and other important creditors. [ ] the crisis is mainly due to Rene's misguided economic policies that have included an overvalued currency and heavy spending on major projects and new government corporations. The government is scrambling to obtain funds from abroad, but the prospects are gloomy, [ ] 25X1 25X1 25X1

International Trade

Japan Moves To Curb Auto Exports to the EC

MITI, in response to a request from the EC, is moving to stem a sharp rise in exports of Japanese autos to Western Europe. According to press reports, exports for the first seven months of 1986 are 40 percent above the same period last year. [ ] For the past five years, Japan's auto makers have held approximately 10 percent of Europe's 10-11 million car market. Japan's market share will rise to approximately 12 percent in 1986, and could reach 15 to 16 percent by the late 1980s as Japanese assembly plants in Europe come on line. [ ] 25X1 25X1

Reaction to Extension of MFA

Many LDCs have mixed feelings about the new Multi-Fiber Arrangement (MFA). They oppose the more restrictive provisions such as antisurge provisions, unilateral restraint, and inclusion of new fibers such as ramie, linen, and silk blends. In particular, China, Hong Kong, and India expressed disappointment. On the other hand, several LDCs accepted the new MFA provisions in lieu of the threatened veto override of the Textiles Trade and Enforcement Act of 1985 (Jenkins Bill) and welcomed the bill's defeat early this month. Hong Kong was especially relieved because the pending veto override placed them in a very vulnerable position. Most of the LDCs believe that, unless the United States achieved major concessions during bilaterals and MFA negotiations, a Congressional override would have been assured. In addition, [ ] the new MFA provides security and protects Thai exports from the dominant competitors—Hong Kong, South Korea, Taiwan, and China. Some LDCs believe that US pressure to control textile imports will continue, and countries such as Hong Kong and Taiwan have threatened retaliatory steps if further restraints are implemented. [ ] 25X1 25X1

Global and Regional Developments

More EC-CEMA Talks

EC officials have proposed a meeting with CEMA counterparts in September for exploratory talks on establishing relations between the two organizations, according to US Embassy sources. The EC's main goal remains bilateral agreements with individual East European states, and it plans to go slowly in negotiations with CEMA until at least two East European countries establish diplomatic relations with the EC. Romania has indicated willingness for bilateral diplomatic as well as economic agreements, possibly by the end of the year. Hungary, Czechoslovakia, and Poland have shown interest in commercial agreements, while Bulgaria, East Germany, and the USSR insist on progress in EC-CEMA relations first. The talks

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are unlikely to produce formal EC-CEMA ties soon. Romania is the only CEMA country close to establishing diplomatic relations with the EC. Some EC officials place a high priority on a broad agreement with Hungary, but talks apparently have bogged down over Budapest's longstanding demands for trade concessions. EC concerns about human rights in Poland may complicate negotiations with Warsaw. 25X1

Japanese Views of Soviet Joint Venture Proposal

In his late July Vladivostok speech, General Secretary Gorbachev highlighted the previously proposed possibility of joint ventures with foreign corporations (largely Japanese) to speed the development of the Soviet Far East. Despite Gorbachev's blessing, Japanese business is taking a wait-and-see attitude, according to the US Embassy in Tokyo. Japanese companies are looking for progress in Soviet joint venture legislation, profit/capital repatriation laws, relaxation of visa restrictions for Japanese businessmen, and some exemption of joint ventures from supply allocation and production quotas as a measure of Soviet intentions. Nonetheless, Japanese officials and businessmen with whom Embassy officers recently spoke believe some movement is likely in the next few years. In view of Moscow's hard currency constraints, Japan probably will be unable to boost sales to the Soviet Union without devising a way to increase Soviet exports. Joint ventures, moreover, provide a way of securing products and resources suitable for Japanese or third-country markets. 25X1

National Developments

Developed Countries

Politics of Japanese Tax Reform

Implementation of Tokyo's long-anticipated tax reform package is likely to be delayed from 1987 to 1988 25X1 25X1 Nonetheless, the government's intentions are already clear—reductions in personal and corporate tax rates to be financed by a new VAT type plus some form of taxation of now tax-exempt savings accounts. Although Prime Minister Nakasone promised during the July general election campaign not to introduce "a new large-scale indirect tax" or to revise the tax-exempt savings system, he has, since the election, allowed the tax council to consider both. Despite Nakasone's stand, the ruling Liberal Democratic Party's (LDP) recent election landslide probably strenghtened the hand of those who could delay, if not block, reform. Many LDP candidates campaigned against new taxes and feel the need to protect their supporters—farmers, small businesses, retailers, and the postal savings lobby. The tug of war between the government's tax reform council and the parallel LDP study group over issues such as the VAT and taxation of savings accounts is likely to cause the original October date for submission of tax reform proposals to the Cabinet to slip. 25X1

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25X6

British Labor Party Spending Plans Under Attack

An independent study of Labor Party spending plans concludes that London's budget deficit would increase to $39 billion by 1990—four times this year's projected deficit—while doing little to decrease unemployment. The study by the widely respected Item Club projects that the increased spending would reduce unemployment by only 500,000 over two years, half of what Labor has promised. By 1990, however, the sharp increase in spending would boost inflation, create a huge balance-of-payments deficit, and reduce economic growth—reversing the initial gains against unemployment. The study supports charges by Conservative spokesmen that Labor's plans, even if phased in over several years, would put a heavy burden on British finances; a Treasury official charged that funding Labor's programs by increasing taxes would force the government to raise the basic rate of income tax from 29 to 53 percent. Because Labor probably would not be able to implement all of these plans—especially renationalization of industry—the study probably overestimates the actual impact on the economy of a Labor government. Nevertheless, it will provide powerful ammunition for the Conservatives, anxious to portray Labor leaders as free spenders who are dangerous to the British economy.

25X1

West German Economic Growth

Economics Minister Bangemann announced last week that the economy grew 3 to 3.5 percent in the second quarter over the same period last year. He predicted that growth would accelerate during the rest of 1986 and into 1987 and rejected US calls for Bonn to stimulate domestic demand. West Germany's major economic institutes have recently lowered their forecasts, but still predict respectable growth of 2.5 to 3 percent in 1986 and continued expansion next year. Two quarters of negative growth preceded the rebound this spring. Chancellor Kohl's coalition hopes that strong, noninflationary growth during the remainder of the year will vindicate its tight economic policies before the national election in January. Bonn's main concern is that additional appreciation of the mark will further depress already sagging exports. If the dollar drops sharply, West Germany will probably call on the United States and Japan for coordinated action to stabilize its value.

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Lisbon Reduces Interest Rates Again

The Portuguese Government lowered interest rates by 3 percentage points last month in an effort to boost investment—the central plank of Prime Minister Silva's economic recovery plan. Despite the cut—the third since he took office last fall—lagging private-sector confidence probably will not create the investment boom Portuguese officials have been anticipating. We expect investment to increase 5 to 7 percent this year—a marked improvement after three consecutive years of decline, but well below the government's 9-percent target. Business confidence is still being hurt by the perceived fragility of the minority government and doubts about Lisbon's willingness to liberalize the economy and give a greater role to market forces. Relatively high excess capacity in a number of sectors also is discouraging new investment. We believe Lisbon will gradually step up its efforts to boost investor confidence to pave the way for the long-awaited recovery in investment.

25X1

Greek Foreign Investment Liberalization Extended to Non-EC Residents

To attract more foreign investment to ease serious foreign payments difficulties, the Bank of Greece last month extended to non-EC residents the May presidential decree that allows EC investors to freely repatriate profits, dividends, and interest on new direct investments, and to re-export the investment funds after three years. The only restriction is that transactions must be registered in advance to ensure their legality. Some investments made prior to 25 July may also be eligible if they fall into a special investment category. Many potential foreign investors in the past had complained that strict Greek controls on capital repatriation were a disincentive to investment. The new regulations appear to be working because the Bank of Greece has recorded $35 million in new foreign investment in the 15 days since they were published.

25X1

Israeli Cabinet Votes To Cut Government Expenditures

According to the US Embassy, the Israeli Cabinet voted early this week to reduce government expenditures by about $210 million. These cuts will come as an across-the-board, 3.9-percent reduction by all ministries, except for Defense whose proposed cuts are still under discussion. Press reports state that Finance Minister Nissim remains confident the defense cuts will not be less than $67 million. Nissim's optimism may be unfounded, however, especially if Defense Minister Rabin gains the $60 million he has requested as compensation for the falling purchasing power of US grant aid to defense industries for procurement and development projects. The Cabinet also stated that, until each ministry presents a detailed plan on its cuts, there will be a 75-percent freeze on all contracts. This partial freeze, however, will not affect prior defense, housing, and education ministry commitments.

25X1

Less Developed Countries

Brazilian Reaction to Informatics Dispute

The third round of consultations between Brasilia and Washington on Brazil's protectionist policies on informatics—computer and software sales—ended last week in Paris without Brasilia's modifying its hardline stance. Brazil has indicated that it will not be able to meet US concerns before the deadline of 16 September. The US Embassy reports that the meetings are receiving widespread press

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coverage in Brazil and that hardline supporters of the restrictive policy are urging Brasilia not to give in to US demands. Brazilian officials privately warned the US Ambassador that President Sarney probably would postpone his visit to Washington, scheduled for 10 September, if he believed that the United States will retaliate. Rising economic nationalism over the informatics issue is likely to constrain Sarney from making sufficient concessions to resolve the dispute before 16 September. Sarney faces a political dilemma: concessions would undercut his supporters in the coming congressional elections, but US retaliation would reduce significantly the political dividends he hopes to gain from the visit.

25X1

Brazil Pushes Increased Foreign Investment Controls

A proposed decree that calls for strict limitations on foreign participation in the Brazilian pharmaceutical industry highlights growing domestic support for nationalist economic policies. Brazilian officials, according to the US Embassy, argue that the draft law only codifies current regulations by restricting imports of products manufactured domestically—investment in the sector through joint ventures would continue. Nonetheless, the proposed legislation is more exclusionary than current regulations, according to the US Embassy, and hardliners probably will intensify their lobbying for more restrictive policies in the coming electoral campaign, when nationalist sentiments will run high. The President is prepared to veto proposals for a market reserve in pharmaceuticals, according to an internal government document, but he probably would change his mind if the current informatics dispute with Washington results in US retaliation.

25X1

Ecuador Administers Adjustment Measures

The government recently announced implementation of IMF-supported economic measures in order to obtain Fund credits of approximately $138 million. The economic package allows a floating foreign exchange rate for private-sector transactions and eliminates interest rate ceilings on domestic bank savings and loans. The IMF standby arrangement will be used to repay a $150 million loan the United States granted in June to cover Ecuador's 1986 financing gap. According to US Embassy reporting, the measures will stimulate the export-led agricultural and fisheries sectors, but will hinder imports and create inflationary pressures. President Febres-Cordero's problems with the leftist-dominated Congress are likely to be exacerbated by his continuing dependence on US and IMF credits.

25X1

Uruguay's Increased Pensions

The Uruguayan legislature voted late last month to raise pensions for some 700,000 former government employees—roughly one-fourth of the population—by 107 percent, retroactive to April 1986. The bill emerged as a compromise between President Sanguinetti and the center-left opposition parties that control Congress. Sanguinetti, according to the US Embassy, acceded to the measure to prevent an opposition override of his veto of an even more extravagant proposal. We concur with Finance Minister Zerbino's public assessment that the bill is,

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nevertheless, a budget-buster that could hobble Uruguay's nascent economic recovery. Although Montevideo will try to cut spending elsewhere, the administration, in our view, probably will have to print money to cover the pension increase. This could cause Uruguay to miss fiscal deficit and monetary targets in its IMF-supported program, delaying more than $100 million in IMF, World Bank, and commercial loans.

25X1

Syrian Exchange Rate Reforms

In an effort to correct its unrealistic exchange rate structure, the Syrian Government last week introduced a new rate for tourists and expatriate workers. The buying rate for the pound will be 22 per dollar—compared with the illegal market rate of 25.5 per dollar and the former tourist rate of 9.75. The measure is part of an overall effort to bring more transactions into legal channels but will not significantly curtail unofficial currency dealings. Other partial devaluation measures enacted this year include moving the rate for exporters to a more profitable level and requiring state trading companies to purchase imports at 11.25 rather than the official rate of 3.9 per dollar. Syrian authorities also have arrested illegal moneychangers seven times this year. Despite the limited reforms, most currency trading and import deals will continue at the lower illegal rate. The government does not have sufficient international reserves to support the multitiered exchange structure—opening of letters of credit takes up to a year—and the new lower official rates could put further downward pressure on the black-market rate.

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Jordan Plans To Spend Funds To Stimulate Economy

According to the US Embassy, the government announced early last week a $360 million program to stimulate the economy over the next two years. The spending is to include about $290 million of accelerated investment during the recently formulated 1986-90 development plan. The remaining $70 million is to be financed by borrowing from the cash reserves of the Social Security Corporation and is to be spent on a variety of government projects. Given an estimated 1986 central government budget deficit of $400-500 million and a recent Central Bank declaration that it does not plan any international borrowing this year, it is not clear how the government intends to finance the $290 million in investment spending. Moreover, this additional spending would exceed the spending targets in the recently released five-year development plan. If the spending does not occur, however, the government will have raised domestic expectations unrealistically—a charge already being leveled at its $1.3 billion five-year development plan for the occupied territories.

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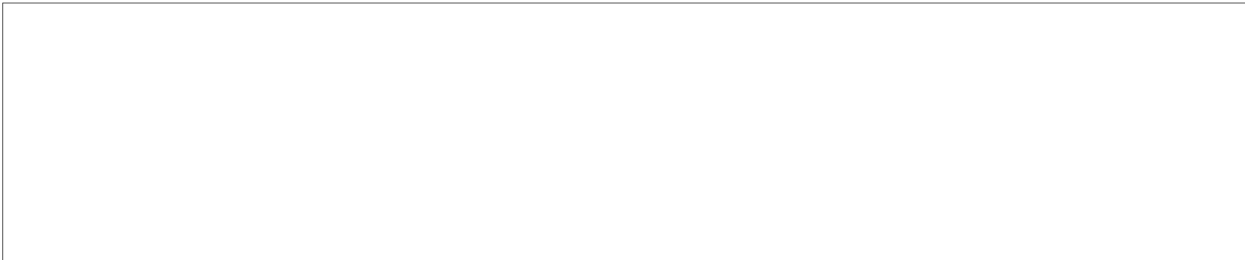

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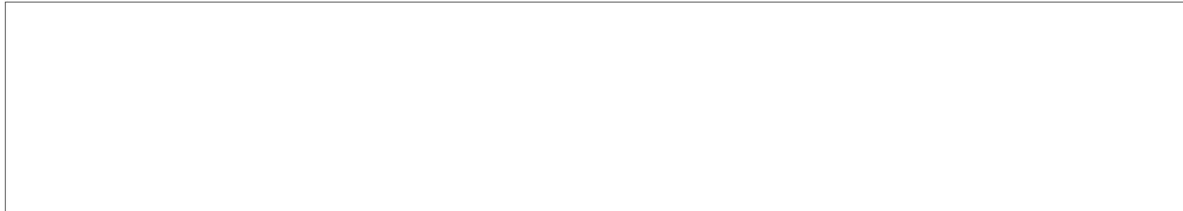

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Indonesian Economic Contraction

According to US Embassy reporting, Jakarta's top economists agree that 1986 is shaping up to be the worst year since the New Order government came to power 20 years ago. The dramatic drop in oil prices has caused Indonesia's oil exports to plunge 43 percent in the first two quarters of 1986 compared with the same period in 1985. [ ] the economy could contract as much as 2 percent for the year even if the recent rebound in oil prices is sustained. The US Embassy also reports that a major debate is brewing over how to deal with an expected $3 billion shortfall in government revenues. Nevertheless, inflation-wary finance officials have so far resisted pressures to engage in deficit financing or to speed drawdowns of foreign reserves. The regime is worried about not only the near-term impact of the economic slump on Indonesia's restive labor force—urban unemployed exceeds 35 percent—but also the political impact of continued budget cuts on next April's parliamentary elections. [ ]

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Communist

Gorbachev Gains Momentum on Economic Issues

Recent top-level decisions suggest that General Secretary Gorbachev's economic program may be gaining speed after several months of slow progress following the party congress. Soviet media report that a Politburo meeting last week made decisions on a range of outstanding issues, including expanding the role of member-run cooperatives in producing consumer goods and providing services. The Politburo also announced plans to reorganize the State Committee for Construction Affairs. On Monday the chairman of the State Committee for Prices, Nikolay Glushkov, was removed. The details of the Politburo decisions are not yet available, and they may not have gone as far as Gorbachev would have liked. Glushkov's retirement removes an unabashed opponent of price reform and may pave the way for a more open discussion of the issue. Reorganization of the construction committee suggests renewed momentum on streamlining the bureaucracy—a key element of Gorbachev's strategy for revamping economic management. The decision on cooperatives—which some officials fear could provide too much competition for the grossly inefficient state consumer sector—appears to respond to proposals that Gorbachev aired at the party congress and again during his recent tour of the Soviet Far East. [ ]

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Growing Pressure on the Soviet Machine-Building Sector

The Soviet press reports that a high-level conference was held recently to discuss the need for "radical enhancement" of the machine-building sector. Politburo member Zaykov decried the sector's slow progress in modernizing and improving product quality, especially after being allocated "absolutely everything that our economy can permit." The conference is but the latest indication of Moscow's concern over the mixed performance of the sector General Secretary Gorbachev is relying on to spur economic revitalization and to improve military capabilities. Although output grew at a respectable pace during the first six months of 1986, the sector failed to meet the overly ambitious targets for quality and technological advance. Leadership expectations, at least in the short term, are unrealistic given the sector's inability to absorb the massive transfer of resources to support the modernization campaign. [ ] 25X1

Troubles in Hungarian Coal Industry

More than 700 Hungarian coal miners at the Borsod and Tatabanya mines have resigned since mid-July, when the government announced plans to restructure the troubled coal mining industry to reduce its financial losses and to stabilize declining output. The regime intends to close at least seven uneconomical mines (out of a total of 36), cut back underground production in favor of less expensive open-pit operations, and extend the workweek to six days, reducing overtime payments. Production costs have escalated as coal output has declined because of the difficult geological conditions and labor shortages that have necessitated more overtime. Despite above-average earnings, about 1,600 miners leave the industry annually, because of harsh working conditions, poor safety standards, and flagging prospects. Industry Minister Kapolyi has publicly stressed that displaced miners will be assured work in the same mining basin, possibly to avert further resignations and promote the orderly relocation of miners to pits that are short on manpower. His assurances may also reflect regime sensitivity to the problem of unemployment in economically depressed regions—a problem that could become an increasing concern for the government if it follows through with plans to close insolvent firms in declining industries. [ ] 25X1

Cuban Economic Policy Inches Leftward

President Castro's latest economic program calls for drastic action against inept management and corruption, but these are only the symptoms of Cuba's economic problems, and his efforts are likely to bring minor improvements at best. The government's "action plan" aims at combating widespread cheating on production records, salaries, and perquisites; corrupt and inept business administration; and insufficient law enforcement [ ] The plan tightens use of some market incentives and relies more on the reinforcement of moral and revolutionary ideals. Nine ministerial working groups were established this month to study long-term remedies to administrative weaknesses and labor deficiencies. According to a source of the US Interests Section, the conclusions of the groups will be presented at a special session of the Cuban Third Party Congress in December. The working group's agenda indicates that new policies will focus on tougher labor discipline, reduced consumption, revisions in planning and investment processes, and political exhortations. Concentrating on voluntary 25X1

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labor and deemphasizing profitability of enterprises suggest a move leftward but probably do not portend a reversion to the radical policies of the 1960s when the Cuban leader attempted a shortcut to "pure Communism." The Soviets have probably urged restraint on Castro and are likely to continue doing so. Nonetheless, the move away from some market incentives is likely to dampen economic output further. Cuban workers, hit by eroding incomes, shortages of goods, and calls for greater sacrifices, are likely to become increasingly outspoken, possibly forcing the regime to turn more to repressive measures.

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