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International Economic & Energy Weekly

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As President Aquino prepares to visit Washington next week, for the first time in recent years the economic news out of Manila is not all bleak. Although Aquino came to power as the Philippine economy was beginning to rebound, and despite the economic measures taken so far, we believe the economic recovery is in doubt as long as investors remain on the sidelines. 25X1

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19 **Israel: Will Debt Spoil the Economic Outlook?** 25X1

Israel has made great strides toward economic recovery in the past year, but continued progress will hinge on the government's willingness to reduce spending to hold the line on budget deficits. The budgetary process will come under added pressure in the next three years when the government is scheduled to repay about $4.7 billion to bank share holders stemming from the bank scandal—and subsequent stock market collapse—of October 1983. 25X1

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Perspective

The Philippines' Economic Balance Sheet Since the February Revolution [redacted] 25X1

As President Aquino prepares to visit Washington next week, for the first time in recent years the economic news out of Manila is not all bleak:

- On the policy front, Aquino's economic team has scored some success in moving ahead with the difficult task of economic reform. Finance Minister Ongpin has dismantled marketing monopolies in sugar, coconuts, and tobacco.
- Restrained growth in the money supply has helped arrest price increases and stabilized the peso's exchange rate.
- The government has introduced tax reforms and promised to reorganize failing financial institutions and lower barriers to imports, as part of Manila's negotiations with the IMF for a $500 million balance-of-payments loan.
- Economic moderates on the commission writing a new constitution have defeated leftist proposals that would have severely restricted foreign investment and protected local producers from nearly all competing imports. [redacted] 25X1

Moreover, according to our econometric model, the two-year recession bottomed out late last year and the economy could grow by nearly 2 percent this year and 6 percent next year. In addition, the country's external finances are in a good position to support recovery. Foreign exchange reserves have grown by 80 percent to $1.6 billion since February, and we calculate that inflows this year will be sufficient to meet debt servicing and import requirements. Aid donors have pledged over $750 million in financial assistance for 1986, and we believe that more than $1 billion may be raised next year. Negotiations with foreign banks and aid donors are almost certain to result in a rescheduling of debt payments due between 1987 and 1991. [redacted] 25X1 Manila is serious about starting to whittle down the debt, according to Ongpin. [redacted] 25X1

Although Aquino came to power as the Philippine economy was beginning to rebound and despite the economic measures taken so far, we believe the economic recovery is in doubt as long as investors remain on the sidelines. Foreign and domestic investors worry that leftists dominate policymaking, that Aquino's conciliatory approach to the Communist insurgents will backfire, and that the administration's inexperienced managerial staff is crippling efforts to implement economic programs. The US Embassy reports that the business community is especially concerned about Labor Minister Sanchez's sympathy for leftist unions—the number of strikes since March has increased 75 percent from the same period last year and has involved over 90,000 workers. Moreover, investor confidence has been eroded by repeated rumors of impending coups. As a result, foreign corporate investments since January are running at half last year's rate. [redacted] 25X1

Over the longer term, Manila's economic planners cannot count on sustaining economic growth with exports. Commodity prices this year are at historically low levels, and most economists expect little improvement for at least the next few years. Another constraint to growth is that the Philippines is seriously over-borrowed—servicing its foreign debt absorbs nearly 40 percent of export earnings. For these reasons, we believe the key to sustainable growth lies in revitalizing the rural economy, which provides a livelihood for 70 percent of the population and accounts for more than one-fourth of national output. 25X1

Aquino's advisers also recognize that an effective counterinsurgency program requires a "decent" rural standard of living, because close to 3 million Filipinos—nearly 13 percent of the labor force—are jobless, and the Communist insurgency continues to thrive. Consumers, small businessmen, and organized labor, however, are likely to resist exchange rate, tariff, pricing, and tax policies designed to boost the rural economy if they believe those policies would hurt urban industries or raise consumer prices. Nevertheless, we estimate that combating the propaganda gains by the Communist insurgents requires agricultural growth rates in excess of 4 percent annually, a rate not achieved since 1980. 25X1

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Iraq: Targeting Iran's Economy [redacted] 25X1

Iraqi air attacks on Iranian economic targets are putting additional strains on an already weak Iranian economy. Since the spring, Baghdad has increased the number, scope, and accuracy of its strikes, expanding attacks on oil facilities and factories related to military production. Although the attacks are likely to add to Iranian economic hardships, Baghdad would need to be more persistent to critically affect Tehran's warmaking ability. [redacted]

Keeping the Pressure on Tehran

The heightened military pressure on Iran's economy is a response to Iraq's defeat at Al Faw earlier this year and an extension of its strategy of pressuring Tehran to end the war. Since early in the conflict, Iraq has periodically increased air attacks to compensate for defeats on the ground and to dispel any perception among its own people that it has lost control of the war. Moreover, Baghdad probably sees an opportunity in Iran's current economic decline to pressure Tehran. [redacted]

Baghdad is exploiting the wartime experience of its pilots and improved weaponry to carry out more damaging raids. Iraq has refined its use of its Mirage aircraft and Exocet missiles and may have used laser-guided missiles and in-flight refueling for the first time this year. Fear of Iranian retaliation and reluctance to risk losing aircraft, however, have hindered the air campaign's effectiveness. Iraq has failed to destroy critical economic targets because it sends too few aircraft, uses relatively ineffective tactics, and—most important—does not follow up its attacks. [redacted]

Iraqi Attacks . . .

Iran's oil production and export facilities have borne the brunt of Iraqi air attacks. Recent attacks on Khark, Sirri, and Lavan Islands and tankers in the Persian Gulf have temporarily reduced Iran's ability to export oil. Iraq raided Iran's Sirri Island transshipment facility for the first time in August, disabling four tankers and causing some customers to refuse to load there. The Lavan oil terminal was hit for the first time on 5 September. Tanker attacks, bad weather, 25X1
and maintenance problems have hampered Iran's shuttle operations and forced Tehran to move its transshipping operations four times in the past several weeks. [redacted] 25X1

On land, at least a dozen gas–crude oil separating plants and crude oil pump stations have sustained severe damage since June. Because of excess capacity, however, these attacks have so far caused only temporary dislocations. Repeated bombings would be necessary to shut down Iranian oil production for an extended period. Widespread airstrikes on 18 June that damaged seven separate facilities prove Iraq's ability to inflict such damage. [redacted] 25X1

Iraqi attacks on Tehran's vulnerable domestic refineries, however, have disrupted domestic supplies of petroleum products. Since May, Iraq has inflicted 25X1
substantial damage to at least three refineries that account for about 75 percent of domestic production. [redacted] shortages forced Tehran 25X1
to impose rationing of gasoline in mid-July. We expect Iran's annual winter heating fuel shortage will be more severe this year as a result of the attacks. [redacted] 25X1

Nonoil economic facilities have increasingly been targeted, particularly those related to military production. In late July, Baghdad hit an ammunition factory; a weapons assembly plant; and machine tool, 25X1
aluminum, and steel factories providing inputs for military industries. Damage to these and other industrial targets are expensive to repair because of dwindling foreign exchange reserves. [redacted] 25X1

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. . . Provoke Ineffective Retaliation

Iranian retaliation—mostly of artillery barrages or raids of one or two aircraft near the border—has been largely ineffective. In August, Tehran fired two Scud missiles against Iraqi oil refineries, but missed. Both sides have avoided another round of attacks on civilian targets, though each has accused the other of hitting residential areas. Baghdad's sensitivity to Scud attacks on residential areas is probably the primary restraint on pursuing a more aggressive air campaign. [redacted] 25X1

Outlook

Iraq may maintain the heightened tempo of its air attacks, but restrictions imposed on the Air Force by Baghdad will continue to limit Iraqi effectiveness. Additional strikes against major targets such as the Tehran oil refinery or Sirri Island are likely as the regime seeks to boost morale and keep pressure on Tehran. Another defeat similar to the loss of Al Faw, however, would probably prompt Iraq to use its airpower even more aggressively. [redacted] 25X1

Tehran's vulnerability to Iraqi air attacks on economic targets and its inability to respond in kind put Iran at a disadvantage. If Baghdad used its full capabilities to destroy crucial economic targets, Tehran would probably find its economic position untenable. At that point, Iran would probably launch missile attacks against Iraqi civilian targets and step up tanker attacks in the Persian Gulf. Tehran may even attack oil facilities of Iraq's Gulf supporters. [redacted] 25X1

[redacted] 25X1

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Eastern Europe: Cloudy Economic Future

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Eastern Europe[1] faces continued sluggish growth through 1990, despite some recent improvements. Good harvests for most countries, benefits from the falling dollar and lower interest rates, and the willingness of creditors to lend to some countries will help the economies this year. However, gloomy prospects for expanding hard currency exports, outdated capital stock, and lack of economic reforms will more than offset the favorable trends.

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Slow Industrial Growth

Midyear industrial performance in most East European countries disappointed government officials, who hoped for a strong start to the 1986-90 plans after last year's weak results. The lackluster performance resulted from slow growth in domestically produced materials, shortages of key imports, and failure to stimulate productivity. Much of the gain in output came from the mining and construction industries, mainly because of fewer disruptions from winter weather than in the previous year.

Generally, the fastest growing sectors were advanced technologies—computers, robotics, microelectronics, and fiber optics—and machine building, reflecting both their own and CEMA's long-term growth strategies and the relatively small base from which output grows. The region suffered at least one high technology setback, however, when a fire in May severely damaged a microelectronics plant in Hungary.

Eastern Europe: Real Gross National Product, 1971-90 *Percent*

	Average Annual Rate of Growth			
	1971-75	1976-80	1981-85	1986-90 [a]
Bulgaria	4.5	1.2	1.2	1.3-1.7
Czechoslovakia	3.4	2.2	1.6	1.3-1.7
East Germany	3.5	2.4	1.7	2.0-2.5
Hungary	3.4	2.3	1.1	1.0-1.5
Poland	6.6	0.9	1.2	1.5-2.0
Romania	6.2	3.9	1.9	1.0-1.5
Yugoslavia	4.5	5.7	1.5	1.0-1.5

[a] Projected.

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Improved Agricultural Production

More favorable weather conditions in 1986 have assured an improvement in agricultural output in most East European countries this year. Romania, Bulgaria, and Yugoslavia—hit by dry weather last year—expect a rebound in grain output. Hungary, however, expects a minimum 4-percent decline in agricultural output because of its continued drought. Meanwhile, the Northern Tier countries expect above-average harvests again, with near-record grain crops anticipated in Poland and East Germany.

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Hard Currency Trade Surplus Diminishes

Current trade trends suggest that the region's hard currency trade surplus could fall below $1 billion this year, less than half the level in 1985 and one-fourth the 1984 balance. Czechoslovakia, Poland, Hungary, and Yugoslavia—the only countries for which midyear data are available—increased hard currency imports an average of 9 percent and exports by only 1.5 percent compared with the same period in 1985.

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The declining surpluses for some countries may reflect a shift in planners' priorities. Hungary, East Germany, Czechoslovakia, and Bulgaria may feel that

[1] This article includes Yugoslavia in the term "Eastern Europe".

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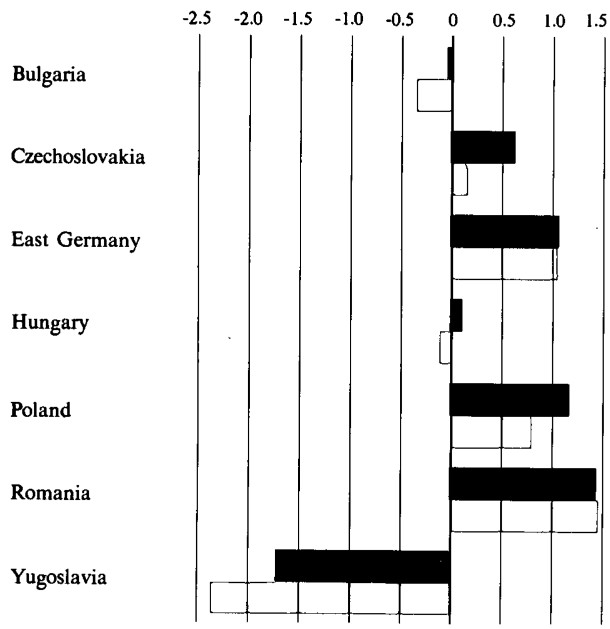
Eastern Europe: Hard Currency Trade Balances, 1985-86[a]

Billion US $

1985 1986



[a]Projected. Projections are based upon 1986 growth rates to date: six months for Poland, Hungary and Czechoslovakia; seven months for Yugoslavia; three months for East Germany, Bulgaria and Romania.

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they can afford more imports given their ability to secure new loans and the financial benefits of the falling dollar and lower interest rates. For them, an injection of badly needed Western equipment and technology at the start of the new five-year plan period might improve the odds of meeting ambitious growth targets. [redacted]

The erosion of trade surpluses also stems from unfavorable economic developments. Many important LDC trading partners, facing declining oil revenues, have been forced to reduce their imports, while others have fallen behind in payments. Falling oil prices have also reduced the revenue from East European reexports of oil. Fear of travel in the region and of contaminated East European exports because of the Chernobyl' accident has also hurt hard currency earnings. In addition, East European manufactured goods continue to lose ground on world markets, particularly to better quality products from the newly industrializing countries. [redacted] 25X1

Some Financial Windfalls

Despite the downturn in trade results, financial developments have been generally favorable for several countries this year. Because of the shortage of attractive Third World lending opportunities, bankers remain eager to lend to East Germany, while Hungary and Czechoslovakia obtained sizable syndicated loans this spring. The rapid rise in Hungary's debt, however, has caused some bankers to become wary about new lending to Budapest. Poland, Yugoslavia, and Romania had to seek more debt relief from Western creditors early this year. [redacted] 25X1

The region has benefited somewhat from changes in world financial markets. We estimate that the decline in interest rates will save the East Europeans at least $700 million in interest payments to commercial banks this year. Some countries will gain as soft financial markets allow them to renegotiate higher priced loans obtained in the early 1980s. [redacted] 25X1

The falling value of the dollar against other Western currencies will reduce the cost of loan repayments. Since much of the region's earnings from trade and services are in nondollar currencies and a large portion of debt service is in dollars, the decline of the dollar has made it cheaper to acquire the currencies needed for debt payments.[2] The 6-percent drop in the dollar against 10 major currencies in the first half of the year alone could save the region as much as $930 25X1

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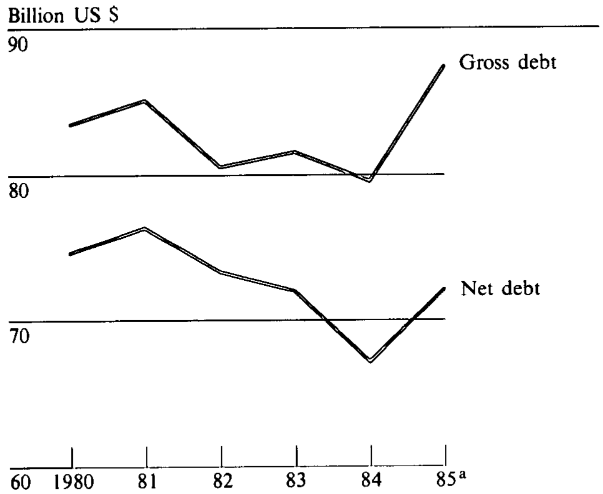
[2] The falling dollar has increased the amount of nondollar debt expressed in dollars. This is largely a statistical effect and does not necessarily reflect a weaker financial position. [redacted] 25X1

Eastern Europe: Gross and Net Hard Currency Debt, 1980-85



[a] Preliminary.

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million in debt service payments to Western creditors in 1986. Much of these potential savings may not be realized this year if some countries postpone payments, as Poland, Yugoslavia, and Romania have already done. In theory, Eastern Europe would benefit most by encouraging exports to Western countries with appreciating currencies and imports from the United States, but the inflexibility of their foreign trade systems largely precludes such adjustments.

Trade Deficit With the USSR Swells

Despite Moscow's insistence on more balanced trade, Soviet data indicate that Eastern Europe—excluding Yugoslavia, which is not a member of CEMA—ran more than a 720-million-ruble trade deficit with the USSR in the first quarter of this year, a sharp jump from the same period last year. Although results varied widely among countries, the region's imports from Moscow rose 8 percent. The Soviets allowed those countries struggling economically—Poland, Romania, and Bulgaria—to increase imports briskly. Romania's import growth was particularly noteworthy, nearly 65 percent. 25X1

So far, the fall in world oil prices has had a limited impact. The region imports more than three-fourths of its oil from the USSR, which prices its oil sales to CEMA countries on a five-year moving average. Even though CEMA countries (except Romania) currently pay the equivalent of $30 per barrel for Soviet oil—double the world price—they have not substituted non-Soviet oil imports for Soviet supplies because they can pay Moscow with lower quality goods instead of the hard currency usually required for purchases in world markets. Yugoslavia, however, has negotiated a reduction of oil prices with Moscow. 25X1

Outlook

We believe the region's overall economic growth will not return to the rates of the early 1970s, when there was a major influx of Western credits. Moreover, some of the favorable developments this year, such as lower interest rates, may prove transitory. GNP growth may average between 1 and 3 percent annually, assuming average winter weather and favorable harvests. East Germany is likely to fall at the upper bound of this range, while Romania, Hungary, and Yugoslavia may lie at the lower end. 25X1

Potentially, the most positive development for Eastern Europe in coming years will be the improved terms of trade with the USSR when the CEMA price formula begins to reflect falling world oil prices. Soviet oil prices may fall by about half in the next few years as lower world prices are factored into CEMA's moving average. Unless the USSR tinkers with CEMA prices, improving terms of trade for Eastern Europe could help the region pay off its debt to the USSR more quickly than planned and possibly free resources for domestic consumption, investment, or increased trade with the West. 25X1

Eastern Europe: Trade With USSR, First Quarter 1985 and 1986

Million rubles

	Exports		Imports		Balance	
	1985	1986	1985	1986	1985	1986 [a]
CEMA Six	7,695	7,685	7,780	8,408	−84	−723
Bulgaria	1,436	1,421	1,423	1,607	13	−186
Czechoslovakia	1,550	1,555	1,545	1,537	5	18
East Germany	1,916	1,742	1,819	1,847	97	−105
Hungary	1,114	1,148	1,106	1,118	8	30
Poland	1,194	1,233	1,460	1,601	−266	−368
Romania	485	586	426	698	59	−112
Yugoslavia	778	718	613	546	165	172

[a] Estimated.

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The other major long-term influences on East European growth are negative:

- ***Insufficient growth of hard currency earnings*** will limit Western imports needed to modernize the economy. Both supply and demand forces will limit exports. Enterprises in most countries lack incentives to export to the West, and goods are often of such low quality that they are unmarketable for hard currency. Even if effective export promotion policies were implemented, they might be thwarted by Soviet pressure to supply more high-quality goods to support Moscow's modernization program.

- ***Outdated capital stock*** will hinder efforts to boost productivity and exports. Most countries decreased investment in real terms in the late 1970s and early 1980s to adjust to their external financial problems, and since then have imported little equipment and failed to stimulate research and development.

- ***Lack of economic reforms*** also will impede growth in productivity and competitiveness. The East European regimes are echoing Gorbachev's calls for better management and tighter labor discipline as the steps needed to cure the ills of centrally planned economies. While such measures may produce some temporary improvements, they will not correct the basic economic weaknesses in Eastern Europe. Although Hungary and Poland have reforms on the books, many are not fully implemented due to worker or industry opposition. 25X1

Policymakers in the region will have to make tradeoffs between investment and consumption in allocating scarce resources. Favoring consumption over investment will hamper efforts to modernize industry, while giving priority to investment may thwart efforts to spur worker productivity and create internal unrest. Limited resources mean either policy will cause sluggish economic growth for Eastern Europe at least for the next five years. 25X1

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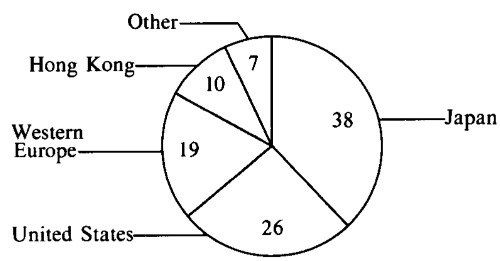
China: Mixed Results Using Foreign Technology [redacted] 25X1

China sees acquisition of foreign technology as crucial to its economic modernization and has purchased billions of dollars worth of equipment and know-how over the last five years. A preliminary assessment of China's use of this technology reveals mixed results. China's use of foreign technology is fairly poor in industries such as electronics and computers. Nevertheless, success in integrating foreign equipment into China's more mature industries—textiles, shipbuilding, energy, consumer electronics, and arms—has contributed significantly to foreign exchange earnings. We believe China's use of foreign technology will improve over the next decade as a result of Beijing's greater control over imports, better education of industrial personnel, and introduction of economic policies that reward effective use of new technology. [redacted] 25X1

China: Sources of Advanced Equipment Imports,[a] 1985

Percent



Total=US $2.4 billion[b]

[a]Computers, scientific instruments, and telecommunications equipment.
[b]Estimates based on partner country trade data reported to the UN. Re-exports through Hong Kong included in country of origin statistics.

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Shopping for Foreign Technology

The Chinese have used a variety of channels—including direct imports, joint ventures, licensing, and covert acquisition—to procure the needed technology.[1] Acquisition strategies have shifted over the last eight years. After a period during which big-ticket imports of whole plants in the late 1970s caused China's import bill to rise precipitously, Beijing became more selective in its purchases of foreign technology in the early 1980s, generally buying individual pieces of equipment that Chinese technicians then tried to integrate into existing production lines. More recently, Beijing has encouraged foreign firms to transfer more technology and know-how through the establishment of joint equity ventures, licensing agreements, and assembly lines. We estimate that China has imported $6 billion worth of computers, instrumentation, and telecommunications equipment over the last five years, spending over $2 billion on those items in 1985 alone. Japan was the leading supplier to China of advanced equipment, followed by the United States, Western Europe, and Hong Kong. [redacted] 25X1

Dual-Use Technologies

With a few exceptions, the impact of foreign equipment in high priority dual-use technology areas has been largely disappointing. [redacted] 25X1

Electronic Components. China's record in absorbing imported technology is extremely poor in the microelectronics sector. [redacted] 25X1 China continues to have serious difficulties operating and maintaining

[1] China's access to Western technology through legal channels has increased as a result of a relaxation of US and multilateral controls on exports of advanced equipment to China. China nonetheless uses covert acquisition methods to acquire selected pieces of controlled equipment. We believe China has acquired only a small portion of its Western technology covertly. [redacted] 25X1

the sophisticated equipment it has acquired and providing the reliable energy supplies and pure chemical inputs that are needed.

Computers. China's record at using foreign computer equipment and production technology is spotty. In aggregate terms, the record is not good: Beijing acknowledges, for example, that as much as 80 percent of China's computers are used only sporadically; nearly half of the computers in China remain in warehouses. Nonetheless, in selected high-priority areas—such as petroleum exploration and computer-aided design of aerospace vehicles and integrated circuits—China's use of imported computers is much better. Imported technology has also been vital to the development of China's computer production capability. Although domestically produced microcomputers continue to have quality and reliability problems, output has jumped from fewer than 2,000 units in 1982 to more than 30,000 units in 1985, according to Chinese press reports. The Chinese acknowledge that nearly all the microcomputers produced in China in recent years were assembled from imported components.

Telecommunications. Installation of imported telephone switching equipment has improved communications services in selected locations, although systems integration problems and the vast demand for services tend to overwhelm the effect of these additions to the network. In recent years, Beijing has concluded several major joint venture agreements with foreign firms to produce telecommunications equipment in China, but the slow process of obtaining multilateral export approvals and difficulties such as shortages of skilled workers have hindered implementation of these deals.

In some priority areas, however—usually related to military research or production—China has been successful in using imported technology to enhance research and production capabilities. For example, China effectively used foreign components and operating manuals to produce the Galaxy supercomputer in 1983. Although we believe the Galaxy operates at only one-fourth the speed of the US supercomputer after which it was modeled, the success of this military project was in marked contrast to a concurrent civilian effort, which took four years longer and resulted in a computer with only a fraction of the capability of the Galaxy.

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Mature Industries

The impact of foreign technology on China's economic development is more noticeable in several mature industries.

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Shipbuilding. China has used imported technology to develop an industry capable of building and repairing oceangoing ships and offshore oil rigs to world standards. In the early 1980s, China contracted with foreign firms to import a wide range of marine equipment, including diesel engines, steering gear, and deck cranes. Largely as a result of the technology acquired, China currently is the world's fifth-largest builder of commercial ships; the industry earned $130 million in foreign exchange in 1985.

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Energy. Imported equipment and resident foreign advisers have generally led to better petroleum reserve estimates and new discoveries at existing fields and improved drilling and recovery techniques for China's onshore oil industry. Foreign technology also is a key factor in the development of China's electric power industry; Beijing has imported large generators and is using licensed Western technology as the basis for upgrading its ability to produce power plant equipment. Imported high-voltage power transmission lines and Western mining equipment have upgraded China's power grids and coal mining capabilities.

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Textiles. China's textile industry has relied heavily on imported technology, acquired through both joint ventures and direct equipment purchases. Through participation in cooperative production arrangements, primarily with Hong Kong firms, China has raised the quality and quantity of textile exports dramatically. Foreign technology also has enabled China to upgrade exports from fairly simple items such as fabrics,

China's Dual-Use Technology Priorities

Technology	Selected Civilian Uses	Selected Military Uses
Microelectronics	Consumer electronics	Weapons guidance/control, avionics
Computers	Industrial production, economic planning, education and research, energy exploration, weather forecasting	Weapons design, logistics, command and control, cryptanalysis
Telecommunications	Civilian communications	Secure military communications
Composite materials	Consumer goods such as sporting equipment	Aircraft, missile nosecones, rocket motors
Biotechnology	Agriculture, medicine	Chemical/biological warfare
Automated manufacturing	Civilian production	Defense production
Lasers	Communications, machine tools, surgical instruments	Directed-energy weapons
Undersea exploration	Energy and mineral exploration	Antisubmarine warfare

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towels, and work gloves to more complex products and fashion apparel. Technological upgrading helped to boost China's textile exports, which in 1985 accounted for 27 percent of China's export earnings.

Consumer Electronics. China has rapidly increased production of consumer appliances and electronics largely by assembling imported components in plants purchased from Japan. China's consumer electronics industry has also begun to export televisions, radios, and cassette recorders. According to Chinese officials, electronics exports in the first half of 1986 reached $223 million—10 times the level of the same period in 1985.

Arms. Since 1980, Beijing has sold over $7 billion in arms abroad and is aggressively pursuing new sales by offering weapons upgraded with Western technology. China's 1986 arms sales brochures show tanks, infantry fighting vehicles, and artillery pieces—improved with British, West German, Austrian, and Israeli assistance—for sale at highly competitive prices.

Obstacles Hinder Technology Use . . .

China's use of Western equipment and technology has been severely hampered by a variety of systemic, institutional, and financial factors, including: 25X1

- ***Inappropriate technology import choices.*** In the past, Beijing has generally not purchased the necessary training and service contracts, software, and peripherals when buying equipment. Moreover, China purchased a good deal of hardware in recent years without regard to compatibility with existing equipment or availability of electricity and spare parts, which limited its use. 25X1

- ***Poor management.*** Managers—many appointed for political reasons rather than for their skills—often are unfamiliar with sophisticated production processes and are unwilling to take the risk of introducing new technologies that might temporarily disrupt production schedules.

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- ***An unskilled work force.*** While researchers in major institutes and universities often are more familiar with Western equipment, factories suffer critical shortages of educated workers and midlevel technicians.

. . . But Slow Improvements Likely

Beijing is aware of its problems in absorbing technology and is working to overcome them by exercising greater control over imports, improving and enlarging China's pool of skilled workers and managers, and providing more economic incentives for technological innovation:

- Since mid-1985, Beijing has required that training and support services accompany purchases of foreign technology. Beijing has also centralized control over technology imports, particularly in priority industries such as semiconductors and computers, to ensure that imported equipment and know-how meet the country's needs.

- The education of students abroad, a new emphasis on technical training, and the introduction of better management techniques will improve China's use of foreign technology and raise the levels of indigenous scientific research and production.

- Economic reforms are encouraging factories to become more competitive and providing new incentives for them to use technological innovation to improve productivity and product quality. 25X1

Opportunities and Risks for the United States

Involvement by US companies, universities, and government agencies will be critical to improvements in China's use of foreign technology. Chinese leaders view US managers as more willing than their Japanese counterparts to engage in cooperative production projects and the transfer of technological know-how. As a result, as Beijing cements the link between hardware imports and transfers of know-how, US market opportunities in some sectors may improve.

The education Chinese technical and managerial students receive in US universities will also remain a vital part of Chinese efforts to improve technology use; US universities host an estimated two-thirds of the Chinese students currently studying abroad. Finally, Chinese managers and planners have gained familiarity with mechanisms used in the United States to encourage technological innovation. 25X1 25X1

The critical role the United States plays in China's technological development also poses several risks. The short-term marketing advantages US firms may gain by engaging in cooperative production projects in China will, in the longer run, permit Chinese factories to substitute domestic products for imports. US firms may also suffer from China's move into new export markets. Chinese exports to the United States have already brought increased competition for US firms in sectors such as textiles. If China's effective use of foreign technology spreads, US firms could also face increased competition in such areas as machine tools and food processing. 25X1

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Middle East and North Africa:[1] The Challenge of the Regional Recession [redacted]

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The region's economies, beset by slack economic activity since world average oil prices began to slide, will remain weak for the remainder of this year. Real economic activity in the Middle East and North Africa probably will decline by 4 to 5 percent in 1986—compared with 3- to 4-percent growth in 1983-84. If OPEC states continue to comply with the recent agreement on lower production quotas and regional leaders are able to tap the private sector for nonoil investment, growth probably will rebound in 1987. Otherwise, the regional economic outlook will remain weak and raise prospects for domestic unrest in some states. The poorer states probably will request further aid from the United States. [redacted]

The Downturn

Hard currency earnings plummeted during the first half of 1986 in the Middle East and North Africa and show few signs of improvement for the remainder of the year:

- Revenues from the sale of oil and petrochemicals—which are by far the major source of foreign exchange earnings in the region—have fallen as much as 50 percent in some countries because of the weak oil market. Others also have been hurt because of price declines for natural gas and commodities such as phosphates.

- Worker remittances probably will drop by about one-third from their 1985 level. As Saudi Arabia and the smaller Gulf states are slowing construction projects, expatriates are leaving because of decreased job opportunities. Egypt and Sudan, in particular, are faced with the difficult task of providing returnees with housing and jobs.

- Tourism—an important moneymaker for Egypt, Morocco, and Tunisia—has declined because of the fear of terrorism.

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- The lower value of the dollar also has substantially reduced the real value of current oil earnings and has eroded assets denominated in dollars. [redacted]

Symptoms of poor economic performance are evident throughout North Africa and the Middle East. Business failures are becoming more common. Banks throughout the Gulf are awash with bad loans because Arab debtors are delaying repayment of principal and interest. Some banks are reluctant to grant more credit, further depressing economic activity. Capital flight continues as investors seek higher rates of interest and greater political stability abroad. [redacted]

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Lower foreign exchange earnings are barely adequate to maintain imports of essential consumer and military goods in some countries. Shortages of goods and black-market activity could become more of a problem in Iran, Iraq, Libya, Sudan, and Syria. Some regimes postponed finalizing their budgets because of uncertain oil revenues. Libya, Oman, Saudi Arabia, and Tunisia have been forced to devalue their currencies. [redacted]

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Severe labor force problems lie ahead for many area governments. Unemployment and underemployment are at least 30 percent in Algeria, Iran, Morocco, and Tunisia. Unemployment is compounded by the return of large numbers of foreign workers to countries such as Egypt and Sudan. The younger generation faces particularly tough times. Population growth is rapid—3.5 percent in Kuwait and 3.3 percent in Jordan—and in several nations over 50 percent of the population is under the age of 25. In many cases, untrained young people cannot compete with more highly skilled South Asians willing to accept lower

[1] Algeria, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, United Arab Emirates, North Yemen, and South Yemen. [redacted]

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North African and Middle Eastern Countries Experiencing Recession

[redacted]

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wages to secure jobs in the region. Women also have been hit hard by tight labor markets. In Saudi Arabia, Kuwait, and Oman, women increasingly are as well educated as men but do not have the same job opportunities because of cultural prohibitions. The economic decline has reinforced these prohibitions. [redacted]

Efforts To Cope

To contend with large budget and current account deficits, most governments have used a combination of reducing subsidies and salaries, cutting back development expenditures, and slashing imports. Some regimes have tried to increase revenues by raising customs duties and licensing fees. Austerity measures, however, generally have not been tough enough. Poorer nations have relied heavily on continued Saudi aid and foreign borrowing to muddle through rather than face the difficult economic and political decisions that present conditions demand. Non-Saudi aid and loans to the region probably will dry up, however, unless recipients implement stricter reforms. Egypt, Mauritania, North Yemen, and Sudan almost certainly will ask for more aid from the United States. [redacted]

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Richer countries, such as Saudi Arabia and the smaller Gulf states, have bought time by drawing down foreign exchange reserves. Reserves in Saudi Arabia and Oman probably will shrink dramatically—by almost 30 percent in 1986. These states will have to rethink this course and enforce more rigid austerity measures if the oil market does not turn around. [redacted]

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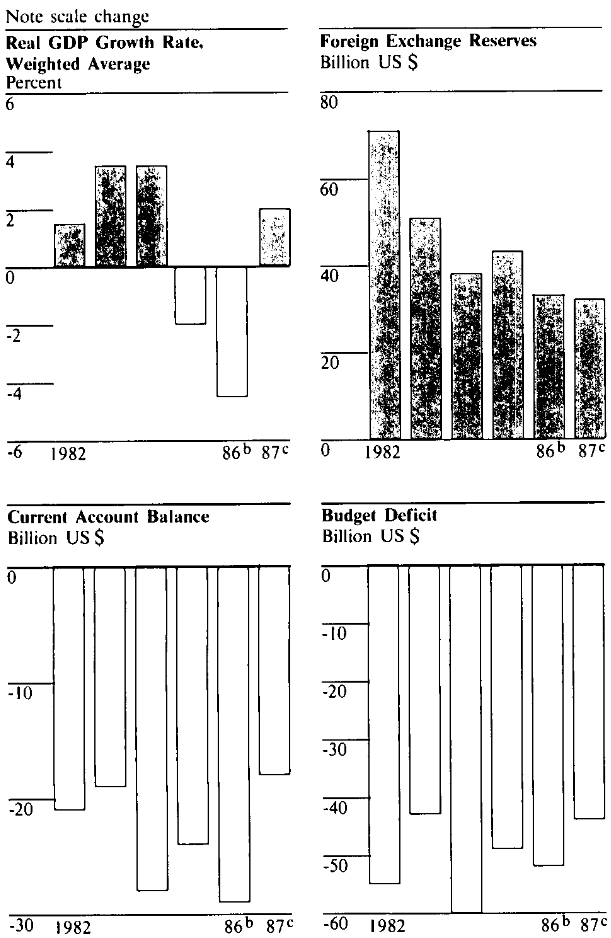
Middle East and North Africa: Economic Indicators,[a] 1982-87



[a] Data for Algeria, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, South Yemen, Sudan, Syria, Tunisia, U.A.E., and North Yemen.

[b] Estimated.

[c] Projected.

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Positive Trends

A few countries highly dependent on imported oil—particularly Lebanon, Morocco, and Sudan—have benefited from lower oil prices. Furthermore, regional borrowers will save about $1 billion—roughly 10 percent—of their collective interest payment obligations in 1986 because of lower interest rates. 25X1

A number of governments increasingly are calling for more free market competition and privatization to boost economic growth, according to Embassy reporting. Such policy developments are unusual in the Middle East, where governments traditionally have distrusted market forces. Bahrain hopes to establish a regional stock exchange where some successful public-sector companies would be privatized and shares would be traded by Gulf state nationals. Some officials in Morocco are promoting industry deregulation. Saudi Arabia is encouraging private investors to match the government's funding of some development projects. Saudi government agencies also have contracted with local companies to improve existing infrastructure. Despite these moves, the poor outlook for the economy and oil revenues has discouraged private domestic investment and promoted capital flight. 25X1

Prospects

Under a scenario of continued OPEC compliance with lower production quotas, oil prices probably will strengthen but still remain volatile. Given higher oil revenues, modest improvements in government efficiency, and private-sector investment, real GDP growth of 2 percent could be achieved next year. 25X1

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On the other hand, regional economic and political difficulties will mount if the OPEC agreement collapses. A prolonged recession would weaken political support for regimes in such countries as Iran, Iraq, and Libya, where living standards have fallen off

Middle East and North Africa: Expatriate Worker Remittances, 1982-86

Billion US $

	1982	1983	1984	1985 [a]	1986 [a]
Total	**4.95**	**6.26**	**6.90**	**6.57**	**4.51**
Egypt	1.94	3.17	3.93	3.78	2.00
Jordan	0.93	0.92	1.05	1.03	0.90
North Yemen	1.18	1.13	1.06	0.94	0.87
Sudan	0.11	0.25	0.25	0.23	0.14
Syria	0.42	0.44	0.30	0.30	0.35
Tunisia	0.37	0.35	0.31	0.29	0.25

[a] Estimated.

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sharply in recent years. Although economic difficulties could provide the stimulus for popular unrest in Egypt and Sudan, the recession alone is unlikely to produce instability in other countries in the region where generally strong domestic security forces discourage organized protest. 25X1

Worker remittances probably will level off rather than continue their dramatic decline, even if the OPEC agreement does not hold. Saudi Arabia and the smaller Gulf states would like to reverse their dependence on expatriate labor but are constrained for several reasons:

- Nationals are unwilling to do manual labor—which they consider demeaning—or are not appropriately trained for jobs expatriates now hold.
- Demand for maintenance and operational staff remains high outside the construction sector.
- Influential groups within the native populations—particularly landlords and merchants—have vested interests in maintaining their incomes by keeping a large immigrant population.

Continued reliance by the Arab Gulf states on expatriate labor could relieve pressure on labor-sending countries in the Middle East and North Africa that have suffered from the recent drop in remittances. 25X1

A prolonged recession probably will aggravate existing problems in regional labor markets and present further impediments to economic growth. Disaffection—especially among unemployed and underemployed young people and women—will grow unless regional governments train local labor more effectively, create more jobs, and permit freer entry into the labor force. 25X1

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Israel: Will Debt Spoil the Economic Outlook? [redacted]

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Israel has made great strides toward economic recovery in the past year, but continued progress will hinge on the government's willingness to reduce spending to hold the line on budget deficits. The budgetary process will come under added pressure in the next three years when the government is scheduled to repay about $4.7 billion to bank share holders stemming from the bank scandal—and subsequent stock market collapse—of October 1983. Israel's debt structure, although not presently a great burden on the economy, may also present serious problems for economic decision makers—borrowing constituted about 41 percent of total government revenue in Israeli fiscal year 1984/85. If borrowing levels have to be increased—in response to greater revenue needs stemming from insufficient budget-cutting action—the government will find an ever growing portion of the budget devoted to debt repayment. [redacted]

Debt Structure

[redacted] economic policy makers are most concerned with the growth in domestic public debt. By yearend 1985, domestic public debt—defined as total private-sector claims on the public sector—stood at 143 percent of GNP, up from 123 percent of GNP in 1984. This ratio is likely to increase in light of the large anticipated bank share repayments the government will undertake from 1987 to 1989. In contrast, foreign public debt—total claims by foreigners on the public-sector minus foreign reserves—stood at 60 percent of GNP in 1985, up from 51 percent the previous year. [redacted]

The maturity structure of the debt—although not currently a problem—could become a more important issue over the next several years. At yearend 1985, short-term debt constituted only about 15 percent of total debt, while long-term debt made up 70 percent. This distribution may change drastically, however, if sustained economic growth and additional budget cuts are not forthcoming. We believe Tel Aviv would opt for short-term borrowing in hopes of lining up additional foreign assistance. Nevertheless, increased borrowings through short-term loans would be a two-edged sword for Israel. Tel Aviv would be able to cover periodic revenue shortfalls more easily but would have to refinance a larger debt more frequently. Additional borrowings in 1986 and 1987 would compound financing problems in 1987 and 1988 when the bulk of the bank share repayment is to take place. [redacted]

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Bank Share Debt Fallout

The bank share scandal and subsequent stock market collapse of October 1983—caused by the questionable stock trading practices of Israel's leading banks—was resolved when the government agreed to purchase back from individual shareholders the full value of their shares, thereby assuming a large future debt obligation. Under terms of the bank stock guarantee program, the government promised to redeem shares worth $6.5 billion. To date, the government has purchased about $1.8 billion. Current plans call for the government to absorb $1.0 billion in either 1987 or 1989 while redeeming $3.7 billion in 1988. The government will probably redeem the $3.7 billion in shares through a firm created by the government and eventually resell them to the public. If the firm cannot repay the government loan by 1993, Tel Aviv would have to convert the $3.7 billion loan into a grant. In any case, the government will have to make interest payments on any replacement bonds or paper issued, increasing pressures for spending cuts on sensitive social programs. [redacted]

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Outlook

Israel's long-term economic outlook depends not only on the ability of the economy to sustain meaningful growth while fundamental changes in the economic

How Does Israel Stack Up?

According to various debt service measures, Israel does not presently appear to have significant debt servicing problems. The debt-service-to-exports ratio stood at 42.1 percent in 1985, up only marginally from the year-earlier figure of 41.8 percent. Furthermore, the ratio of total debt to GNP was 139 percent last year, while the ratio of net foreign capital inflows to debt service payments was 111 percent, both within the bounds of debt manageability. Poor export growth, when combined with the upcoming bank share repayments, however, may push the debt service ratio over 50 percent, straining an already financially strapped Israeli economy. In addition, any decline in US economic assistance, which makes up a large part of net foreign inflows, would add to a worsening debt situation.

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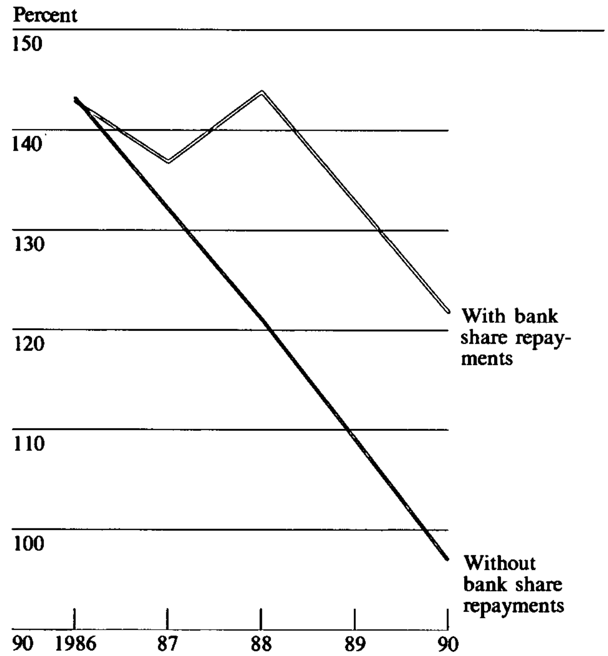
The potential impact of the bank share repayment problem can be seen in the following scenarios:

- *The first case assumes the government's budget deficit and the current account deficit remain at 5 percent and 20 percent, respectively, of GNP for the period; real interest rates are fixed at 5 percent; and GNP grows at 2 percent annually. If the bank share repayment problem did not exist, the debt/GNP ratio falls from 143 percent in 1986 to 97 percent by 1990.*

- *The second case assumes the bank share repayments are fully paid by the government in 1987 and 1988. The impact of the bank share repayment scheme is evident as the debt/GNP ratio would fall to 137 percent in 1987, increase to 144 percent in 1988—as the large $3.7 billion payment is fully absorbed—while decreasing to 133 percent in 1989.*

Israel: Domestic Public Debt Scenarios,[a] 1986-90



[a]Debt/GNP ratio. Domestic public debt is defined as total private-sector claims on the public sector.

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system are implemented, but also on the government's ability to keep debt growth within manageable bounds. If the economy fails to perform up to government expectations, Tel Aviv will be hard pressed to undertake meaningful long-term economic reforms. A sputtering economy may then lead to an increasingly larger debt service burden.

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Prime Minister Peres and Finance Minister Nissim may bring debt relief to the forefront of economic discussions during their September visits to Washington. Both Peres and Nissim are likely to press for a reduction in the average interest rate on the approximate $10 billion in debt owed to the United States from 10 percent to 8 percent. This would save Israel up to $200 million in annual debt payments. In late 1985 Israel unsuccessfully sought debt relief that would have saved as much as $500 million annually. [redacted] 25X1

Beyond the September visits, the scheduled government rotation in October will be an important test. If then–Prime Minister Shamir can build upon the economic gains achieved by Peres, the economy will be better able to weather larger debt payments and the end of the $1.5 billion in 1985-86 supplemental US economic assistance. Given Likud's poor economic track record, however, it may encounter serious problems in coordinating economic policy with Labor, thereby imperiling the gains made during the past year and worsening prospects for controlling debt. [redacted] 25X1

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Briefs

Energy

Spot Oil Price Trends

Spot oil prices have risen in recent weeks following OPEC's decision to reduce production in September and October. Key North Sea and US crudes are selling for $15.40 and $16.35 per barrel, respectively, compared with $9.30 and $11.15 the first week of August. We estimate the average world oil price in early September was about $14 per barrel. Higher prices probably also reflect increased concern over an escalation in the Iran-Iraq war. Barring a supply disruption, prices may weaken in coming weeks, however, unless OPEC producers adhere strictly to the production agreement, especially given an unusually large increase in inventories in recent months. 25X1

Oil Demand Rises in Six Major Developed Countries

Oil demand in the six major developed countries in the second quarter rose by 5 percent above year-earlier levels. The six countries—France, Italy, West Germany, the United Kingdom, Japan, and the United States—account for approximately 60 percent of non-Communist oil demand. All six registered higher sales—ranging from 3 percent in Japan and the United States to 23 percent in West Germany—reflecting lower retail prices and some inventory building at the secondary and tertiary levels. Sales of all major products rose, including an average 12-percent increase in light fuel oil sales over year-earlier levels. Sales in West Germany and France rose by 53 and 25 percent, respectively. In West Germany, homeowners' stocks of heating oil, for example, reached an alltime high of 115 million barrels, almost 65 percent above year-earlier levels. Oil consumption gains may wane in coming months as higher prices slow consumer stockbuilding.

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International Finance

New World Bank Investment Program

The International Finance Corporation (IFC), the World Bank's private-sector financing arm, announced a program that eliminates the risk of loss for foreign investors in projects that the IFC originates. Under the new program, called Guaranteed Recovery of Investment Principal, investors would deposit funds with the IFC for a fixed term, which then would be invested in a developing country project. At the end of the prescribed period, the investor would have the option to extend the agreement with the IFC, take full ownership of the project shares, or withdraw its principal. The program aims at investments of $20-30 million but would guarantee projects up to $100 million—considerably greater than previous IFC investments. This new program represents the Bank's third major effort in the past year to encourage capital flows to LDCs. In June, the IFC helped launch the Emergency Markets Growth Fund, a mutual fund that invests in securities of developing countries. A year ago it established the Multilateral Investment Guarantee Agency (MIGA) to insure investors against noncommercial risks such as war, political unrest, currency nonconvertibility, and expropriation.

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International Trade

LDCs' Stake in New GATT Round

Because of the dramatic rise in exports of some LDCs, many more developing countries participating in the new GATT round now have a greater stake in lowering barriers to trade. While several other factors will be involved in the negotiations, we believe the shifts in world trade will of themselves work in favor of reducing the traditional global trade barriers such as tariffs and quotas. LDCs now account for 13 percent of the world's manufactures exports—nearly double their share in 1973 and almost equal to that of the United States. Within certain product categories, the LDCs' increase in shares has been even more expansive—16, 18, and 26 percentage points for apparel, electrical machinery, and consumer electronics, respectively. Developing countries, therefore, have emerged as important players in the new round of GATT negotiations. 25X1

Share of World Exports, 1973 and 1984

Percent

	Total Trade	Food-stuffs	Raw Materials	Fuels	Manufactures
	1973				
United States	13.5	17.0	10.7	3.3	15.1
Japan	5.8	1.0	1.0	0.2	9.1
European Community	38.6	30.6	17.6	13.8	49.8
LDCs	20.1	28.1	29.6	67.9	7.0
	1984				
United States	11.5	15.1	11.8	2.4	13.8
Japan	8.5	0.8	0.8	0.1	14.1
European Community	32.2	34.4	19.1	15.0	39.4
LDCs	26.3	30.4	27.7	60.6	13.1

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Shares of Selected World Export Products, 1973 and 1984

Percent

	Total Trade	Steel	Textiles	Apparel	Consumer Electronics	Electrical Machinery
	1973					
United States	13.5	5.1	5.7	1.7	8.0	19.3
Japan	5.8	18.9	9.1	2.8	10.2	10.1
European Community	38.6	57.0	50.2	45.1	44.4	46.2
LDCs	20.1	2.6	18.4	30.1	15.9	9.6
	1984					
United States	11.5	2.5	4.8	0.9	6.2	17.8
Japan	8.5	17.9	8.2	1.5	14.2	21.2
European Community	32.2	47.1	43.3	31.2	33.2	26.1
LDCs	26.3	9.5	21.2	46.6	42.2	28.0

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GATT Services Issue Still Troublesome

Brazilian, Indian, and EC GATT representatives in Geneva have agreed on a two-meeting approach to the services issue, and the EC representative is lobbying other LDCs for support, according to diplomatic sources. Under this approach, goods negotiations would be conducted under GATT auspices, and a separate meeting—outside of GATT—would consider services. This agreement does not have the formal support of EC member states; however, British and West German trade officials have indicated that the two-meeting approach may be a good fallback position should the GATT ministerial become deadlocked over this issue. The discussions in Geneva have strengthened the position of hardline LDCs—led by Brazil and India—as the negotiations on services continue. A number of so-called moderate LDCs lean toward the hardliners' position on services and could be induced to support the two-track approach. Most industrialized countries fear this would undermine the fragile consensus among developed countries and the moderate LDCs worked out during the GATT preparatory meeting in July. A split between industrialized countries and the LDCs would complicate launching of a new GATT round. [redacted] 25X1

Global and Regional Developments

Soviets Questioning Nicaragua's Aid Expenditures

Moscow is again pressing Managua to make better use of the economic aid it receives. [redacted] 25X1 Moscow has already agreed to increase economic aid by 60 percent this year and is not likely to cut funding, but the Soviets appear determined to press for improved accounting. The Soviets apparently are concerned that Nicaraguan incompetence is contributing to economic deterioration, and they may insist on more say in Nicaragua's economic planning. Managua is dependent on the USSR for oil, military hardware, and foodstuffs, and it probably will comply with Soviet suggestions despite Marenco's resistance. [redacted] 25X1

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National Developments

Developed Countries

Japanese Economy Grows in Second Quarter

Tokyo announced this week that the Japanese economy grew at an annual rate of 3.6 percent in the April-June quarter, leading us to believe that real GNP will increase by about 2 percent this year. According to Japanese Government statistics, the economy—which declined by 2 percent in the first quarter—was bouyed in the second quarter by both consumer and government spending. The 53-percent appreciation of the yen against the US dollar since last summer has lowered import prices, boosting the real income of households and increasing the real purchasing power of government expenditures. Large increases in import volumes and weak exports continue to act as a drag on the economy, however. We believe that further declines in exports are likely in the months ahead, suggesting that growth may slow again. If this occurs, the Nakasone government increasingly would face calls for a change in Tokyo's austere fiscal stance, but the forces in favor of a continued tight policy remain formidable. The Finance Ministry—one of the key supporters of fiscal austerity—is now beginning work on the fiscal 1987 budget. Although the requests submitted to the ministry add up to a 6.7-percent increase in the general account budget, the Finance Ministry will probably work to reduce the figure to 5 percent at most. 25X1 [redacted] 25X6

Japanese Interest in US Research

Nippon Telegraph and Telephone (NTT) is turning to the United States to fill gaps in its basic research capabilities. [redacted] the company 25X1 is pursuing R&D projects with foreign firms—particularly US—that have technical capabilities or areas of expertise it lacks. So far this year, it has entered four agreements with US firms—three in the area of semiconductor processing equipment and one in multiple cell technology. [redacted] 25X1 Although NTT advertises these projects as joint relationships, the bulk of the research activities will fall to the US firm.

[redacted] 25X1

British Note Sale Boosts Foreign Exchange Reserves

London's issue of a $4 billion floating-rate note in the Eurobond market last week boosts its foreign exchange reserves to about $23 billion. Official reserves have fallen steadily since 1982, as London has paid off high-cost foreign borrowing from the late 1970s, and were down to the equivalent of only about six weeks of imports by last year. Both the Treasury and the Bank of England indicated that the recent note issue was undertaken solely because of the low interest rate—one-eighth of a percentage point below the London interbank bid rate—and denied there was any other motive, such as bringing sterling into the European Monetary System. It is likely, however, that London took advantage of good market conditions to boost its reserves in the event sterling comes under downward pressure in the runup to the next election, due in 1988 but possible as early as next spring. The Treasury is particularly concerned about the sterling/deutsche mark exchange rate and would prefer to intervene in the foreign exchange market to stabilize the pound rather than risk a domestic outcry by raising already high British interest rates. [redacted] 25X1

French Unemployment Up, Inflation Down

Unemployment in France reached an alltime high in July with almost 2.5 million people out of work on a seasonally adjusted basis; the 10.5-percent unemployment rate is a postwar high. At the same time, inflation fell to just over 2 percent for the last 12 months, the lowest rate in 20 years. While pleased with the low rate of inflation, French Government officials are coming under increasing public pressure to do something about persistently high unemployment. Further job creation initiatives are under consideration, including extension of a youth public employment program for first-time job seekers, measures to encourage work at home, and creation of more community service jobs. 25X1

French Denationalization Candidates Named

Economics Minister Balladur confirmed on Wednesday the selection of giant glassmaker Saint-Gobain, banking group Paribas, and insurance company Assurances Generales de France as the first firms to be spun off in the government's ambitious denationalization program. All are internationally well known and profitable—chalking up a total of over $500 million in profits last year—and were carefully selected to ensure a successful first venture into privatization. Press reports indicate that shares with a total market value of about $6.7 billion are likely to be sold between November and February 1987. Under the denationalization plan passed by the National Assembly in July, foreigners will be allowed to purchase up to 20 percent of the companies' shares. Although these privatizations are likely to go smoothly, the government will probably proceed carefully in offering the other 65 state-owned firms slated for denationalization. Many of these enterprises will not be as attractive to investors as the first three, and too many selloffs could innundate the Paris capital market. 25X1

Italian Cabinet Agrees on 1987 Budget Proposal

The Italian Cabinet this week outlined a budget proposal for 1987 that has at least a fighting chance of passing Parliament by the end of the year. The most contentious issue will be the call for no real growth in current spending to reduce the public-sector deficit to 12 percent of GDP—from a projected 14.5 percent this year. Capital spending will rise, however, to woo voters in upcoming elections. Parliament will flesh out the proposal over the next two weeks and the formal budget will be presented at the end of the month. Rome hopes such early discussion will ease the budget's passage, but debate on spending limitations is likely to be prolonged in part because the healthy economy has reduced pressure to control the deficit. In conjunction with the budget, Rome also plans to introduce legislation to cut government costs for pensions, unemployment compensation, local government financing, social security, and family allowances. The proposed reforms face intense opposition from all political parties and will undoubtedly be mired in heated parliamentary debate for several years. The furor over the reform legislation may serve to deflect criticism of the spending limits in the budget and help get a deficit-reducing package through the Parliament by yearend. 25X1

Spanish Economic Growth Picks Up

Bank of Spain estimates indicate that the Spanish economy grew at an annual rate of 3 percent in first half 1986, almost twice as fast as in the same period last year. Domestic demand was the engine of growth—private consumption increased 3 percent, due primarily to rising real wages and lower taxes, while fixed investment surged 8 percent, buoyed by improving company profits, declining interest rates, and renewed corporate optimism. The foreign trade picture was weak, however, despite the gains from declining oil prices, as imports are rising rapidly in the wake of EC accession. We believe growth will remain at about 3 percent in the second half, again restrained by the foreign sector. With the inflation rate still about 5 percentage points above the EC average, Spanish firms will find it difficult to compete on world markets with their West European counterparts. In addition, wage increases will continue to outpace productivity, leading to increasing unit labor costs and a further deterioration in competitiveness. [redacted] 25X1

Less Developed Countries

Ecuador Liberalizes Imports Under Reform Package

Quito plans to reduce tariffs by 50 percent on 153 import items as part of IMF-supported economic measures announced 11 August, according to US Embassy reporting. Duties on industrial goods and raw materials will be lowered as Ecuador moves to broaden its export base in response to overdependence on fluctuating oil revenues. More than 60 percent of Ecuador's imports are inputs to local industry. Liberalization of tariffs on foodstuffs, liquor, and luxury consumer appliances is expected to decrease contraband and help offset price increases on key consumer and industrial imports resulting from the recent 35-percent devaluation. [redacted] 25X1

Tunisian Reform Efforts

During the past month, the Tunisian Government has instituted currency devaluation and other economic reforms to eliminate mounting deficits and curry favor with the international donor community. In addition to the 15-percent devaluation announced midmonth, Tunis has:

- Indirectly increased bread prices by reducing the loaf size.
- Raised prices of couscous and pasta, local staples.
- Announced the first sale of public enterprises in the construction, textile, and tourism sectors.
- Furloughed nearly 1,000 public-sector workers.
- Adopted budget cuts totaling about $70 million.
- Inaugurated a "national loan" program to raise $25 million through individual donations.

The government also approved further reforms to be implemented in the next few months, including price increases for milk, sugar, and cooking oil, and layoffs of an additional 3,000 workers. Tunis, however, ruled out rescheduling any of its nearly $1 billion in debt service payments due this year. [redacted] 25X1

Although opposition to the reforms has been muted, the Bourguiba government is concerned about the need for a steady stream of aid to maintain domestic stability. Tunis is hoping the IMF team currently in country will be impressed with reforms to date and will approve the pending $180 million standby loan. The government also hopes to impress the World Bank before talks begin in Washington later this month on a $125 million agricultural-sector loan. Moreover, Tunis is counting on its newly adopted austerity measures to sway Western governments—particularly the United States and France—to provide immediate balance-of-payments support. Tunisian reserves now equal less than four days' worth of import needs. [redacted]

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Afghan Reexport Trade

[redacted] approximately 80 percent of the goods imported into Afghanistan by Kabul merchants are reexported—or smuggled—abroad, mainly to Pakistan. Textiles, electrical equipment, tires, and plastics are the principal products in this trade. Smuggling from Afghanistan is encouraged by Pakistani trade restrictions, which exclude the importation of some items, subject others to quota and licensing restrictions, and apply high tariffs to additional categories. Kabul merchants pay customs duties averaging 35 percent on imports and then tack on a 15-percent profit margin for themselves before selling the products to traders from Pakistan. The traders cover the costs of shipment to Pakistan and usually pay "taxes" to insurgent forces along the road to Peshawar. [redacted] By encouraging the reexport trade, Kabul substantially increases its revenues from import duties and maintains an important source of foreign exchange earnings. [redacted]

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Thailand To Protest on US Sugar Sale

Foreign Minister Sitthi plans to raise the issue of US sugar "dumping" during his visit here later this month, according to media reports. Sugar is Thailand's fifth-largest commodity export, and US sales could add to recent bilateral trade tensions over export subsidies for US rice. The Thai sugar industry alleges that a recent US sale to China of 146,000 metric tons of sugar at below-market rates has depressed world sugar prices by about 20 percent and Thai producer prices by more than one-third. Bangkok almost certainly fears that additional US sales would cut into its share of China's sugar imports—75 percent last year—as well as result in further price slides. [redacted]

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Communist

Soviet Joint Ventures With Western Firms

[redacted] the USSR has established guidelines for joint ventures with Western firms, [redacted] The guidelines will permit 49-percent foreign ownership, a convertible medium—such as dollars—for accounting purposes, and repatriation of profits. The Soviets are soliciting specific proposals from US firms; according to a press report, they have already received proposals from the Japanese. Moscow must still legalize foreign ownership and formally issue guidelines for establishing joint ventures. Such provisions may be included in an impending decree reorganizing the foreign trade structure, but separate legislation is also likely along the lines of that adopted by other Communist countries. Western businessmen will need more details on such issues as the amount of Western control over management, supply of raw material and intermediate goods, and labor policy before they can formulate firm proposals. Although many businessmen will be wary of joint ventures given the inefficiencies of the Soviet economy, others may accept the risks to gain entry to the Soviet market. [redacted]

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USSR Announced Wage Reform

The Politburo reformed the Soviet wage and salary structure late last month, promoting greater differentiation between the lowest and highest skill categories to encourage improved job performance and acquisition of advanced skills. [redacted] 25X1
[redacted] the reform calls for higher salary rates for managers and engineers and increased wage rates for highly skilled workers. The greatest increases would go to those with skills vital to the modernization program, such as designers and machinists. Enterprises are to generate their own funds for financing the increased wages and salaries, primarily by raising labor productivity. Actual increases in wage and salary rates are likely to be slow in coming. Most enterprises will be hard pressed to achieve the increase in labor productivity necessary to fund the program because of slow technological progress, supply problems, and traditional pressures to meet ambitious production goals at any cost. [redacted] 25X1

25X1

New Soviet Terms for Grain Contracts

The Soviets are demanding that all grain exporters provide a 30-day grace period on payments. This is in addition to Moscow's insistence in July on the right to reject shipments for quality reasons—including breakage, high moisture content, and contamination—on arrival at Soviet ports. [redacted] The Soviets have made few grain purchases in the last few months, in part because of exporters' refusal to sell under the new guidelines. [redacted] The present buyers' market for wheat and the recent softening of sellers' resistance to past demands make it unlikely that the USSR will back down on its new terms. [redacted]

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25X6

25X1

China's Labor Reform Package

China's Labor Minister has announced a reform package that eliminates guaranteed lifetime employment for new workers in state factories and gives managers additional authority to fire employees. Effective 1 October, all new state workers will sign renewable employment contracts, now in experimental use for roughly 4 percent of the state workers. The reforms also institute national retirement and unemployment systems. The announcement indicated that workers already under the lifetime employment system will not be placed under contract. The fact that these reforms bear significant political and social costs demonstrates the strength of the reform coalition and its commitment to push ahead with other urban industrial reforms in management and finance. Resistance from lower level bureaucrats and party members, however, poses a serious obstacle that is already slowing implementation of some measures. Labor reforms will not sit well with workers if employment security is threatened. Chinese economists have said that 15 million "surplus" state workers may be laid off over the next five years. [redacted] 25X1

Shanghai Adopts Flexible Foreign Exchange Measures

The Shanghai branch of China's State Administration of Foreign Exchange Control recently arranged for two joint ventures—one with excess Chinese currency but no foreign exchange, the other with excess foreign exchange and no renminbi (RMB)—to swap US $1 million worth of RMB for an equivalent amount in US dollars. The swap will allow the foreign exchange–short venture—the Shanghai Foxboro Company—to purchase the US components needed for its assembly operation, while providing the RMB-short apartment complex—which rents to foreigners and receives only foreign exchange—currency for local expenses. Earlier this year, China's State Council issued regulations easing their rules under which joint ventures are allowed to remit profits. [redacted] 25X1
[redacted] however, the regulations have done little to ease the chronic foreign exchange problems of most joint ventures. 25X1 Shanghai has been having trouble attracting foreign investment because of its poor infrastructure and notoriously bureaucratic administration and appears to be interpreting the regulations liberally to lure and retain foreign investors. For example, Shanghai may grant foreign exchange loans to enterprises against future export earnings. Shanghai also is allowing some joint ventures that produce goods China would otherwise have had to import to demand foreign currency for their products sold in China. Despite this flexibility, we believe joint ventures in Shanghai and elsewhere will continue to have difficulty obtaining the foreign exchange needed to buy imported components, pay expatriate salaries, and remit profits. [redacted] 25X1

Impact of Typhoon Vera on North Korea

Damage from Typhoon Vera to the east coast of North Korea in late August will aggravate the serious shortages that already exist throughout the North Korean economy. As of early September, nearly 300 people reportedly had lost their lives. There was extensive damage to military facilities, factories, houses, roads, railroads, powerlines, and fishing and cargo ships. Agriculture was hard hit, with several thousand acres of corn, rice, and vegetables flooded. P'yongyang is giving priority to reconstruction of damaged facilities and is trying to save as much of the grain as possible. It is also hoping to make up for some of the loss by reseeding to fall vegetables. We have not heard of any offers of help by the USSR or China. The typhoon damage will hinder P'yongyang's drive to fulfill many construction and production targets by Kim Il-song's 75th birthday on 15 April 1987. They may also put a damper on the start of the next long-term economic plan, already two years behind schedule. Moreover, the losses to agriculture and fishing came at a time when food shortages apparently already were worsening. [redacted] 25X1

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Directorate of Intelligence

Economic & Energy Indicators

12 September 1986

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12 September 1986

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Economic & Energy Indicators

Industrial Production

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
United States	2.6	–7.2	5.9	11.6	2.3	0.5	–2.7	–3.8	–1.0
Japan	1.0	0.4	3.5	11.1	4.6	0.7	0.9	4.0	–3.8
West Germany	–2.3	–3.2	0.3	2.4	4.8	–0.3	11.8	41.0	
France	–2.6	–1.5	1.1	2.5	0.5	–4.9	5.1	31.2	
United Kingdom	–3.9	2.1	3.9	1.3	4.7	3.2	–2.7	–13.5	
Italy	–1.6	–3.1	–3.2	3.3	1.2	11.7	8.9	36.7	
Canada	0.5	–10.0	5.3	8.8	4.3	–0.9			

Gross National Product [a]

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985			1986	
					Year	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr
United States	2.5	–2.1	3.6	6.4	2.7	4.1	2.1	3.8	0.6
Japan	4.1	3.1	3.3	5.0	4.5	2.7	5.8	–2.1	3.6
West Germany	–0.2	–1.0	1.5	3.0	2.4	6.8	–0.2	–6.5	
France	0.2	1.8	0.7	1.5	1.4	3.6	2.3	0	4.0
United Kingdom	–1.4	1.9	3.4	2.6	3.3	–1.1	1.8	2.9	
Italy	0.2	–0.5	–0.2	2.8	2.3	1.0	2.3	5.3	
Canada	3.3	–4.4	3.3	5.0	4.5	7.0	5.4		

[a] Constant market prices.

Consumer Prices

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jul	Aug
United States	10.3	6.2	3.2	4.3	3.5	1.4	–1.7	0.4	
Japan	4.9	2.6	1.8	2.3	2.0	0	–0.8		
West Germany	6.0	5.3	3.3	2.4	2.2	–0.9	–1.1	–2.6	0.7
France	13.3	12.0	9.5	7.7	5.8	0.8	1.7	0.8	
United Kingdom	11.9	8.6	4.6	5.0	6.1	4.5	0.4	0.7	
Italy	19.3	16.4	14.9	10.6	8.6	6.2	5.0	3.8	5.9
Canada	12.5	10.8	5.8	4.3	4.0	4.8	3.0	6.8	

Money Supply, M-1 [a]

Percent change from previous period seasonally adjusted at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
United States [b]	7.1	6.6	11.2	7.0	9.1	7.9	16.8	15.8	18.1
Japan	3.7	7.1	3.7	2.8	5.0	7.6	9.4	7.0	6.5
West Germany	1.1	3.6	10.2	3.3	4.4	9.8	11.3	21.3	-0.4
France	12.2	13.9			8.7	20.4	1.9	16.4	
United Kingdom	NA	NA	13.0	14.7	16.7	9.2	33.0	14.7	14.0
Italy	11.2	11.6	15.1	12.3	13.7	8.9			
Canada	3.8	0.7	10.2	3.2	4.1	-13.4	-1.9	28.7	35.0

[a] Based on amounts in national currency units.
[b] Including M1-A and M1-B.

Unemployment Rate [a]

Percent seasonally adjusted

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	Jun	Jul	Aug
United States	7.5	9.6	9.4	7.4	7.1	7.0	7.1	7.0	6.8	6.7
Japan	2.2	2.4	2.7	2.7	2.6	2.6	2.8	2.7	2.9	
West Germany	5.6	7.7	9.2	9.1	9.3	10.2	8.6	8.4	8.6	8.5
France	7.6	8.4	8.6	9.6	10.0	9.9	10.0	10.4	10.5	
United Kingdom	10.0	11.6	10.7	11.1	11.3	11.5	11.6	11.7	11.7	
Italy	8.4	9.1	9.9	10.4	10.7	11.5				
Canada	7.5	11.1	11.9	11.3	10.5	9.7	9.6	9.5	9.9	9.7

[a] Prior to May 1986, unemployment rates for France were estimated.

Foreign Trade [a]

Billion US $, f.o.b.

	1981	1982	1983	1984	1985	1986 1st Qtr	2nd Qtr	May	Jun	Jul
United States [b]										
Exports	233.5	212.3	200.7	217.6	213.3					
Imports	261.0	244.0	258.0	325.7	345.3	92.9	90.8	30.3	31.8	34.1
Balance	−27.5	−31.6	−57.4	−108.1	−132.0					
Japan										
Exports	149.6	138.2	145.4	168.1	173.9	47.7	51.3	17.6	16.9	17.7
Imports	129.5	119.6	114.0	124.1	118.0	29.9	29.0	9.2	10.1	9.8
Balance	20.1	18.6	31.4	44.0	55.9	17.8	22.3	8.4	6.9	7.9
West Germany										
Exports	175.4	176.4	169.5	171.9	184.2	55.1	60.9	17.6	21.4	21.2
Imports [c]	163.4	155.3	152.9	153.1	158.9	45.0	47.6	14.4	16.0	16.0
Balance	11.9	21.1	16.6	18.8	25.3	10.1	13.3	3.2	5.4	5.3
France										
Exports	106.3	96.4	95.1	97.5	101.9	30.4	29.8	9.7	10.1	10.8
Imports	115.6	110.5	101.0	100.3	104.5	30.3	30.9	10.0	10.3	10.6
Balance	−9.3	−14.0	−5.9	−2.8	−2.6	0.1	−1.1	−0.3	−0.2	0.2
United Kingdom										
Exports	102.5	97.1	92.1	93.6	100.9	26.2	26.8	8.9	8.8	9.0
Imports	94.6	93.1	93.7	99.3	103.5	28.4	29.2	10.0	9.7	9.9
Balance	7.9	4.0	−1.6	−5.7	−2.6	−2.1	−2.4	−1.1	−0.9	−0.9
Italy										
Exports	75.4	73.9	72.8	73.4	78.8	23.3	24.5	8.1	8.2	8.6
Imports	91.2	86.7	80.6	84.4	90.8	26.3	24.3	8.0	8.1	9.0
Balance	−15.9	−12.8	−7.9	−10.9	−12.0	−2.9	0.2	0.1	0.1	−0.4
Canada										
Exports	70.5	68.5	73.7	86.5	88.0	21.7	21.2	7.1	6.7	
Imports	64.4	54.1	59.3	70.6	75.7	19.9	19.6	6.4	6.5	
Balance	6.1	14.4	14.4	15.9	12.3	1.8	1.7	0.7	0.3	

[a] Seasonally adjusted.
[b] Imports are customs values.
[c] Imports are c.i.f.

Current Account Balance [a]

Billion US $

	1981	1982	1983	1984	1985	1986 1st Qtr	2nd Qtr	May	Jun	Jul
United States	6.3	−8.1	−46.6	−106.5	−117.7	−33.7				
Japan	4.8	6.9	20.8	35.0	49.2	12.7	23.2	7.7	7.6	8.0
West Germany	−6.8	3.3	4.3	6.7	13.8	6.9	8.2	2.7	1.9	2.7
France	−4.7	−12.1	−4.9	−0.8	0.4	1.1	0.3			
United Kingdom	15.3	8.5	4.7	1.9	4.9	0.8	0.7	0	0.1	0
Italy	−8.6	−5.7	0.6	−2.9						
Canada	−5.0	2.1	2.4	2.6	−0.4	−2.0	−1.3			

[a] Seasonally adjusted; converted to US dollars at current market rates of exchange.

Export Prices in US $

Percent change from previous period at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
United States	9.2	1.5	1.0	1.4	–0.7	–0.5	1.2	7.1	
Japan	5.5	–6.4	–2.4	0.2	–0.6	26.1	24.9	–3.5	
West Germany	–14.9	–2.8	–3.2	–7.1	0	40.7	16.6	–2.4	48.8
France	–12.0	–5.5	–4.8	–2.9	2.5	33.2			
United Kingdom	NA	NA	–6.2	–5.1	2.3	–2.6	7.2	–1.7	–15.8
Italy	–7.8	–3.0	–4.4	–5.2	–0.3	25.9			
Canada	3.9	–2.0	0.2	–0.4	–3.5	–16.3	5.5	–0.8	

Import Prices in US $

Percent change from previous period at an annual rate

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jun	Jul
United States	5.3	–2.0	–3.7	1.7	–2.4	–7.1	–10.8	–0.4	
Japan	3.6	–7.4	–5.0	–2.8	–4.3	–5.3	–49.2	–2.2	
West Germany	–8.6	–4.7	–5.2	–4.8	–1.5	9.8	–11.6	–24.1	6.7
France	–7.8	–7.2	–7.0	–3.8	–0.3	10.3			
United Kingdom	NA	NA	–5.7	–4.5	0.5	–0.5	2.4	–18.2	–8.2
Italy	1.0	–5.3	–6.6	–3.7	–1.0	10.7			
Canada	8.7	–1.1	0.6	1.0	–2.1	– 8.9	3.6	–23.0	

Exchange Rate Trends

Percent change from previous period at an annual rate

	1981	1982	1983	1984	1985	1986					
						1st Qtr	2nd Qtr	May	Jun	Jul	Aug
Trade-Weighted											
United States	10.5	10.6	5.8	9.1	6.3	−17.8	−11.3	−13.7	21.7		
Japan	9.3	−5.7	10.4	6.2	6.8	26.8	42.4	81.8	18.4		
West Germany	−2.1	7.0	5.8	1.0	1.7	8.5	6.0	11.3	6.5		
France	−5.1	−6.1	−4.7	−2.1	2.7	5.8	−10.4	−3.1	7.4		
United Kingdom	2.5	−2.1	−5.0	−2.5	2.0	−26.0	9.5	11.8	3.7		
Italy	−9.2	−5.1	−1.6	−3.1	−3.8	5.5	5.2	9.3	11.7		
Canada	0.3	0.2	2.3	−2.3	−3.6	−13.1	1.7	6.2	− 7.6		
Dollar Cost of Foreign Currency											
Japan	2.7	−12.9	4.6	0	−0.3	32.2	33.5	42.8	−2.2	48.3	27.5
West Germany	−24.6	−7.2	−5.2	−11.5	−3.3	31.3	17.1	19.5	−1.0	35.5	39.7
France	−28.7	−20.8	−15.9	−14.7	−2.7	29.7	4.4	15.7	−2.8	27.7	27.8
United Kingdom	−13.2	−13.4	−13.3	−11.9	−3.0	1.7	20.8	19.3	−7.7	−2.0	−16.9
Italy	−32.8	−18.8	−12.3	−15.6	−8.6	30.1	14.5	18.8	−2.0	35.2	37.6
Canada	−2.5	−2.9	0.1	−5.1	−5.4	−6.9	5.7	6.4	−13.1	6.8	−0.7

Money Market Rates

Percent

	1981	1982	1983	1984	1985	1986				
						1st Qtr	2nd Qtr	Apr	May	Jun
United States 90-day certificates of deposit, secondary market	16.24	12.49	9.23	10.56	8.16	7.68	6.77	6.67	6.75	6.88
Japan loans and discounts (2 months)	7.79	7.23	NA	6.66	6.52	6.38	5.98	6.12	5.98	5.82
West Germany interbank loans (3 months)	12.19	8.82	5.78	5.96	5.40	4.51	4.52	4.47	4.55	4.55
France interbank money market (3 months)	15.47	14.68	12.51	11.74	9.97	8.96	7.41	7.55	7.27	7.41
United Kingdom sterling interbank loans (3 months)	13.85	12.24	10.12	9.91	12.21	12.26	10.09	10.41	10.14	9.72
Italy Milan interbank loans (3 months)	20.13	20.15	18.16	15.91	14.95	16.00	12.71	13.66	12.50	11.97
Canada finance paper (3 months)	18.46	14.48	9.53	11.30	9.71	11.08	9.03	9.52	8.78	8.80
Eurodollars 3-month deposits	16.87	13.25	9.69	10.86	8.41	7.91	7.00	6.95	6.99	7.07

Agricultural Prices

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jul	Aug
Bananas Fresh imported, (Total world, $ per metric ton)	214.0	217.0	232.0	243.0	110.3	109.8	108.5	108.9	NA
Beef (¢ per pound)									
Australia (Boneless beef, f.o.b. US Ports)	112.4	107.4	111.1	101.0	96.6	97.6	91.3	90.0	91.5
United States (Wholesale steer beef, midwest markets)	100.0	101.4	97.6	100.9	90.7	87.8	84.4	89.6	90.3
Cocoa (¢ per pound)	89.8	74.3	92.1	106.2	98.7	95.7	82.6	87.6	NA
Coffee ($ per pound)	1.28	1.40	1.32	1.44	1.43	2.01	1.73	1.49	1.47
Corn (US #3 yellow, c.i.f. Rotterdam, $ per metric ton)	150	123	148	150	125	116	116	98	87
Cotton (World Cotton Prices, "A" index, c.i.f. Osaka, US ¢/lb.)	72.69	74.48	85.71	63.91	57.87	53.60	45.51	36.35	NA
Palm Oil (United Kingdom 5% bulk, c.i.f., $ per metric ton)	571	445	502	730	501	289	241	221	NA
Rice ($ per metric ton)									
US (No. 2, milled, 4% c.i.f. Rotterdam)	632	481	514	514	484	453	352	288	NA
Thai SWR (100% grade B c.i.f. Rotterdam)	573	362	339	310	249	236	224	230	NA
Soybeans (US #2 yellow, c.i.f. Rotterdam, $ per metric ton)	288	244	282	283	225	218	213	203	198
Soybean Oil (Dutch, f.o.b. ex-mill, $ per metric ton)	507	447	527	727	571	407	348	336	NA
Soybean Meal (US, c.i.f. Rotterdam $ per metric ton)	252	219	238	197	157	188	184	183	185
Sugar (World raw cane, f.o.b. Caribbean Ports, spot prices ¢ per pound)	16.93	8.42	8.49	5.18	4.04	5.83	7.45	5.58	5.50
Tea Average Auction (London) (¢ per pound)	91.0	89.9	105.2	156.6	90.0	86.4	85.6	79.8	NA
Wheat (US #2. DNS c.i.f. Rotterdam, $ per metric ton)	210	187	183	182	169	172	158	129	124
Food Index [a] (1980=100)	88	78	86	92	81	95	94	83	84

[a] The food index is compiled by *The Economist* for 14 food commodities which enter international trade. Commodities are weighted by 3-year moving averages of imports into industrialized countries.

Industrial Materials Prices

	1981	1982	1983	1984	1985	1986			
						1st Qtr	2nd Qtr	Jul	Aug
Aluminum (¢ per pound)									
Major US producer	77.3	76.0	77.7	81.0	81.0	81.0	81.0	81.0	81.0
LME cash	57.4	44.9	65.1	56.8	47.2	51.4	53.1	50.7	51.0
Chrome Ore (South Africa chemical grade, $ per metric ton)	53.0	50.9	50.0	50.0	43.9	40.0	40.0	40.0	40.0
Copper [a] (bar, ¢ per pound)	79.0	67.1	72.0	62.4	64.5	64.5	64.5	60.6	59.1
Gold ($ per troy ounce)	460.0	375.5	424.4	360.0	317.2	342.6	341.6	348.4	365.4
Lead [a] (¢ per pound)	32.9	24.7	19.3	20.0	17.7	16.7	17.6	17.0	17.5
Manganese Ore (48% Mn, $ per long ton)	82.1	79.9	73.3	69.8	68.4	67.2	64.8	64.8	65.6
Nickel ($ per pound)									
Cathode major producer	3.5	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
LME Cash	2.7	2.2	2.1	2.2	2.2	1.8	1.8	1.8	1.8
Platinum ($ per troy ounce)									
Major producer	475.0	475.0	475.0	475.0	475.0	475.0	475.0	475.0	475.0
Metals week, New York dealers' price	446.0	326.7	422.6	358.2	291.0	383.1	420.1	438.0	495.7
Rubber (¢ per pound)									
Synthetic [b]	47.5	45.7	44.0	44.4	44.1	42.8	38.7	38.3	NA
Natural [c]	56.8	45.4	56.2	49.6	42.0	41.7	40.1	43.6	43.5
Silver ($ per troy ounce)	10.5	7.9	11.4	8.1	6.1	5.9	5.2	5.0	5.1
Steel Scrap [d] ($ per long ton)	92.0	63.1	73.2	86.4	74.4	74.0	71.8	NA	NA
Tin [a] (¢ per pound)	641.4	581.6	590.9	556.6	543.2	357.4	250.5	244.0	245.5
Tungsten Ore (contained metal, $ per metric ton)	18,097	13,426	10,177	10,243	10,656	8,673	7,567	7,112	6,360
US Steel NA (finished steel, composite, $ per long ton)	543.5	567.3	590.2	611.6	617.8	551.2	554.4	NA	NA
Zinc [a] (¢ per pound)	38.4	33.7	34.7	41.5	35.4	28.5	33.8	36.5	36.5
Lumber Index [e] (1980=100)	95	84	114	105	103	100	121	111	NA
Industrial Materials Index [f] (1980=100)	85	71	82	76	69	69	70	68	67

[a] Approximates world market price frequently used by major world producers and traders, although only small quantities of these metals are actually traded on the LME. As of February 1986 tin prices from the Penang market.
[b] S-type styrene, US export price.
[c] Quoted on New York market.
[d] Average of No. 1 heavy melting steel scrap and No. 2 bundles delivered to consumers at Pittsburgh, Philadelphia, and Chicago.
[e] This index is compiled by using the average of 10 types of lumber whose prices are regarded as bellwethers of US lumber construction costs.
[f] The industrial materials index is compiled by *The Economist* for 18 raw materials which enter international trade. Commodities are weighted by 3-year moving averages of imports into industrialized countries.

World Crude Oil Production Excluding Natural Gas Liquids

Thousand b/d

	1981	1982	1983	1984	1985 [a]	1986 [a] 1st Qtr	May	June	July
World	**55,837**	**53,092**	**52,625**	**53,674**	**52,931**	**54,029**			
Non-Communist countries	**41,602**	**38,810**	**38,228**	**39,257**	**38,692**	**39,758**			
Developed countries	12,886	13,276	13,864	14,302	14,730	15,022			
United States	8,572	8,658	8,680	8,735	8,933	8,898	8,848	8,808	8,800
Canada	1,285	1,270	1,356	1,411	1,457	1,480			
United Kingdom	1,811	2,094	2,299	2,535	2,533	2,711	2,538		
Norway	501	518	614	700	785	856	826		
Other	717	736	915	921	1,022	1,077	927		
Non-OPEC LDCs	6,036	6,633	6,823	7,515	7,845	7,556	7,998		
Mexico	2,321	2,746	2,666	2,746	2,733	2,376	2,527	2,547	2,500
Egypt	598	665	689	827	874	758	845		
Other	3,117	3,222	3,468	3,942	4,238	4,422	4,626		
OPEC	22,680	18,901	17,541	17,440	16,117	17,180	18,000	19,300	20,320
Algeria	803	701	699	638	645	602	600	600	600
Ecuador	211	211	236	253	280	275	300	300	285
Gabon	151	154	157	152	153	160	160	170	170
Indonesia	1,604	1,324	1,385	1,466	1,235	1,223	1,305	1,235	1,250
Iran	1,381	2,282	2,492	2,187	2,258	1,890	2,100	2,200	2,300
Iraq	993	972	922	1,203	1,437	1,732	1,700	1,700	1,900
Kuwait [b]	947	663	881	912	862	1,169	1,400	1,500	1,600
Libya	1,137	1,183	1,076	1,073	1,069	1,000	1,100	1,200	1,150
Neutral Zone [c]	370	317	390	410	355	276	220	300	340
Nigeria	1,445	1,298	1,241	1,393	1,464	1,417	1,550	1,490	1,600
Qatar	405	328	295	399	302	352	360	430	400
Saudi Arabia [b]	9,625	6,327	4,867	4,444	3,290	4,256	4,250	5,100	5,600
UAE	1,500	1,248	1,119	1,097	1,146	1,287	1,405	1,505	1,505
Venezuela	2,108	1,893	1,781	1,813	1,621	1,541	1,550	1,570	1,620
Communist countries	**14,235**	**14,282**	**14,397**	**14,417**	**14,239**	**14,271**			
USSR	11,800	11,830	11,864	11,728	11,350	11,350			
China	2,024	2,042	2,121	2,280	2,496	2,496	2,496		
Other	411	410	412	409	393	425			

[a] Preliminary.
[b] Excluding Neutral Zone production, which is shown separately.
[c] Production is shared equally between Saudi Arabia and Kuwait.

Big Seven: Inland Oil Consumption

Thousand b/d

	1981	1982	1983	1984	1985	1986						
						Jan	Feb	Mar	Apr	May	June	Jul
United States [a]	16,058	15,296	15,184	15,708	15,726	15,923	16,056	16,188	15,743	15,852	15,998	16,309
Japan	4,444	4,204	4,193	4,349	4,123	4,661	5,002	4,547	3,924	3,568	3,577	
West Germany	2,120	2,024	2,009	2,012	2,060	2,096	2,406	2,141	2,640	2,388	2,473	
France	1,744	1,632	1,594	1,531	1,493	1,626	2,009	1,525	1,702	1,245	1,284	
United Kingdom	1,325	1,345	1,290	1,624	1,402	1,286	1,483	1,447	1,427	1,330		
Italy [b]	1,705	1,618	1,594	1,513	1,516	1,718	1,855	1,535	1,495	1,345	1,506	
Canada	1,617	1,454	1,354	1,348	1,259	1,261	1,280	1,109	1,239	1,325		

[a] Including bunkers, refinery fuel, and losses.
[b] Principal products only prior to 1981.

Big Seven: Crude Oil Imports

Thousand b/d

	1981	1982	1983	1984	1985	1986						
						Jan	Feb	Mar	Apr	May	June	Jul
United States	4,406	3,488	3,329	3,426	3,201	3,329	2,993	3,000	3,701	3,872	4,508	4,291
Japan	3,919	3,657	3,567	3,664	3,377	3,126	4,273	3,673	3,469			
West Germany	1,591	1,451	1,307	1,335	1,284	1,321	1,258	1,429	1,285	1,340	1,263	
France	1,804	1,596	1,429	1,395	1,476	1,430	1,420	1,380	1,608	1,235		
United Kingdom	736	565	456	482	523	493	445	494	610	767	442	
Italy	1,816	1,710	1,532	1,507	1,462							
Canada	521	334	247	244	283	353	424	260	185			

Crude Oil Prices

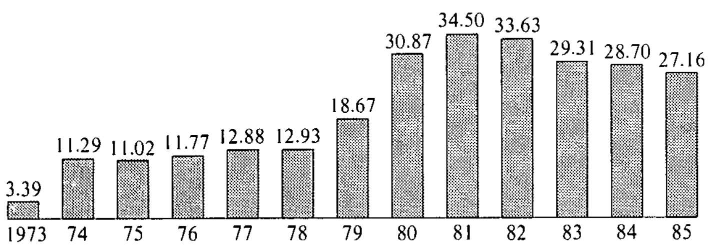
US $ per barrel

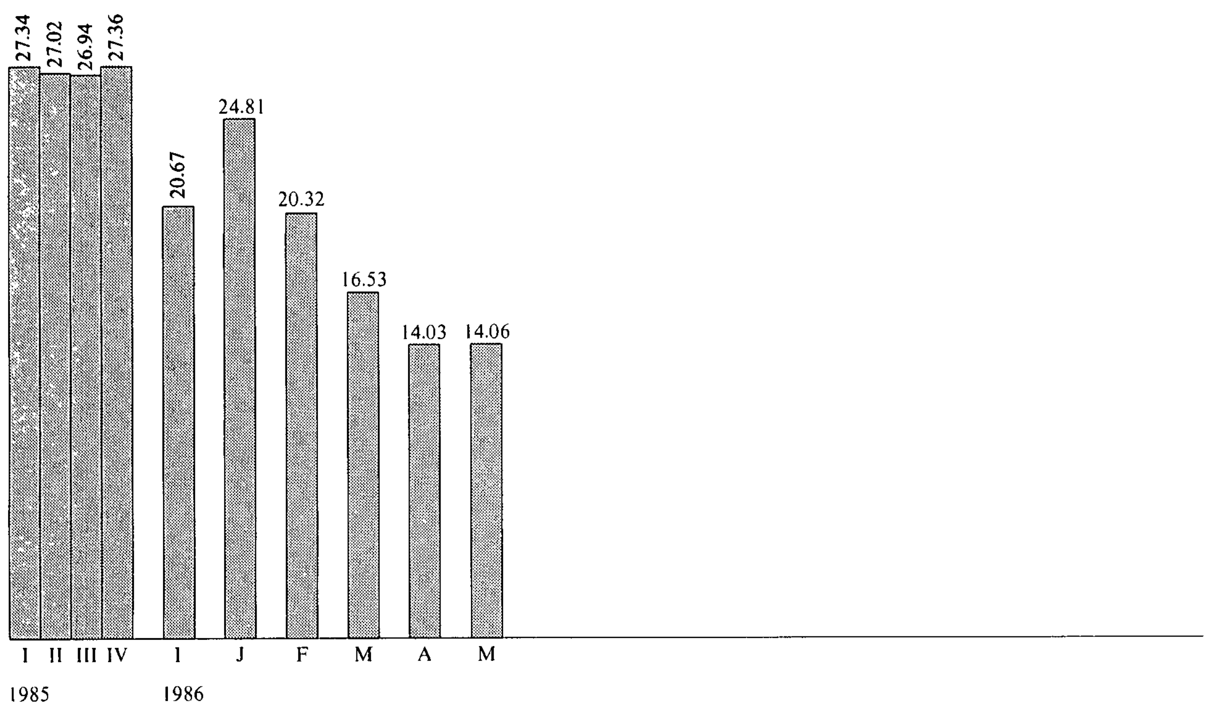
	1980	1981	1982	1983	1984	1985	1986			
							1st Qtr	2nd Qtr	May	Jun
OPEC Average [a] (Official Sales Price)	30.87	34.50	33.63	29.31	28.70	28.14	28.09	28.08	28.07	28.11
World Average Price	NA	NA	NA	NA	NA	27.16	20.67	NA	14.06	12.87

[a] F.o.b. prices set by the government for direct sales and, in most cases, for the producing company buy-back oil. Weighted by the volume of production.

Average Crude Oil Sales Price[a]

US $ per barrel





[a] The 1973 price is derived from posted prices, 1974-84 prices are derived from OPEC official sales prices, and beginning in 1985, prices are a measure of average world sales prices.

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