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partly because of Castro's recalcitrance. The Kremlin maintains its substantial economic aid to Cuba—about $5.4 billion in 1986—but growing frustration with Cuban economic mismanagement is causing Moscow to push harder for more market-oriented economic reforms. Increasing Soviet pressure on Castro to decentralize the economy and meet export commitments will almost certainly increase friction in the bilateral relationship. 25X1

In the absence of major reforms or external relief, Havana probably will continue its current policy of increasing austerity to mitigate financial problems and exhorting the population to produce more. This approach, so far, has failed to stem the current economic slide and is unlikely to meet with future success. Havana appears locked into a cycle of continuing stagnation in economic growth and consumption levels, rising domestic discontent, and tighter domestic control. Current efforts to diversify exports, meanwhile, probably will not begin to pay off until the middle of the next decade. 25X1

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Perspective

Cuba: Long-Term Economic Troubles [redacted] 25X1

We believe the Cuban economy—which has deteriorated markedly since early 1986—will continue to face economic stagnation, consumer austerity, and increasing dependence on the Soviet Union into the next decade because of severe hard currency shortages and President Fidel Castro's refusal to make needed reforms in the economy. Persistent drought, low world prices for Cuban exports, and Castro's increasing reliance on doctrinaire economic policies have sharply undercut economic growth over the past two years. Moreover, worsening hard currency shortages have cut vital imports from the West, and the Castro government has defaulted on its official Western debt for the first time. Havana has virtually exhausted its hard currency reserves, access to Western credit, and inventories of vital industrial inputs. [redacted] 25X1

Cuban payments arrears are damaging Havana's relations with both Western bankers and commercial suppliers. Cuban imports from the OECD dropped by 50 percent during the final two quarters of last year as Western partners cut trade credits to Havana, and both Western lending and deliveries remain low this year. Despite efforts to diversify the economy, Cuban hard currency earnings remain dependent on weak agricultural exports such as sugar and tobacco. Cuba's reputation as an unreliable supplier has also undercut Havana's efforts to diversify exports and find new trade partners. [redacted] 25X1

Castro's response to his economic troubles has been to call on the population to make further consumption sacrifices. Increased austerity, including reduced rations and higher prices for food and other basic commodities, appears to be fueling popular discontent. This discontent, illustrated by anti-Castro graffiti and sabotage, is further decreasing worker productivity and probably heightening the desire of many Cubans to leave the island. The Castro regime, keenly aware of domestic dissatisfaction, has responded by increasing internal security. [redacted] 25X1

Havana has exhausted virtually all options available in the short run that could stem the current economic decline. Western creditors are unlikely to provide more credits or debt relief, and the Soviets appear unwilling to offer large infusions of additional aid—especially badly needed hard currency—that could revive the island's economy. Market-oriented reform of Cuba's economy would seem to offer hope over the longer term, but President Castro reportedly continues to reject such measures. Castro's personal identification with the Cuban revolution makes him hesitant to invite the criticism that would be implicit in the complete reversal of past economic policies. [redacted] 25X1

Even before the reform-minded Gorbachev came to power, the Soviets had been trying to promote economic diversification and planning reforms aimed at making the island more self-sufficient. These efforts have been unsuccessful, however,

**Key LDC Debtors:
Economic/Financial Indicators**

	Foreign Debt [a] *(billion US $)*	Months of Import Coverage by Reserves [b]	Other Indicators
Brazil	110	3.3 (Jul 87) 1.9 (Apr 87)	Monthly inflation rate—officially 3 percent in July and 6.4 percent in August—probably will return to double digits this month.
Mexico	104	17.0 (Jul 87) 10.2 (Apr 87)	**Current account swung from a $1 billion deficit for first six month of 1986 to a $3 billion surplus for same period this year.**
Argentina	51	2.8 (Jun 87) 3.9 (Feb 87)	Trade surplus for first-half 1987 totaled only $610 million, less than half the comparable figure for 1986. Reserves in mid-August totaled $1.7 billion.
Venezuela	36	7.1 (Mar 87) 10.1 (Dec 86)	Inflation rose 5.2 percent in July bringing annual rate to 84 percent; government moving to impose more extensive price control system.
Indonesia	40	8.7 (Dec 86) [c] 10.3 (Sep 86)	Tight monetary policy continues although rupiah liquidity has eased due to forced conversion of foreign exchange holdings into rupiah by state banks.
Egypt	30	1.5 (Apr 87) 1.4 (Jan 87)	Foreign exchange collected under new currency regime surpassed $1 billion since mid-May; IMF remains concerned about long-term viability of exchange rate system; black market creeping back into operation.
Philippines	28	3.2 (Jun 87) 3.7 (Mar 87)	GNP target for 1987 revised downward from 6.8 percent to between 5.1 and 5.8 percent because of poorer-than-expected performance in several sectors, including agriculture.
Chile	19	8.4 (Jun 87) 7.6 (Mar 87)	Economy grew at a 6-percent annual rate during first-half 1987. Inflation slowed in August to 1.4 percent, down from 1.7 percent in July.
Nigeria	19	1.0 (Jun 87) 0.9 (Feb 87)	Central Bank puts total international reserves, including gold and SDRs, at $851 million.
Peru	15	3.7 (Feb 87) 4.7 (Nov 86)	Inflation spurted to a 130-percent annual rate during July-August after running at a 100-percent rate during first-half 1987.

[a] Yearend 1986.
[b] Derived from the ratio of foreign exchange reserves, excluding gold, to imports.
[c] Foreign reserves, excluding gold, plus net foreign assets of commercial banks used in deriving months of import coverage.

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International Financial Situation: Update on LDC Debt [redacted] 25X1

Developments in LDC debt situations this week focus on the Philippines as well as Brazil and Nigeria:

- In the wake of an aborted military coup in late August, ***Philippine*** President Aquino shuffled her Cabinet to relieve civil-military tensions and end the bickering between Cabinet members that has contributed to political instability. Of her financial team, Aquino dismissed Finance Secretary Ongpin, a respected conservative businessmen, because of public and Congressional criticism that he "caved in" to foreign creditors during the country's difficult debt negotiations. According to the US Embassy, Aquino probably will also replace Central Bank Governor Fernandez, who reportedly has wanted to quit for some time, and Economic Planning Secretary Monsod, who has publicly endorsed selective repudiation of the country's foreign debt. If Aquino replaces Monsod and Fernandez, she probably will select technocrats who reflect the expertise and conservative economic approach of Ongpin's replacement Vicente Jayme, former Secretary of Public Works and Highways.

  Jayme's first priority in the foreign policy sphere will be to conclude the $13.2 billion rescheduling agreement with commercial bankers. The accord has been stalled since mid-August because of Manila's decision to delay implementation of the controversial Planters Product Inc. (PPI) loan agreement—a $56 million private-sector debt guaranteed by Manila. This same issue threatened the last rescheduling agreement but was resolved when Manila and the commercial banks agreed to treat the PPI loan as government guaranteed debt. According to [redacted] US Embassy reporting, Jayme is likely, in the near term, to pursue the same kind of debt strategy as his predecessor. In our judgment, he will complete the accord before the 15 November deadline to ensure continued good relations with creditors and to sustain the Philippines' modest economic recovery. 25X1

  Nonetheless, the US Embassy reports Jayme believes LDC debt problems are no longer solvable by traditional approaches. His reported readiness to explore unorthodox ideas, excluding outright debt repudiation, combined with continued pressure from a nationalistic Congress—that already has called on Manila to renege on the PPI agreement and reopen debt talks—suggests future negotiations with foreign creditors may be more prolonged and contentious than in the past. Manila will need to negotiate with the IMF in April when its current standby arrangement expires, and will probably need new funds from commercial creditors next year as well. With only $13 billion in commercial debt, the Philippines does not have as much leverage with bankers as Brazil, Mexico, and Argentina. As a result, Manila probably will play up its special relationship with the United States and will expect Washington to intervene with commercial creditors.

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The new Aquino Cabinet also must make continued headway on promoting the private economy and increasing political stability if foreign and domestic investment is to solidify and be sustained. Although foreign investment is up sharply from last year, the actual dollar amounts remain low—only about $17 million from US investors this year, according to the Embassy. [redacted] 25X1

[redacted] 25X1

In our judgment, wary investors will continue to look elsewhere in Asia unless Manila makes headway on programs that address social inequities, creates a more favorable labor climate, and convinces the international audience that military dissatisfaction with Aquino has dissipated.

- The proposal ***Brazil*** will present to its Bank Advisory Committee today probably will not differ significantly from ideas already put forth in recent weeks by Finance Minister Bresser. [redacted] 25X1
[redacted] According to the US Embassy, Brasilia's position has hardened in the wake of the fallout at home of Bresser's nonproductive meetings with US officials earlier this month. Brasilia is thus likely to continue to push for long-term fixed interest rate exit bonds covering up to 50 percent of its $72 billion commercial bank debt. Moreover, Brazil almost certainly will continue to insist on a rescheduling agreement from banks, with no IMF program, and is unlikely to make a token interest payment unless it wins a major concession from banks. It is likely to begin negotiations proposing that the interest spread over LIBOR be eliminated, but will probably accept a compromise rate that is less than the 0.813 percentage point over LIBOR received by Mexico and Argentina, according to the Embassy. Bankers, for their part, are highly skeptical that today's negotiations will set the stage for an agreement, according to press reports. 25X1

- ***Nigeria*** and the IMF have been unable to conclude the review of the 1986 standby arrangement. According to the US Embassy, the main issues yet to be resolved relate to improving Lagos's fiscal performance, including reducing government expenditures, increasing customs receipts, and accurately counting total oil export revenues. In addition, the IMF remains concerned with the foreign exchange auction system, especially the continuing sale of $100 million biweekly in order to maintain the current exchange rate. Instead of attempting to resolve these difficulties, the IMF may not complete the review and instead focus on designing a new standby to begin next year, according to the US Embassy. [redacted] 25X1

[redacted] 25X1

Boldface indicates change over the previous week

Status of Debtor-Creditor Relations	Domestic Political Scene
Bresser met with Argentine, Mexican, and Philippine counterparts in New York yesterday to exchange ideas on debt.	**Latest version of draft constitution contains highly controversial provisions; also provides for parliamentary system of government.**
Seeks support from Tokyo for a proposal to convert debt into long-term bonds guaranteed by international organizations and foreign governments.	De la Madrid's state-of-the-nation address earlier this month indicated that current policies could continue until his term ends in 15 months, suggesting a prolonged period of high inflation.
Buenos Aires probably will not meet October IMF targets; likely to ask for waiver. Scheduled to receive $750 million from banks this month.	Opposition Peronists—who favor a debt moratorium—won gubernatorial and congressional elections on 6 September. Buenos Aires will have difficulties carrying out economic reforms.
President Lusinchi approved signature of Caracas's domestically controversial $20.3 billion debt accord with commercial creditors. Set to be signed 1 October.	**Congress has appropriated an additional $700 million to finance infrastructure projects; likely will boost inflation in fourth quarter.**
Asian Development Bank made Jakarta eligible for limited amounts of interest-free, 40-year loans to bolster economy.	New Parliament and People's Consultative Assembly will convene 1 October. Assembly meets every five years to set new guidelines for state policy.
IMF asked Cairo to complete debt accords with creditor governments before requesting new loans from the Fund.	Mubarak looking forward to reelection by referendum in October; considering ways to soften political impact of further economic reforms.
As of mid-September, 40 banks still must sign $13.2 billion debt accord [redacted]	**Military presses for removal of armed forces chief Ramos; Aquino's political and business supporters urge her to address military concerns.** 25X1 25X1
Wrapping up bilateral debt negotiations; probably will sign accords with Spain and Austria later this month.	President Pinochet unexpectedly granted 16-percent wage increase for public-sector workers and 12-percent minimum wage hike effective 1 September; hopes to improve political image.
IMF will defer review of standby arrangement targets until early 1988.	Military taking first steps toward returning to civilian leadership. Committee reviewing Constitution is barred, however, from addressing contentious issues.
Lima and two foreign banks have agreed on a debt-for-commodities repayment scheme amounting to about $70 million; scheme limited to short-term debt.	**July wage increases have not satisfied most workers; state workers participated in strike last week; teachers set to strike next month.**

Cuba: Hard Currency Current Account Balance, 1983-87 *Million US $*

	1983	1984	1985	1986	1987 [a]
Current account balance	**238**	**−239**	**−153**	**−483**	**−250**
Trade balance	511	82	73	−198	50
Exports	1,431	1,283	1,356	1,098	1,000
Sugar	368	258	187	253	170
Petroleum products	578	548	573	300	300
Imports	920	1,201	1,283	1,296	950
Net services and transfers	−273	−321	−226	−285	−300

[a] Estimated.

[redacted] 25X1

Cuba's Financial Crisis

Havana's hard currency current account deficit tripled in 1986 as export earnings fell further. Cuba, for the first time, missed payments to its official creditors, and its outstanding Western debt rose to about $4.7 billion—more than four times the value of 1986 hard currency export earnings. To meet its critical financing needs, the Castro government drew down hard currency reserves to less than one month's import coverage and increasingly relied on expensive short-term trade credits from Western commercial suppliers. Cuban commercial entities are up to 12 months in arrears to creditors, [redacted] As a result, Western firms have placed increasingly stringent credit limitations on sales to Cuba. Several West German and Japanese firms now insist on payment for merchandise in advance or on delivery. [redacted]

Havana's poor payment record has caused Western governments recently to restrict trade credits and export insurance on sales to Cuba:

- Japan, historically Havana's leading supplier, eliminated export insurance for Cuba in late 1986.
- Italy also suspended trade credits and export insurance to Cuba by the end of the year.
- France now insures export credits only under restrictive terms, [redacted] 25X1
- [redacted] Spain—Havana's most loyal and, currently, leading supplier—has reduced exports to Cuba in this year's commercial agreement. [redacted] 25X1 25X1

Impact on the Economy

As a result of hard currency shortages, credit cutbacks, and other factors, imports from Cuba's leading Western suppliers in real terms in fourth quarter 1986 were less than one-half the level of the second quarter.[1] [redacted] financial shortage and a resulting austere import policy—which Fidel Castro announced at the end of 1986—are keeping Cuban imports from the West depressed this year. [redacted] 25X1 25X1 25X1 25X1

Cuba's inability to acquire capital goods and intermediate inputs from the West seriously undercuts Cuban economic growth and modernization goals. According 25X1

[1] Spain, Japan, West Germany, Great Britain, Italy, and France accounted for 78 percent of Cuba's industrial imports from the OECD. Canada—Cuba's number-three supplier in 1986—is not included because most of Canada's exports to Cuba consisted of grain shipments paid for by the Soviet Union. [redacted] 25X1

Cuba: Declining Trade With the West

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Havana's severe hard currency shortage and default on Western debt repayments is choking off vital imports from the West. The financially strapped Castro government now finds Western suppliers increasingly unwilling to ship critical intermediate and capital goods—a situation that is unlikely to improve into the 1990s. The Soviets, moreover, appear unwilling to boost aid to offset the economic damage caused by declining trade with the West. Domestic dissatisfaction with the Castro regime appears to be on the rise, but Havana has responded only through exhortations to produce more and by tightening security.

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The Role of Western Trade

Cuba's trade with the developed Western countries began expanding in the mid-1960s as Havana adjusted to the imposition of the US trade embargo and searched for goods unavailable from socialist trading partners. By 1975, trade with the West accounted for more than 40 percent of Havana's foreign trade—up from 24 percent in 1965—and was the channel for quality intermediate and capital goods critical to Cuban industrial production and efforts to modernize the economy. By 1986, however, the Western share in Cuban foreign trade had steadily fallen to less than 14 percent, amounting to nearly $2.4 billion.

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Havana has traditionally paid for its Western imports with earnings from sugar and, to a lesser degree, tobacco and coffee exported to Western customers. More recent sources of foreign exchange have been sales of excess oil from the Soviet quota—an especially important source of hard currency during 1983-85—and exports of shellfish.

Depressed commodity prices, natural disasters, and the continuing inefficiencies of central planning seriously eroded Cuba's hard currency earnings in the mid-1980s. Hurricanes, drought, and weak prices on the world market caused sugar earnings to fall 50 percent between 1983 and 1985. In addition, the fall in world oil prices caused revenues from sales of surplus Soviet-supplied oil to decline sharply. At the same time, Havana used trade credits and commercial loans to boost imports—from about $900 million in 1983 to $1.3 billion in 1986.

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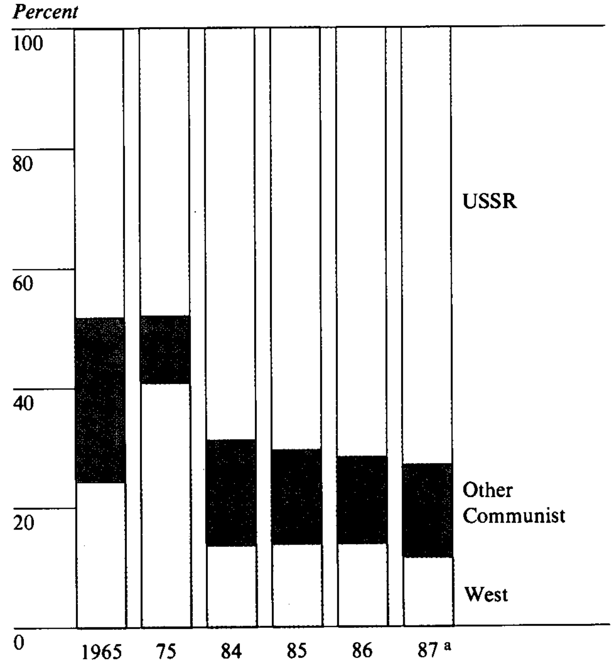
Cuba: Share of Total Trade by Major Area



[a] Estimated.

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Cuba: Factors Hampering Hard Currency Earnings

Sugar. *Production of sugar, Cuba's leading export to its CEMA partners and its largest hard currency earner, is persistently below target, and the current 1986/87 crop—hampered by drought in the growing season and battered by harvest rains—will likely be limited to 6.5 million metric tons, the lowest in 20 years. Cuba has failed to meet sugar commitments to both CEMA and OECD countries this year and,* [redacted] *is purchasing foreign sugar to help meet obligations.* [redacted] 25X1 [redacted] *Havana's sugar earnings from the 1987/88 crop will also be depressed. Not only is part of the harvest already committed to cover missed deliveries from 1986/87, but the recent drought has ensured low crop yields. Additionally, Western experts estimate that world sugar prices will remain low because of oversupply and declining demands in developed countries.* [redacted]

Oil. *With low prices on Western markets, the oil provided by Moscow to Havana for resale has lost its prominence as a revenue earner. Cuba is slowly expanding domestic oil extraction, which may come to 20,000 b/d in 1987. The high sulfur content of Cuba oil limits its profitability as a revenue earner, although this production marginally reduces Cuban dependence on Soviet supplies to meet domestic needs.* [redacted]

Other Agricultural. *Production of tobacco and cigars has been hampered in recent years by crop disease and persistent drought. Exports of citrus fruit, a major component of Cuban trade with the Soviet Union and Eastern Europe, play only a minor role in trade with the West mainly because of poor quality.* [redacted] 25X1

Shellfish. *Strong demand for Cuban lobster, the leading export to the OECD in 1985, makes the Cuban lobster farm and fishing industries promising hard currency earners.* [redacted] 25X1

[redacted] 25X1 25X1

Nontraditional. *The Soviets are assisting Havana in the development of nickel mines and processing plants, but initial output is dedicated to the USSR and has remained small because of continuing construction delays.* 25X1 *Competitive prices are likely to allow Cuba to successfully promote pharmaceutical sales to Third World countries. Production from the fledgling Cuban electronics industry will probably only be acceptable to CEMA customers.* [redacted] 25X1

Tourism. *Havana is trying to boost hard currency receipts by expanding tourist facilities and marketing efforts to attract more visitors, most of whom now come from Canada.* [redacted] 25X1.1 [redacted] *tourism appears to have peaked in* 25X1 *1986 and is now declining because of over-priced, low-quality accommodations and services.* [redacted] 25X1

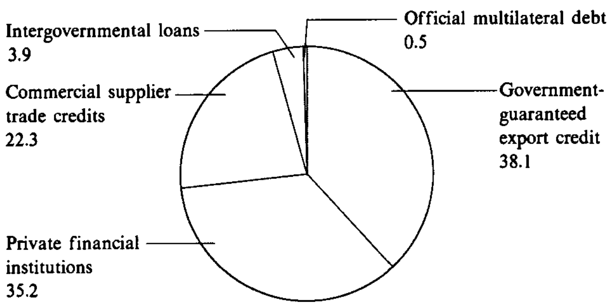
shortages. Fidel Castro's rejection of economic decentralization, and the elimination of limited existing entrepreneurial opportunities and incentive payments probably will undermine Cuban labor productivity. Agricultural yields, moreover, will be depressed through the next year, and world commodity markets for important Cuban exports will remain weak. In addition, Havana has virtually exhausted its access to Western credit that could support trade. [redacted] 25X1

Although a reversal of the current decline is unlikely, some Western countries will continue at least limited trade with Cuba. US officials report that Western commercial officers in Havana want to maintain their share in the limited Cuban market in order to expand sales easily if trade prospects improve. Furthermore,

Cuba: Hard Currency Debt Disbursed, December 1986

Percent

Total=US $4.7 billion



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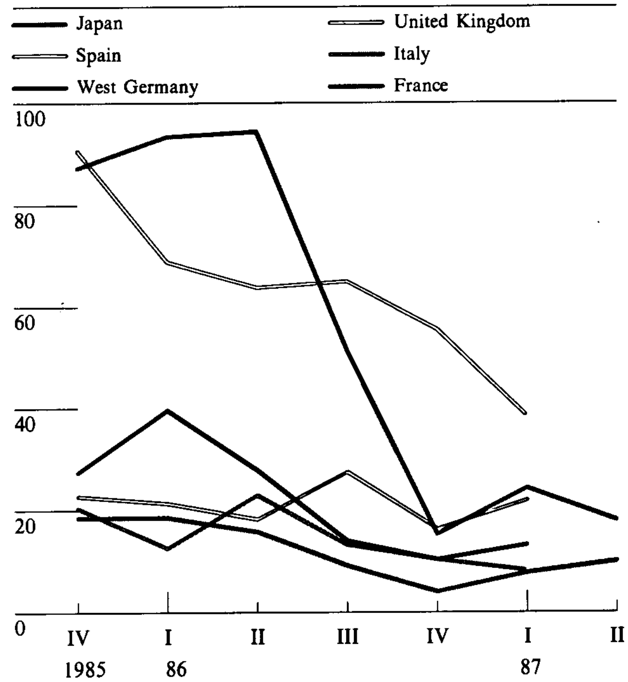
Cuba: Leading OECD Exporters, 1985-87 [a]

Million US $



[a] Data in constant October 1985 dollars.

[redacted] 314311 9-87

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to Havana's claims, economic growth dropped to 1.4 percent in 1986, compared with a 7.2-percent average annual growth for the 1981-85 period. We believe these figures are inflated and probably mask negative real growth in 1986. [redacted] lack of Western fertilizer and equipment has depressed the output of the Cuban citrus industry and undermined expansion efforts. Similar shortages undoubtedly affect other Cuban crops and industries. Difficulty with acquiring Western spare parts, for example, has hampered the transportation industry, [redacted]

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Alternative Strategies Fail

Startup delays, bad management, and poor quality control have hampered Havana's attempts to diversify the island's export base and boost export potential, according to the US Interest Section. The Cuban hard currency shortage, moreover, has led to a cutback in commercial staff operating in Western countries, limiting Havana's ability to export. Cuban efforts to expand trade with Latin America have been largely unsuccessful because of Cuba's limited range of attractive exports, its lack of hard currency to pay for imports, and its inability to provide credits to potential customers. [redacted]

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No Recovery in Sight

Havana's ability to counter the current decline in its imports from the West will probably continue to be limited by weak export earnings and hard currency some Western governments—especially Spain, Italy, and France—see preservation of economic ties as important to maintaining political influence. 25X1

Cuba's decline in trade with the West will boost the the island's dependence on economic links to the Soviet Bloc. The Soviets, however, appear unwilling to increase subsidies to Cuba and are unlikely to boost aid to the degree necessary to offset the economic setbacks resulting from Havana's loss of important Western imports. In particular, Moscow almost certainly will not increase needed hard currency support. Furthermore, Western-quality intermediate and capital goods cannot be replaced through intra-CEMA trade. 25X1

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Cuba: Food Rations and Prices,[a] 1987

	Monthly Food Ration (*per person*)	Ration Price (*US $ per pound*)	Parallel Price (*US $ per pound*)
Beans	20 (ounces)	0.24	1.80-2.00
Canned milk [b]	3 cans	NA	NA
Coffee	4 (ounces)	0.96	24.00
Cooking oil	8 (ounces)	0.40	3.20
Lard	1 pound	NA	NA
Meat			
First-class beef	7 (ounces)	NA	NA
Second-class beef	5 (ounces)	NA	NA
Chicken	2 (pounds)	0.70	3.00
Rice	5 (pounds)	0.24	1.50
Sugar	4 (pounds)	NA	NA
Tomato sauce	1 can	0.25	2.00
Vegetables [c]	As available	NA	NA

[a] Prices converted from the current official exchange rate of one peso equals one US dollar.
[b] Six cans for persons 65 and older.
[c] For example, the potato ration can vary from 0 to 8 pounds per month.

[redacted] 25X1

To minimize its culpability, Havana places much of the blame for Cuba's chronic food shortages on unfavorable weather conditions. Severe droughts have periodically plagued the island for six years, delaying crop plantings, reducing yields, and killing livestock. Torrential spring rains this year provided only brief respite from the droughts, while damaging several food crops even further. [redacted]

Domestic Reaction to Food Controls

Cubans have reacted to tighter rationing and price increases with restrained anger [redacted] While continued rationing has the support of some, recent interviews with a broad cross-section of Cubans reveal that even those who generally support the Castro government are unhappy over food shortages and long lines. Consumers are dissatisfied particularly with price hikes last year that raised grocery prices by about 15 percent but failed to decrease the lines to purchase food. Many city dwellers, however, applauded Castro's attack on farmers and middlemen who had profited from the farmers' free markets. [redacted] 25X1

Discontent over government food policies is widespread among farmers angered by the dissolution of the free markets. The government has threatened farmers with imprisonment and confiscation of all possessions for selling food illegally or giving it away to nonrelatives, [redacted] Few farmers, however, are complying fully with government regulations, mainly because state prices do not cover production costs. [redacted] some farmers have reacted by letting livestock loose in the fields to

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Cuba: Troubled Domestic Food Sector [redacted] 25X1

Havana's tightened government control of food production, marketing, and pricing has worsened chronic Cuban food shortages and resulted in rising domestic discontent. The inefficiencies of central planning mechanisms, foreign-payments difficulties, and unfavorable weather suggest that little significant improvement in food availability is likely to develop over the next year. Havana's failure to remedy the situation will add to growing, but contained, popular discontent, while contributing to increasing Soviet frustrations with overall Cuban economic policy and food policy, in particular. [redacted]

The Current Situation

The Cuban Government faces embarrassment and increasing popular discontent over food shortage problems. All Cubans have a monthly ration of basic foods at nominal prices, but principal foodstuffs often are missing from Cuban stores. Waiting 15 days for the monthly meat ration is not uncommon, [redacted] Recent Cuban exiles also report that milk usually is unavailable, and bread and cooking oil are of low quality. Even when food is available, the rationed portions are insufficient to last the average Cuban through the month. [redacted]

The food problem was made more acute last year when Havana began reversing steps taken in the early 1980s that had liberalized the marketing system. The Castro government's "food offensive" was part of Havana's return to more doctrinaire Marxist economic policies. The farmers' free markets—which allowed farmers to sell production in excess of government distribution quotas at free market prices—were disbanded, despite their success in generating increased food production and distribution networks. As the food situation has worsened over the last year, the government has responded with general plans for stricter control of food collection agencies. [redacted]

Factors Behind Food Shortages: A Closer Look

Havana's food problems are largely the result of a system of centralized pricing and production quotas that have reduced output and slowed distribution. Havana's determination, particularly in the 1960s, to direct long-term capital investment toward the sugar sector was made at the expense of food production. Higher urban wages also have aggravated food shortages by draining skilled labor and management from farms. [redacted] 25X1

Havana's worsening hard currency shortages have complicated Cuban food problems. Cuban foreign payments difficulties—heightened by the fall in world prices for reexported Soviet oil and the reduction of hard currency sugar earnings—have forced Havana to trim hard currency import expenditures this year. Cuts in already limited Cuban food purchases from the West are being accompanied by reduced imports of Western fertilizer and spare parts for the agricultural sector. 25X1 According to the US Interests Section, 25X1 the reduced availability of imported agricultural inputs has slowed the planting and harvesting of local food crops. [redacted] 25X1 25X1

Moreover, the diversion of domestically produced food abroad to meet trade obligations to socialist partners and to earn hard currency from the West adds to domestic food shortages. Ironically, sugar rationing in sugar-rich Cuba continues as Havana tries—so far unsuccessfully—to meet export quotas to CEMA while selling sugar to the West for badly needed hard currency. [redacted] 25X1 25X1

Havana also continues to send scarce milk, grain, and chicken to Nicaragua, according to Embassy reporting. [redacted] 25X1 25X1

Supplementing the Ration Diet

Frequent food shortages force the average Cuban to supplement government-regulated ration quotas by a variety of legal and illegal means. For example, food can be purchased in several alternative Cuban markets in addition to the ration market and in restaurants, government-subsidized cafeterias, and school lunchrooms:

- *Government-regulated parallel markets where basic consumer goods and "luxury" items such as Bulgarian canned peaches and Cuban cheese are available at higher prices. Although supply is sometimes scant, these markets provide consumers a legal outlet to supplement diets while drawing down private savings and adding to state coffers.*

- *The illegal black market, which can meet demands for even rare commodities—but at prices significantly higher than other markets. Other forms of illegal trade include the gray market, where items are bartered without government supervision, and the "red" market, where diplomats—often from the Soviet Bloc—trade items purchased at special diplomatic stores for a black-market rate,* [redacted] 25X1 25X1 *the current black-market exchange rate ranges from 6 to 15 pesos to the dollar in contrast to the official rate of about one peso to the dollar.* [redacted] 25X1

In addition, Cubans have set up intricate personal networks to guarantee access to scarce foods. Rural residents assist urban relatives by transferring rations and sending "care" packages, some farmers, and fishermen skim production from state food-collection agencies for sale, while some cafeteria and grocery employees pilfer food, [redacted] 25X1 25X1 *Moreover, Cuban consumers have developed intricate networks for trading unwanted goods for preferred items. To cope with frequent lines for food and other consumer goods, some Cubans also leave their jobs to wait in lines, while others hire professional line-keepers.* [redacted] 25X1

Meanwhile, Soviet pressures to rationalize the Cuban food sector will probably result in little more than window-dressing measures such as the ministerial-level committee formed earlier this year to study food production problems in response to Soviet prodding. Any benefits from these studies are likely to be offset by increasing food demands from natural population growth, by Castro's reluctance to eliminate the well-worn rationing system, and by continuing difficulties with financing imports of critical hard currency inputs. [redacted] 25X1

Moscow is likely to apply increasing pressure on its Cuban ally to rationalize food production, particularly if, as we expect, there are no real gains in food output over the medium term. Increased Soviet pressure may reveal itself in a growing proportion of project-tied aid from Moscow and a larger number of Soviet technical advisers in Cuban agricultural ministries that would effectively limit Cuban policy options over the long run. [redacted] 25X1

[redacted] 25X1

Line at a Havana bakery. [redacted] 25X1

destroy crops. [redacted] 25X1 25X1

Soviet Frustrations

In addition to general pressures to adopt Gorbachev-style reforms in order to liberalize the economy, Moscow has increasingly emphasized to senior Cuban officials the political, social, and economic importance of eliminating the rationing of consumer goods, particularly food, [redacted] Moscow has sharply criticized 20 years of continued Cuban rationing as an embarrassment to Communism and a poor example for other Latin American countries. Earlier this year Moscow reportedly renewed pressure on Havana to produce enough food domestically to be able to end rationing. The Soviets, specifically, have questioned the heavy concentration of planned Cuban investment in sugar relative to food and investment in new sugar factories even though current mills are operating at less than 85-percent capacity, [redacted] 25X1 25X1

Outlook and Implications

Despite popular unhappiness and Soviet pressure, we see little likelihood of significant policy change by Havana to reverse the cycle of food shortages and continued rationing any time soon. Constrained by ideology, Castro probably will preserve the system as a symbol of equity to maintain the support of the poor, who view rationing as a "right" guaranteed by the revolution, and to use the distribution of ration coupons through block committees in order to keep tabs on the population. [redacted] 25X1

Domestic discontent over food policies, therefore, is likely to grow and probably will result in some continued cuts in food production by disgruntled farmers and in an increasing use of illegal markets and distribution networks. Public gripes over food availability and prices probably will continue to be met with calls for revolutionary spirit and self-sacrifice. Havana undoubtedly would meet any serious outward displays of dissent with a quick, repressive response. [redacted] 25X1

Prospects for Pharmaceutical Patent Protection

	Status of Patent Protection	Major Concerns	US Bilateral Action	Prospects for Improvement
Argentina	No product patent for pharmaceuticals Considering proposal to shorten term of process from 15 to 5 years	Process patent lapses if product is not produced or process is not used locally for two years Situation could worsen if proposed bill requiring or encouraging the use of generic drugs is passed	Bilateral consultations with the United States continuing	Prospects for adequate patent protection dim for foreseeable future
Brazil	No product or process patent for pharmaceuticals	Constitutional article exempting pharmaceuticals from patent protection possible; final draft due in November	Pending 301 petition filed by Pharmaceutical Manufacturers Association accepted by US Trade Representative 23 July 1987	Unlikely to make any progress in next several years PMA action may slow process and increase pressure for constitutional article
Chile	1931 law exempting pharmaceuticals from product patent protection	Discriminatory registration procedures	US industry expected to file 301 petition November 1987 US companies in Chile filed pending Supreme Court case challenging constitutionality of 1981 law	Prognosis is fair, better than in Brazil or Argentina If Supreme Court rules against US industry petition, would lessen chance for change in 1931 law, for political reasons
India	No product patent for pharmaceuticals	Process patent term only five years from date of filing or seven years from date of issue, whichever is shorter Indian Government can override patents for "government undertaking"	No action pending	Memorandum of Understanding signed 9 July 1987 on Vaccine Action Program stated that an accord on intellectual property, including patents, will be developed and agreed on within 90 days; details unclear
Indonesia	No patent law Draft patent bill under consideration expected in Parliament late 1987 but final version may not cover pharmaceuticals	Decree issued June 1987 creates more stringent licensing regulations for pharmaceutical firms Concern that final version might not include protection for pharmaceuticals	Decision on GSP benefits postponed until 1 October 1987 Possibility of PMA filing a 301 petition	Draft patent bill under consideration by a presidential commission, expect submission to Parliament in late October
Malaysia	New patent law enacted in 1986 providing process and product protection	Too soon to determine effectiveness of enforcement	No action pending	Not applicable

LDCs: Resisting Pharmaceutical Patent Protection [redacted] 25X1

The reluctance of many LDCs to strengthen pharmaceutical patent protection will probably continue despite US pressure for tougher standards. Many LDCs are targeting their pharmaceutical industries for development and view patent protection as undercutting this objective. The lack of adequate LDC enforcement of existing patent laws and resistance to adopting tougher standards could pose difficulties for broader US GATT objectives and ultimately strengthen LDC competition in key pharmaceutical markets. [redacted]

A Different Kind of Drug Problem

Ineffective pharmaceutical patent protection has been a source of friction involving several LDCs and the United States and Western Europe over the past few years. Moreover, the issue has become entwined in the broader problem of intellectual property rights protection, including protection for copyrights, trademarks, and patents. United States political and economic pressure—such as unfair trade practice cases and the threat of removing Generalized System of Preferences (GSP) benefits—to achieve such protection has resulted in tougher standards only in some instances. We believe that seven of the eight LDCs involved in bilateral negotiations with the United States on pharmaceutical patent protection will strongly resist agreement. [redacted]

Economic Versus Legal Perspectives

A serious stumblingblock in negotiating patent protection is the differing perspectives between the industrial and developing countries. While industrial nations see patent protection as a legal right, LDCs view it in economic and political terms. Many LDCs have targeted their pharmaceutical sectors in order to promote economic development, and the counterfeiting of patented drugs allows nascent pharmaceutical industries to avoid significant research and development expenditures. Most of these countries, therefore, do not provide adequate legal protection for patented pharmaceuticals and have resisted outside pressure to introduce patent legislation. In some cases, such as Thailand, the issue has focused on nationalist interests and self-determination. [redacted] 25X1

Even where patent legislation has been enacted, LDC political and economic pressures have resulted in continuing violations. Although US economic pressure helped push Mexico, Taiwan, and South Korea 25X1
to adopt stronger patent laws, for example, the economic and political forces resisting patent protection still remain, potentially undermining effective enforcement. The Mexican patent law includes a 10-year adjustment period during which pharmaceuticals will not receive product patent protection. We believe this interim period could be extended because of Mexican pharmaceutical industry pressure. In South Korea, adequate enforcement of its new patent law is seriously threatened by opposition in both government and industry. For similar reasons, counterfeiting pharmaceuticals in Taiwan has decreased, but the patent law has not eliminated the problem. [redacted] 25X1

Major Centers of Resistance

Among the LDCs currently considering pharmaceutical patent protection, Thailand, Brazil, and Indonesia, 25X1
in particular, have intensified their resistance to adopting tougher standards. Common elements of the three countries' positions include resistance to outside pressure, a degree of anti-US sentiment, powerful vested interest groups, and a desire for a strong indigenous pharmaceutical industry. [redacted] 25X1

Some government officials have stated that ***Thailand*** has no intention of bowing to US pressure on the patent issue. Bangkok's hard line is, in part, in response to domestic accusations of Thailand acquiescence to the United States on the copyright issue.

According to US Embassy reporting, a Thai Government meeting in August concluded that Bangkok would rather give up GSP benefits than agree to take actions—such as pharmaceutical patent protection—which are viewed as running counter to Thailand's national interest. As a result, we believe the current US threat of removing GSP benefits as a penalty for insufficient intellectual property right protection will probably not produce patent legislation and may even increase Thai resolve to deny US pharmaceutical protection.

The Thais' increasingly negative perception of their economic relationship with the United States is further complicating patent negotiations, according to the US Embassy. Such sentiment stems partially from the 1986 US Farm Act, which subsidized American rice exports, and partially from Bangkok's belief that the pending US omnibus trade legislation is protectionist and harmful to US-Thai trade. A recent Thai editorial stated that the profit lost to US firms from intellectual property right infringement is insignificant compared with the damage to Thailand from subsidized US rice exports.

In addition to political resistance to US pressure, most ***Brazilians*** do not believe there is an economic case for increased pharmaceutical protection. Indeed, according to the US Embassy in Brasilia, US companies control about 72 percent of the total market and have lost about $20 million during 1979-86—or about 1 to 2 percent of total sales—because of patent infringement. In addition, a number of US subsidiaries in Brazil are involved in pirating US patented drugs, according to Embassy reporting.

In the current political atmosphere, we believe US pressure will not only be ineffective in producing pharmaceutical patent protection in the near term, but may also reverse recent gains, including liberalizing pricing and easing registration restrictions. Patent protection might even become impossible if the Brazilian constitution now under consideration contains provisions excluding pharmaceuticals from patent coverage.

Powerful domestic pharmaceutical interests oppose pending ***Indonesian*** legislation providing pharmaceutical patent protection and will probably significantly undercut enforcement if the legislation is passed. According to the US Embassy in Jakarta, there are two key pharmaceutical issues under debate: whether the patent legislation should include pharmaceuticals at all, and, if so, whether it should cover pharmaceutical products as well as production processes. President Soeharto is expected to resolve the issue in late September. 25X1

We believe the threat of US trade actions against Indonesia for inadequate intellectual property protection will not further the case for pharmaceutical 25X1
patent protection in particular. Although general patent legislation will probably be enacted, perceived US pressure regarding pharmaceuticals could stiffen Jakarta's resolve to include protection for that industry, out of fear of appearing to bow to US demands. 25X1

Implications for US Interest

Improved LDC pharmaceutical patent protection is probably years away in many cases. Such hardline countries as Brazil and Thailand may, in fact, become 25X1
more inflexible in the face of strong US economic pressure. In addition, vested domestic interests will probably weaken the enforcement of new laws should they be enacted. Moreover, tensions in US bilateral relations created by disputes over pharmaceutical protection could ultimately cause the general climate for US investment to deteriorate further in some countries. In these cases, adverse changes in LDC pricing policies and pharmaceutical registration regulations would be more likely to hurt US pharmaceutical company performance than would the continued 25X1
lack of patent protection. Even US drug firms that have competed successfully despite patent infringement could find their operating environment more constrained. 25X1

Continued LDC infringement of US pharmaceutical patents could pose additional problems for US interests. Efforts to achieve improved international intellectual property protection in the Uruguay round of GATT negotiations could be threatened by increased 25X1
US bilateral disputes with those countries currently

Prospects for Pharmaceutical Patent Protection (continued)

	Status of Patent Protection	Major Concerns	US Bilateral Action	Prospects for Improvement
Mexico	Law amended in 1986 providing product patent protection for 14 years from date of issue 10-year transition period, product patent coverage begins in 1997	10 years until product patent protection will begin Patent holder given only five years to work patent before it can be voided by petition Ability to enforce patent law is questioned due to powerful vested interests of Mexican pharmaceutical industry	No action pending	National pharmaceutical concerns likely to seek to revoke law or extend transition period; position of next President may determine their success
Singapore	Process and product patents available to inventions patented in the United Kingdom; coverage in accordance with the United Kingdom Patents Act Government-use exceptions; patents can be ignored if for use in government hospitals or institutions Compensation limited to 5 percent of net ex-factory bulk cost of the drugs	Enforcement of legislation has been inconsistent Compulsory licensing provision required working patent in Singapore within three years of UK patent grant	No action pending; legislation provides adequate protection	An Inter-Ministerial Committee has been meeting for several years to consider changes; the lack of urgency makes timetable uncertain
South Korea	Newly enacted patent law covering both processes and products, effective 1 July 1987	Significant concerns over effectiveness of enforcement New law only applies to US patents	Promises to resolve 301 case now being implemented	Although it now provides patent protection, its willingness to enforce law is questioned
Taiwan	Amended patent law in 1986 to provide process and product protection	Enforcement of process patents ineffective due to burden of proof requirements	No action pending, issue resolved through a 301 case and other trade pressures	Prospects for further reform in the near term is good
Thailand	Pharmaceuticals excluded from 1979 patent law	Patentholders must "work the patent" in Thailand in order to obtain protection	USTR accepted PMA's 501 petition for the 1987 GSP review, President's decision on status due 1 April 1988, could remove Thailand from GSP	Patent issue being studied by five- or six-person group; expected to report recommendation in October or November; probably will recommend against patent protection, given committee membership Prospect for pharmaceutical patent protection is dim for next year or two

25X1

resisting patent protection, since GATT decisions are made by consensus. In addition, it is possible that LDCs without pharmaceutical patent protection could begin to export counterfeited pharmaceutical products in the future, competing with legitimate US drug exports in third-country markets. Such problems stemming from ineffective Third World pharmaceutical patent protection will probably grow in the next few years as other countries begin to develop their own indigenous pharmaceutical sectors. [redacted] 25X1

[redacted] 25X1

Prospects for Intellectual Property Rights Reform in the Uruguay Round

Intellectual property rights (IPR)—which refers to patents, copyrights, and trademarks—is on the agenda for the ongoing GATT Uruguay round. The issue is controversial because GATT members have not yet agreed on which intellectual property issues should be addressed, and patents are particularly sensitive. Many LDCs are wary of including intellectual property in the GATT forum because they see a GATT agreement on IPR as mainly benefiting developed countries. They also do not want attention in the Uruguay round diverted from issues of more interest to them such as agriculture and tropical products. Brazil and India have been particularly vocal, arguing that setting international standards and minimum levels of protection are outside the scope of GATT and should be confined to the World Intellectual Property Organization. Brazil is also using obstructionist tactics as a means to stall progress on this issue, in our view. [redacted] 25X1

On the other hand, we believe there is growing support among LDCs for discussions on intellectual property issues in GATT. According to Embassy sources, Thailand prefers a multilateral approach rather than a bilateral approach, and South Korea and Singapore have also supported the talks. In our view, many LDCs could agree to broad GATT standards on intellectual property provided they include preferences for LDCs. [redacted] 25X1

Greece: Living Beyond Its Means 25X1

Two years of economic austerity have not significantly reduced Greece's current account deficit. The October 1985 austerity program has sharply reduced real wages but has fallen short of most other objectives. Although Prime Minister Papandreou still stresses the need for stabilization, he may adopt more expansionary policies before the next election—due by 1989—which will push the current account deeper into the red at a time when scheduled amortization payments are high. As a result, we believe Greece probably will encounter financing difficulties by the end of this decade.

Emerging Current Account Problems

Greece traditionally has experienced current account deficits, typically in the range of 3 to 4 percent of GNP but was able to finance these deficits without incurring large foreign debts because of steady inflows of private direct investment. The current account deficit doubled as a percent of GNP during 1979-81, however, because of higher oil prices and the profligate policies of the conservative New Democracy government. After taking office in October 1981, Andreas Papandreou boosted wages and increased government intervention in the economy, which undermined business confidence and eroded Greek competitiveness. When Papandreou further eased policy in anticipation of the 1985 election, the current account deficit soared to a record \$3.3 billion—10 percent of GNP—in 1985. Net foreign debt, excluding military obligations, tripled during 1982-85 to \$13.9 billion.

Shift to Austerity

To obviate the need for IMF assistance, Papandreou announced a two-year austerity program in late 1985. The measures included a 15 percent devaluation of the drachma, substantial advance deposits on imports, and—the centerpiece of the program—a revision of the wage indexation formula intended to reduce real wages by at least 11 percent over two years. 25X1

Greece's current account deficit fell in 1986 by 46 percent to \$1.8 billion, but not because of the austerity program. The decline in oil prices saved Greece almost \$1.2 billion, and transfers from the EC increased \$500 million, while the nonoil trade deficit actually worsened. Private consumption remained strong, partly because wages covered under the austerity program constitute less than 50 percent of household income. Moreover, savings were drawn down, and households turned to the underground economy to supplement earnings. Continued growth in government spending also boosted imports. 25X1

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Making Ends Meet

This year the current account deficit is likely to hold at roughly \$1.7 billion—about 4.5 percent of GNP. Athens also must repay \$1.5 billion of medium- and long-term debt in 1987. Greece will be able to finance these needs through about \$800 million in private-capital inflows, \$1.25 billion in EC loans, about \$460 million in commercial loans, and the rest from further borrowing or a drawdown of foreign exchange reserves, now at \$2.2 billion. 25X1

The End of Austerity

In a major economic policy speech earlier this month, which was clearly aimed at pleasing all sides, Papandreou announced the formal end of the austerity program but stressed the need for continued stabilization. The conciliatory tone of the speech—he spoke of the need to lower taxes, reduce government intervention, boost private investment, and improve Greek 25X1

Greece: The Economy at a Glance, 1982-87

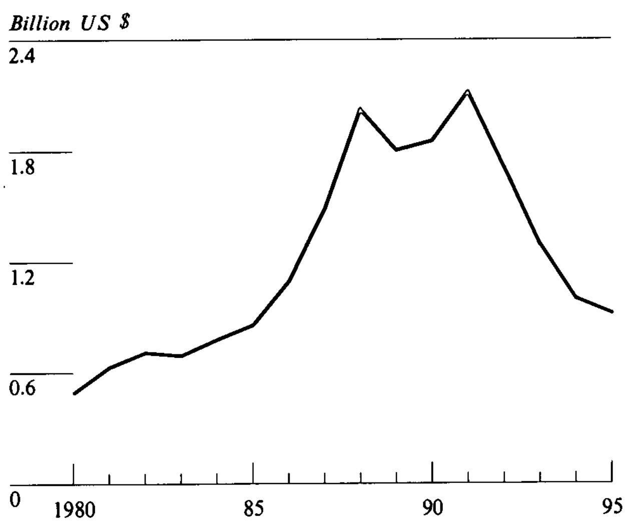
Percent

	1982	1983	1984	1985	1986	1987 [a]
GDP growth	−0.2	0.4	2.8	2.1	1.0	−0.3
Unemployment	5.7	7.8	8.1	8.3	9.3	10.0
Inflation	21.0	20.5	18.4	19.3	16.8	16.0
Public sector borrowing requirements as a share of GDP	12.6	11.3	15.5	17.8	13.5	14.0

[a] CIA estimate.

[redacted] 25X1

Greece: Scheduled Debt-Amortization Payments, 1980-95



[redacted] 314255 9-87

competitiveness—contrasted markedly with Papandreou's socialist rhetoric during his first term. Nevertheless, he was very short on specifics. [redacted] 25X1

Athens has, in fact, already retreated significantly from the 1985 austerity plan. The preimport deposit scheme was abolished at EC insistence. More important, we calculate that almost two-thirds of the benefit of the October 1985 devaluation has been lost because subsequent exchange rate adjustments have not fully offset the inflation differential between Greece and its trading partners. The public-sector borrowing requirement fell last year, because Athens appropriated most of the gain from lower oil prices, but it now appears stalled at about 14 percent of GDP—crowding out private investment and fueling inflation. [redacted] 25X1

The status of the restrictive wage policy is less clear. This was the most successful part of the austerity program, reducing real wages by about 11 percent. While Papandreou promised that "true take-home pay" will rise next year, Athens may still try to hold nominal wage increases below the rate of inflation. [redacted] 25X1

Greece: Balance of Payments, 1982-87

Million US $

	1982	1983	1984	1985	1986 [a]	1987 [b]
Current account	−1,885	−1,876	−2,130	−3,276	−1,756	−1,650
Trade balance	−5,927	−5,386	−5,351	−6,268	−5,591	−5,900
Exports, F.O.B.	4,141	4,105	4,394	4,293	4,503	5,100
Fuel	648	725	893	834	510	400
Imports, C.I.T.	10,068	9,491	9,745	10,562	10,094	11,000
Fuel	2,778	2,647	3,080	3,188	1,702	1,500
Invisibles balance	4,042	3,510	3,221	2,992	3,835	4,250
Payments	−2,056	−2,019	−2,068	−2,268	−2,597	−2,800
Interest/profits	−784	−874	−1,082	−1,237	−1,356	−1,500
Earnings	6,098	5,529	5,289	5,260	6,432	7,050
EC funds	550	834	715	869	1,393	1,600
Tourism	1,527	1,176	1,313	1,428	1,833	2,100
Shipping	1,657	1,309	1,095	1,038	998	950
Remittances	1,043	935	922	800	906	1,000
Capital account	1,779	2,303	2,477	3,146	1,923	
Private	676	919	869	809	758	
Entrepreneurial Capital	304	313	246	290	300	
Real estate	399	423	474	431	462	
Amortization	−136	−174	−189	−102	−98	
Public	1,103	1,385	1,608	2,338	1,165	
Central bank	1,018	577	1,015	1,970	751	
Central government	119	205	124	168	911	
Public enterprises	568	1,114	1,076	916	488	
Suppliers' credit	−26	14	−11	47	2	
Amortization	−574	−526	−597	−762	−987	
Errors and omissions	−40	−357	−312	22	128	
Change in reserves	−146	70	35	−107	295	

[a] Estimated.
[b] CIA estimate.

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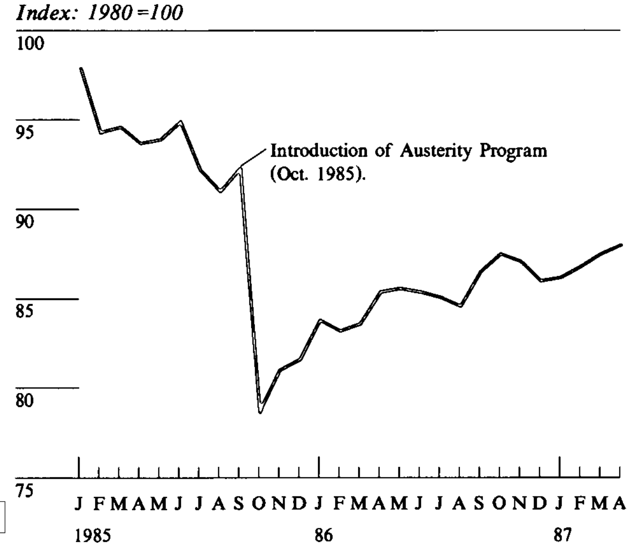
Supply Rigidities Shackle Greek Competitiveness

Greece's chronic, large external deficits partly reflect structural imbalances in the economy. Most of these problems derive from state intervention—Athens' traditional response to economic difficulties—particularly under Papandreou's Socialist government.

The high cost of labor, combined with inflexible labor laws, is one major supply barrier:
- *Wage increases boosted unit labor costs by 30 percent, relative to its trading partners, soon after Papandreou came to power in 1981, and indexation has kept labor costs high.*
- *Wage increases in sectors facing foreign competition exceeded the national average.*
- *Restrictive dismissal, overtime, and part-time regulations hinder firms' ability to respond to market signals and efficiently allocate resources.*

The huge public-sector deficit, combined with Athens' pervasive system of capital controls, has severely depressed private investment—which has been declining for at least six years—hurting Greek competitiveness:
- *Some government-administered prices are kept below production costs.*
- *Seventy-five percent of total bank credit is allocated by the government.*
- *Lending to politically favored sectors is subsidized.*
- *Laws discourage the development of alternatives to bank finance.*

Greece: Trade-Weighted Real Exchange Rate, 1985-87 [a]



[a] Data for end of month.

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Impact of a Currency Depreciation on Greece's Trade Balance, 1988-90 [a]	*Percent*		
	1988	1989	1990
Real depreciation at 10 percent			
Impact on exports	4.9	9.1	9.4
Impact on imports	−2.0	−3.3	−3.3

[a] A 10-percent real depreciation would return the exchange rate to the level of October 1985.

Outlook

Greek economic policy is in transition from austerity to what Papandreou in vague terms calls a "program of development." At present he appears to still emphasize stabilization, but we think he will ease up as the next election approaches, particularly with regard to fiscal policy and wages. In addition, concerns about inflation probably will keep Athens from implementing the substantial real devaluation that we feel is needed to improve Greek competitiveness.

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Unless Athens adopts needed stabilization measures and policies to enhance competitiveness, the external deficit will widen. Greece will have difficulty in finding the resources to finance both higher amortization payments and a higher current account deficit. Capital investment—primarily direct investment—will probably stagnate because of Greece's structural problems, a lack of capable Greek partners for joint ventures, and the government's recent move to take over the North Aegean Petroleum Company—by far the largest foreign investment in the country. Moreover, Athens could have trouble maintaining the confidence of foreign commercial banks, which hold about 70 percent of Greek foreign debt. Even the EC could prove reluctant to continue supporting Greece's deficits once the austerity measures are lifted. [redacted] 25X1

[redacted] 25X1

Spanish Agriculture: Coping With EC Membership [redacted] 25X1

Spain's entry in January 1986 into the European Community will ultimately benefit its agricultural sector by providing substantial development assistance, forcing it to modernize, and increasing its access to the huge EC market. Spain, however, will realize the benefits slowly because of the seven- to 10-year phasein period. The inefficient dairy and beef industries are likely to suffer, and even the more competitive fruit and vegetable farmers probably will experience only limited gains because of continuing EC restrictions. Adjusting to the Common Agricultural Policy (CAP) and other EC regulations is likely to accentuate regional differences, with the north generally doing poorly and the south faring relatively well. Membership will eventually result in significant declines in US agricultural exports to Spain—especially corn. Because of the large size of its agricultural sector, Spain will probably become an important player in the formulation of EC agricultural policy. [redacted]

A Profile of Spanish Agriculture

Spain is a major agricultural power. It is the world's primary producer of olive oil, the third-largest of wine, the fourth-largest of dried fruit and almonds, and the sixth-largest of citrus fruit. With more than two-thirds of its exports going to the EC-11, Spain is the largest exporter of farm produce to the Community after the United States and Brazil. But, while the Spanish agricultural area is large—equal to more than one-fourth the combined farmland of the other EC countries—it lags them in productivity. Productivity is less than half the Community average, and in the feedgrain and oilseed sectors Spain is one of the least productive in the EC. Notably, large imports of corn and soybeans have been responsible for Spain's overall agricultural trade deficits. [redacted] 25X1

25X1 *The major problems facing Spanish agriculture are the small, fragmented, subsistence-level landholdings in the north; the large, underutilized, and unprofitable holdings in the south; and the aging, poorly educated labor force. Moreover, although irrigation is required to sustain reasonable yields, only 15 percent of the cultivated land is irrigated. Marketing structures also are deficient for many products and distribution costs are high. Madrid's system of price supports and subsidies also has contributed to inefficiency by promoting development in areas where Spain does not have a comparative advantage—such as grains—to the neglect of Mediterranean products where Spain has vast productive potential. For most goods, however, Spanish prices are below those in the EC.* [redacted] 25X1

Impact of Accession on Production and Regional Development

EC accession had only a marginal impact on Spanish agricultural output during Spain's first year as a member, because CAP regulations liberalizing intra-EC farm trade are being phased in over seven to 10 years. Spain's inefficient sectors probably will be hit hard later in the transition period, which is likely to be troublesome even for the more competitive producers, as they become subject to tough CAP regulations and face increased EC competition:

- Dairy and beef output will probably suffer the most, since these products will be subject to high EC quality standards and must adhere to the EC's 5.4-million-metric-ton milk quota—more than 15 percent below annual Spanish production. Most meat production—heavily dependent on imported feedgrains—is likely to be hampered by higher production costs because of the imposition of variable import levies.
- Even the competitive fruit and vegetable growers probably will experience only moderate gains because the EC can maintain preaccession quotas until 1990 and does not have to eliminate them entirely until 1996. Spain also faces competition

from Morocco, Israel, Algeria, and Tunisia, which have more favorable trade terms under the Community's Mediterranean policy.

- The grain sector is expected to expand because of higher support prices, but a possible ceiling on wheat, high-quality standards for barley, and competition from France may dampen output.

- Continued protection of the olive oil sector probably will prevent a decline in output until after 1990, when it will likely fall because of EC policies aimed at reducing the Community's surplus.

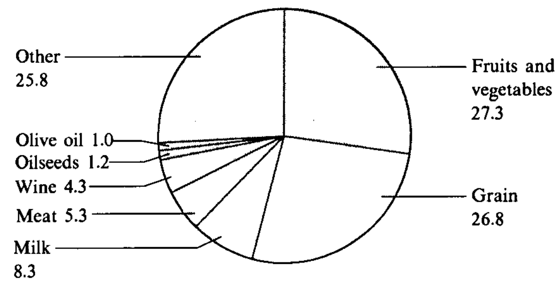
- Table wine output also could decline somewhat because the EC's quota is about 10 percent below annual Spanish production, and some producers may switch to high-quality wines that are not subject to quotas. [redacted]

The agricultural sector's adjustment to EC regulations will produce mixed results for Spain's varied regions during the transition period, and is likely to accentuate the sharp differences that already exist. The beef- and milk-producing regions in the northwest will be the biggest losers. Higher CAP prices will not offset the large production declines, and many farmers are likely to be forced out of agriculture. The fruit and vegetable areas of the Mediterranean coast stand to gain the most. Despite EC trade restrictions, farmers there are some of the most efficient in Spain, are increasingly open to new technology, and have the advantage of a longer growing season. Accession is not expected to have appreciable consequences for the grain and livestock—other than beef—areas of central Spain, while the olive groves and vineyard regions of the south and west will benefit from higher CAP prices and structural aid, despite a fall in output. [redacted]

Spain: Agricultural Production, 1985

Percent

Total=78 million metric tons



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Government Policies and EC Assistance

Community membership has forced Madrid to address agricultural production problems and growing regional disparities. The basic objective of Spanish land reform in recent years has been to increase productivity through forced leasing schemes or expropriation of the large estates in the south and consolidation of the small, fragmented farms in the north. Madrid also hopes to expand irrigated land from 15 to 25 percent of total cultivated area. The government would like to implement early retirement plans for older farmers and is providing low-interest loans and special credits to younger farmers. In 1986 the EC approved $12.8 million for projects to upgrade the fruits and vegetables, meat, grain, and wine sectors, and $70.9 million for projects establishing new marketing facilities. With EC consent, the government has continued to provide aid for insurance and subsidies for the purchase of farm equipment, fertilizer, improved seeds, and fuel. [redacted]

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penetration of European outlets, and Spain's agricultural trade balance with the EC should improve. Accession already has prompted the more modern farmers to invest in improved production techniques and to form marketing organizations and producers' associations. On the downside, agriculture's growth potential may well be frustrated by some opposition to land reform, the strain that the cofinancing of development projects may place on Spain's central budget, and the unfavorable natural conditions in some regions that leave little room for increased output. Moreover, modernization in the more backward sectors will be long and difficult, and the political pressures associated with the probable increase in agricultural unemployment may slow government rationalization plans. 25X1

EC entry also will force Madrid to develop the necessary bureaucracy to effectively administer the CAP and to cope with farmers' varied interests. Although not yet a strong political force, the formation of producer groups is certain to strengthen the farm lobby and increase demands for better terms in price and other negotiations. Dairy farmers have already taken to the streets to protest the EC's milk quota; fruit and vegetable growers have demonstrated over the fact that they face more restrictions than non-EC Mediterranean farmers; and corn producers have sought to limit US corn imports because of the downward pressure on domestic corn prices. As Madrid becomes more experienced with CAP and other EC regulations, it is likely to push Spanish interests more aggressively in EC negotiations and aim at consolidating a "Mediterranean" block within the Community. This is certain to take time, but given the sheer size of Spain's farm output—and its even bigger potential—we expect Spain eventually to become a major player in the formulation of EC agricultural policy. 25X1

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Major EC Accession Terms for Spanish Agriculture

- *Most of Spain's agricultural goods are subject to a seven-year transition period. The EC's Common External Tariff (CET) against third-country commodities was adopted upon accession, and tariffs against Community farm products are to be abolished in eight annual stages. Madrid also must dismantle state monopolies, align domestic prices with those of the EC, and phase in all remaining CAP regulations by the end of the transition period.*

- *Fruits and vegetables are subject to a two-stage, 10-year transition period. During the first phase, lasting four years, Spain must implement the CET and begin lowering tariffs against Community members. It may maintain quotas on trade with third countries, however, and EC members can retain quotas on Spanish products. During the second stage, all quantitative restrictions are to be eliminated, and Spain must complete tariff dismantlement.*

- *Oils and oilseeds also are subject to a two-stage, 10-year transition period. During the first five years, Spain will be able to maintain import controls at preaccession levels for oils, but must begin to reduce tariffs for oilseeds. During the second phase, all trade barriers are to be abolished. The CAP will apply fully by the end of the transition period.*

- *Imports of various third-country goods—notably grains—are subject to the EC's system of variable levies. Madrid was required to impose the levies upon accession and remit the revenues to Brussels.*

- *Imports into Spain of certain "sensitive" products—including wine, milk, cheese, butter, live cattle, beef, and bread wheat—are subject to set quantitative limits with predetermined annual rates of growth. The EC Commission will continually monitor import levels to determine if these rates should be changed.*

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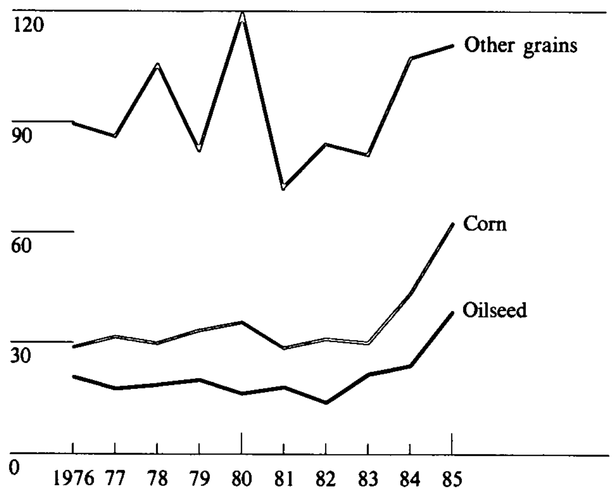
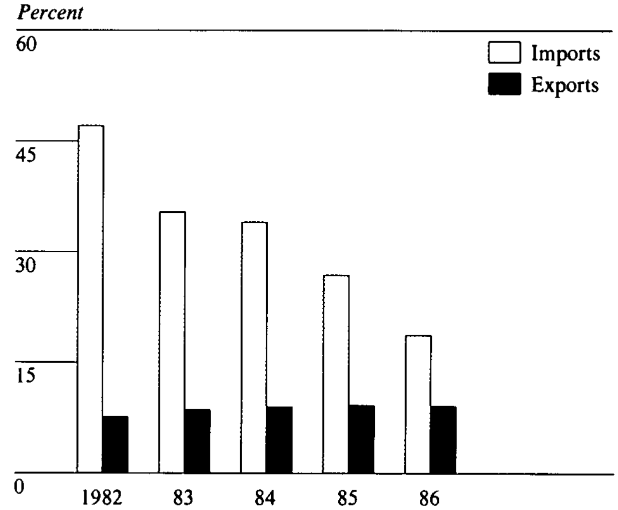
Spain: Self-Sufficiency in Selected Commodities, 1976-85 [a]



[a] Production as a share of consumption.

[redacted] 314313 9-87

Spain: US Share of Agricultural Trade, 1982-86



[redacted] 314315 9-87

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is likely to reduce Spain's traditionally positive agricultural trade balance with the EC, which may even turn negative. Imports are certain to rise substantially because of lower trade barriers and higher Community import prices, while small gains are expected for exports because Spain's competitive sectors will be subject to EC import controls throughout the transition period. Indeed, in 1986 Spain's farm trade surplus with the EC fell from $1.5 billion to $1.3 billion, as imports surged 111 percent and exports grew only 33 percent. [redacted]

Spanish entry into the EC probably will lead to an improvement in its traditional agricultural trade deficit with the United States as imports fall and exports remain stable. Indeed, in 1986 Spain's food deficit with the United States fell to $480 million from $570 million a year earlier, and the US share of Spanish agricultural imports fell more than 8 percentage points to 19 percent. Accession will cause a sharp drop in US corn exports to Spain—which account for 40 percent of total US food sales to Spain—because of the EC's system of variable import levies, but this is not likely to occur until 1991. Under the settlement terms of the US-EC dispute over the impact of Spanish entry on US exports, Spain is required to buy 2.0 million tons of non-EC corn annually between 1987 and 1990.[1] While the United States faces competition from such non-EC suppliers as Argentina, US exports probably will remain near previous levels through 1990. [redacted] 25X1

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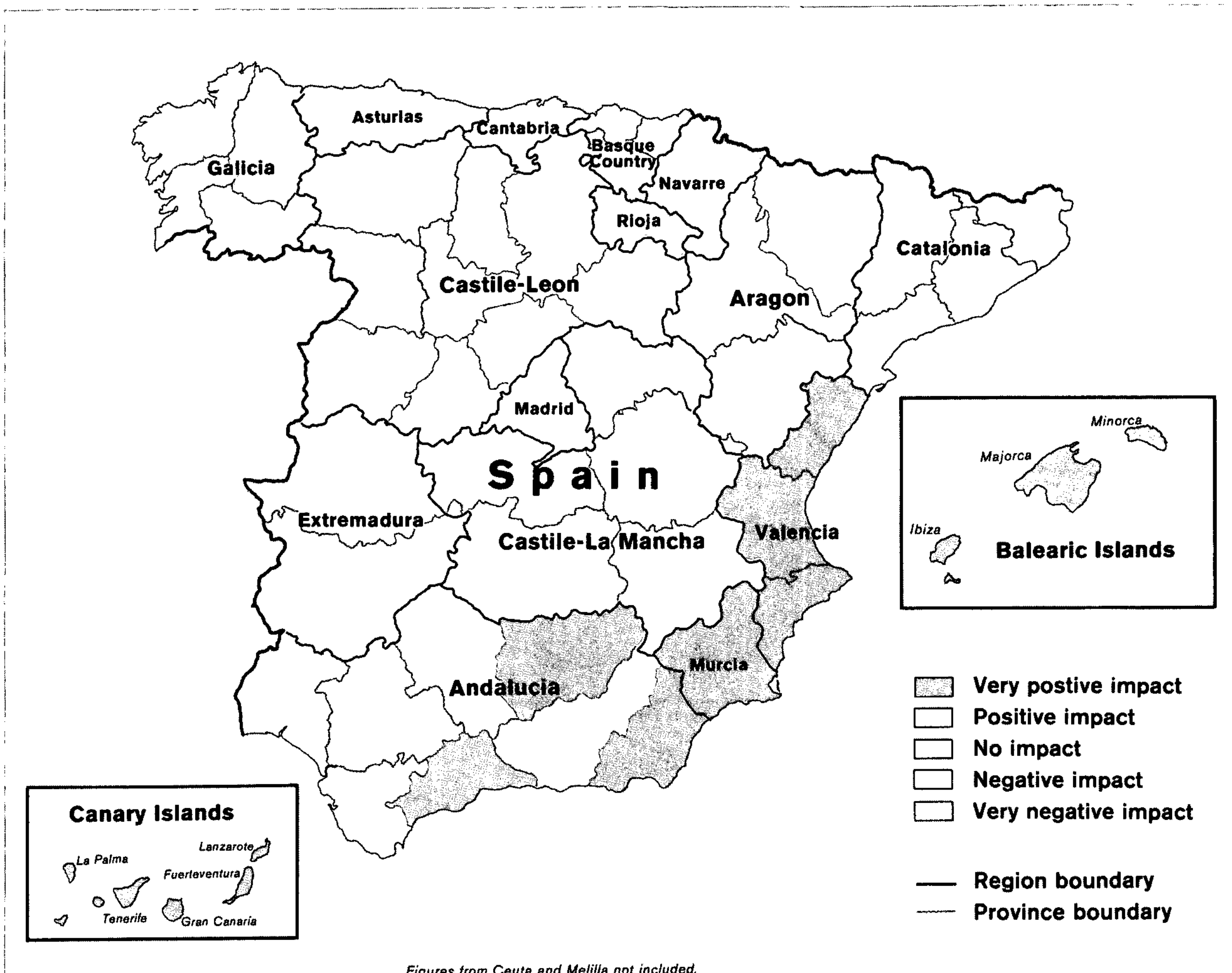
Outlook

As EC trade barriers are eliminated after the transition period, EC entry will force the agricultural sector to modernize and will also lead to substantial production gains for many commodities—especially fruits and vegetables. Spanish farmers will step up their

[1] If Spain does not meet its obligation, the EC Council is required to make up the difference. [redacted] 25X1

Impact of EC Membership on Spain's Agricultural Regions



Figures from Ceuta and Melilla not included.

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Madrid also has been relatively successful in securing EC development assistance for its various regions. It received $200 million from the Community's Regional Development Fund last year for infrastructure projects and $7.3 million from the Agricultural Guidance and Guarantee Fund for mountainous regions. Most noteworthy, however, was the EC Agricultural Council's decision to declare nearly 62 percent of Spain's farmland as "disadvantaged," with about 80 percent of that classified as "most disadvantaged." This means that the EC's share of project financing will increase substantially to about 50 percent.

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Trade Effects and Implications for the United States

The major effect of EC entry on Spain's agricultural trade relations during the transition period will be to increase trade with its EC partners and to reduce imports from third countries, including the United States. In 1986 the EC's share of Spanish trade rose almost 10 percentage points to 55 percent. Accession

Briefs

Energy

Burma May Become Oil Importer

Sharply declining oil production may force Rangoon to begin importing crude oil, according to Embassy reporting. Burma's oil production has declined by one-third since January, from 21,000 b/d to about 14,000 b/d because of aging oil fields. Moreover, refineries are operating at only 30-percent capacity. Widespread fuel shortages have resulted in rising gasoline and diesel prices and transportation bottlenecks, and have crippled development projects. Rangoon has requested assistance from development banks, including a $24 million loan from the World Bank, to finance oil imports of up to 10,000 to 15,000 b/d. This sudden turnaround in Burma's fuel self-sufficiency could at last encourage the government to allow foreign involvement in onshore exploration and production in hopes of bringing new wells on line quickly. [redacted] 25X1

International Finance

Cuba's Paris Club Creditors Meet

According to US Embassy reporting, Havana's failure to change economic policies to meet debt repayment schedules has exhausted the patience of official creditors, who are meeting to discuss Cuban debt relief. Paris Club chairman Trichet has reportedly said that creditors might have to "reorient their whole thinking on Cuba," suggesting the Club is tiring of one-sided efforts to help Havana meet payments. Cuba last July released data showing increased hard currency deficits and near-zero economic growth in 1986. The Paris Club will probably extend no new credits to Cuba because of Havana's refusal to cooperate on economic adjustment. They may compromise on old debt to encourage future repayment, but deteriorating hard currency accounts probably preclude full Cuban payments to creditors this year. [redacted] 25X1

Somalia Backpedals on IMF Reforms

President Siad has announced plans to reverse key parts of Somalia's IMF reform program by ending the foreign exchange auction and reimposing fixed prices on some food items, according to the US Embassy. The Foreign Minister told US diplomats that the changes are not intended to repudiate reform but to bring it into line with domestic priorities. Siad probably cancelled the auction—which has sharply devalued the Somali shilling—to appease his Marehan clan, whose financial and political interests have been damaged by the IMF reforms. He probably judged that Mogadishu's declining ability to pay for imports, together with reduced US military aid, is eroding vital support from the armed forces. He also may have concluded that returning the economy to government control will improve the standard of living. In breaching IMF guidelines, Somalia risks losing substantial assistance from the United States and others, but Siad probably expects to persuade donors to accommodate the changes. [redacted] 25X1

North Korean Debt Rescheduling

Western banks—which recently declared North Korea in default on $790 million in debts—have suspended legal action to seize the North's assets, according to press reports. The move follows P'yongyang's agreement in principle to the banks' proposal for rescheduling. North Korea has demanded changes in the terms, however, namely a four- rather than a one-year grace period and a smaller initial payment. The two lead banks reportedly have accepted the changes but must secure approval of all 140 banks involved in the loans. North Korea must sign the agreement and make a $32 million downpayment by 2 October to forestall further legal action. P'yongyang probably agreed to reschedule because it recognized it had no more bargaining room, but there is good reason for bankers to be skeptical about whether it will go through with the deal. Since North Korea took out the loans in the early 1970s, it has made few payments—and none since 1984—in spite of three previous reschedulings. Moreover, North Korea is also in serious arrears on the $1 billion owed on other commercial bank loans and on government and government-backed credits from Western Europe and Japan. [redacted]

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International Trade

[redacted]

25X6

[redacted]

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Midyear USSR–Eastern Europe Trade Results

Between January and June, the Soviets ran up a 200-million-ruble deficit in trade with Eastern Europe, the first midyear trade gap with the region since the early 1970s, according to recently released Soviet trade statistics. Lower CEMA oil prices—reflecting last year's sharp decline in world oil prices—helped cut the value of Soviet exports more than 5 percent compared with the first half of 1986. East European exports to the USSR expanded 4 percent, marking an improvement over the sluggish pace in the comparable period last year. Moscow may want to run small deficits with East European countries over the next few years because the East Europeans must repay trade debts by shipping more goods to the USSR. Since the mid-1970s, Eastern Europe has accumulated a debt of about 17 billion rubles—about $26 billion—as Moscow extended trade credits to help the region adjust to higher oil prices. Soviet deficits may grow larger, however, because the value of exports to Eastern Europe will probably remain depressed despite Moscow's efforts to offset lower oil prices by increasing deliveries of machinery and manufactured goods. To avoid larger deficits, Moscow may have to accept slower growth in imports, threatening plans for increased East European contributions to Soviet economic modernization. 25X1

USSR: Trade With Eastern Europe, First Half 1987

	Exports		Imports		Trade Balance (*million rubles*)
	Total (*million rubles*)	Growth From Same Period Last Year (*percent*)	Total (*million rubles*)	Growth From Same Period Last Year (*percent*)	
Total	**16,588**	**−5.2**	**16,805**	**4.1**	**−217**
Bulgaria	3,050	−5.4	3,317	10.1	−267
Czechoslovakia	3,375	0.2	3,480	5.2	−105
East Germany	3,704	−3.2	3,488	0	216
Hungary	2,205	−4.6	2,469	5.1	−264
Poland	3,042	−10.9	2,894	5.2	148
Romania	1,212	−10.6	1,157	−6.8	55

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Australian Opposition to US Trade Bill

In a Washington press conference last week, Minister for Trade Negotiations Michael Duffy strongly criticized the trade bill pending in Congress, citing quotas on lamb imports, sugar subsidies, and the expansion of the Export Enhancement Program as measures likely to increase Australia's trade deficit with the United States. Duffy warned that bilateral ties would be seriously strained if these items are passed in their present form, suggesting that Australia might discontinue purchasing US military goods on a cash basis. Australia relies on the US market for more than 12 percent of its exports and is already upset over accepting limits on beef exports to the United States last week. Canberra probably will continue lobbying against the bill in Washington, and the issue almost certainly will come up again when Prime Minister Hawke visits California next month. Australian officials remain adamant, however, that the US-Australian joint defense facilities will not figure in any trade dispute. 25X1

Global and Regional Developments

Bundesbank President Clarifies Recent EMS Agreement

Bundesbank President Poehl has dismissed claims by French and EC officials that the recent agreement to reform EMS intervention rules involves in any way an automatic commitment by the bank to defend other EMS currencies before the intervention limit is reached. In a hastily convened press conference designed to provide the West German assessment of the recent EC Finance Ministers meetings in Denmark, Poehl asserted that he would not have agreed to the changes if they had endangered the Bundesbank's autonomy in setting monetary policy. While agreeing that the opportunity now exists for the Bundesbank to intervene before the intervention levels are reached, he stressed that such action requires the consent of the country with the strongest currency—almost always West Germany. These decisions, he added, would be taken on the basis of whether they affected West German price stability. Moreover, Finance Minister Stoltenberg, who also attended the meetings, signaled that West Germany would not agree to further steps to improve West European monetary cooperation until additional steps are taken to liberalize West European capital markets. Indeed, Poehl sharply criticized Rome for imposing exchange controls on the lira only hours after the meetings had ended. 25X1

Slim Prospects for New Coffee Quota

Faced with sagging world prices, the International Coffee Organization is meeting in London to decide whether to reintroduce old export quotas or establish a new quota system. According to US Embassy reporting, consumers and most producers support the US position of a new quota allocation based on exportable production and coffee stock holdings rather than politically determined quotas. Producers are concerned that Brazil, the world's largest producer, will reject a new quota allocation if its current 30-percent quota share is endangered. Producers have been trying to persuade Brazil to be more flexible, but there is no indication that Brasilia has softened its position. Although preferring redistributed quotas, most producers will opt to accept a reintroduction of the old quotas—which would satisfy Brasilia—rather than risk the continuation of no quotas at all. Quotas were suspended during a surge in coffee prices in 1986, and, without Brazil's agreement to establish some type of quota system, world coffee prices will continue to decline. Brazil recently has been quiet on the quota issue, leaving the proposals to other producers. The producers are not sufficiently organized to develop objective criteria setting a quota that would both appease producers and consumers and convince Brazil a new system would be beneficial. 25X1

Producer and Consumer Positions on International Coffee Organization Meeting

	Reintroduction of Quotas	Current Negotiating Position
United States and Other Consumers	Want reintroduction for price support.	Will agree on reintroduction based on allocation.
Brazil	Will agree on reintroduction as long as current market share is maintained.	Brazil does not need quotas to maintain export earnings; will agree on reintroduction, but most likely not based on objective criteria.
Colombia	Willing to accept a decrease in its quota share for reintroduction of quota.	Is willing to do whatever it takes to have a reintroduction in quotas; seems optimistic that agreement will be reached.
Guatemala	Believes reintroduction or suspension will result in either share loss or export earnings decline.	Will agree to quota reintroduction; considering increased sales to nonmembers to decrease stocks.
Indonesia	Wants reintroduction of quotas based on new system.	Strong supporter of consumer position; wants to see consumers accept nothing less than objective criteria for quota allocation.
Ivory Coast	Prefers reintroduction of quotas that would appease all involved.	Has convinced Brazil that Brasilia should be the leader in deliberations toward a new allocation system; believes that success rests on consumers being more flexible toward objective criteria.
Kenya	After hard bargaining, believes that midnight agreement will be reached on reintroduction.	Has minimal hopes for improved quota share; looking at selling more to nonmembers to decrease stocks.
Mexico	Will settle for reintroduction of quotas based on ad hoc system for temporary price support.	Will settle for current quota share as long as it is open for future negotiations.
El Salvador	Willing to accept a reduction in its quota share for reintroduction of quotas.	Supports new quotas that would provide maximum earnings in short run; hopeful that higher quotas can be negotiated in 1987 agreement.

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West Germany Rejects EC Steel Proposal

Domestic considerations have led West Germany to reject key aspects of an EC proposal to restructure the West European steel industry, threatening another period of sour relations between Bonn and its European allies. Bonn, according to press accounts, contends the plan would eliminate too many jobs, is too narrowly focused, and should not be funded from the EC budget. Defense of West German steel interests has probably taken on greater importance for Chancellor Kohl since his Christian Democrats suffered sharp losses in the recent state elections. The Christian Democrats are also trying to improve their political standing in North Rhine–Westphalia—West Germany's largest state and center of its steel industry—an area traditionally dominated by the opposition Social Democrats. [redacted] 25X1

Change in China's Tin Policy

China—one of the world's largest tin producers—has agreed to decrease its tin exports and has applied to join the Association of Tin Producing Countries (ATPC), reversing its previous plans to increase tin exports and its noncommittal position toward joining the ATPC. Many tin producing countries have asked China to join the ATPC in an effort to better control world tin supply and firm up world tin prices. Should Beijing follow through, the ATPC would probably have a stronger case in urging Brazil—another leading producer—to join the organization. [redacted] 25X1

Soviets Seeking Oil Technology Through Joint Ventures

The Soviets plan to promote their new approach to joint ventures at their "Oil and Gas 87" trade fair being held in Moscow from 20 to 28 October, which several Western manufacturers are scheduled to attend. Soviet officials believe that the depressed state of the petroleum equipment market in the West has improved their chances for attracting Western companies into joint ventures. If implemented, joint venture agreements would displace some of the need for direct purchases by the USSR for its oil and gas industries. Currently, however, Moscow is continuing to negotiate contracts with Western firms for oil services, technology, and equipment. The USSR, [redacted] is close to signing 25X1
two agreements with Dreco, a leading Canadian manufacturer of Arctic drilling equipment—one for the inspection and modernization of Soviet equipment for Arctic drilling and the other for the manufacture and sale of Soviet turbodrilling equipment. In addition, several West European petroleum equipment companies have expressed interest in forming joint ventures to supply the Soviet domestic market—if they receive adequate compensation. [redacted] 25X1

National Developments

Developed Countries

West German Position on Economic Issues

The West Germans expect criticism of their tight fiscal policy at next weeks' IMF meetings, but domestic considerations almost certainly preclude a change in policy. Despite the diminishing prospect of a significant reduction in its trade surplus, Bonn probably will continue to oppose new stimulative measures including bringing forward the tax cuts scheduled for 1990, as long as even moderate growth

persists. Projected sharp increases in the budget deficit—due largely to slower growth and revenue cuts called for in the tax plan—coupled with continuing rapid monetary growth are rekindling public fear of renewed inflation. Moreover, state leaders are urging Bonn to delay tax reform because of its impact on state revenues. Instead of focusing on growth, the West Germans will probably try to steer IMF discussions toward stabilizing the exchange rate system. Bonn, which blames West Germany's slower growth on the sharp appreciation of the mark, fears that a further steep appreciation will slash growth prospects even more, while doing little to reduce the trade surplus. [redacted] 25X1
[redacted] Finance Ministry officials are pessimistic about prospects for keeping exchange rates at current levels for much longer and are looking for ways to manage the expected further decline in the dollar. Bonn might be willing to temporarily push West German interest rates lower, but officials probably will advocate stronger US action, such as another discount rate hike. [redacted] 25X1

French Economic Woes

Recent French media references to "France's economic decline" overstate the problems, but this exaggerated emphasis on mediocre economic performance gives Prime Minister Chirac no comfort as he prepares for the presidential election expected next spring. France has been buffeted by a steady stream of bad economic news: unemployment has risen to more than 11 percent, the government has been forced to cut its growth forecast for 1987 to an anemic 1 to 2 percent, and inflation—though still low—is inching above 3 percent. In addition, the trade balance, which is the most widely watched barometer of French competitiveness, has dropped sharply into the red. [redacted] the 25X1 Prime Minister is under pressure to stimulate the economy before the election. To do so, however, would expose Chirac to charges of political expediency. Chirac will probably earmark some of the revenues from the government's highly successful denationalization program for new public works projects, a move that would take a few workers off the unemployment rolls. He may also engineer minor, but politically popular tax cuts, such as his recent move to reduce the value-added tax on cars and phonograph records. [redacted] 25X1

British Industrial Production Surpasses Prerecession Level

Led by a 1.5-percent gain in manufacturing output, British industrial production in the three-month period ending in July rose by 0.6 percent over the previous three months—pushing output past its prerecession 1979 level and setting a new record for the Thatcher years. Financial markets were pleased by the news and believe that industry still has reserve capacity to meet Britain's surging domestic demand without adding to imports. Most economists expect the growth in manufacturing output to slow next year and do not foresee any buildup in inflationary pressures as a result of the recent rise. London will use the figures to blunt opposition criticism that the Thatcher government has presided over the "deindustrialization" of Britain. [redacted] 25X1

Turkey's Current Account Shows Temporary Improvement

Turkey's current account deficit in first-half 1987 was less than one-half the year-earlier figure, but Ankara probably cannot sustain the improvement for the full year. The main factor in the reduction—from $ 1.1 billion to $ 450 million—was a 16-percent increase in exports, as Turkish businessmen took advantage of generous export incentives put in place last December. Ankara also benefited from higher earnings from tourism and increased workers' remittances—which are higher this year in dollar terms largely because of the appreciation of the deutschemark. Nonetheless, most forecasters still expect a current account deficit for 1987 very close to or larger than the $1.5 billion recorded last year. They argue that Turkey failed to import enough raw materials and capital goods this year to maintain export growth, and conclude that imports must accelerate or exports slow down; in fact, the trade balance deteriorated sharply in July. At the same time, Ankara's growing foreign debt and higher international interest rates probably will cause interest payments during July-December to exceed the $1 billion paid so far this year. While international creditors are continuing to provide sufficient new loans to cover Ankara's 1987 financing bill of roughly $5 billion, a failure to reduce the deficit below last year's level will heighten fears that Turkey may experience a recurrence of financing problems prevalent in the 1970s. 25X1

Japan's New Regulations To Promote Biotechnology

Two of the principal Japanese Government ministries responsible for regulating the use of genetic engineering technologies are expected to standardize approval policies for the use of these technologies by the end of the year. This new government coordination will greatly promote biotechnology, an industry that Japan has made a national priority. Currently the Ministry of Health and Welfare is responsible for granting permission to drug firms while the Ministry of International Trade and Industry processes applications from the chemical industry to use the technology. In those cases where the technology involves products that can be used by both sectors, the approval needs to be granted by both ministries, often a cumbersome and discouraging process. The lack of standardization of the criteria for approval has often been cited by both Japanese and US industry analysts as a barrier to commercialization of the biotechnologies. 25X1

Australia Announces Balanced Budget

Australia's budget for the fiscal year ending June 1988 continues the financial restraints introduced in May in the interim budget. Canberra will not raise taxes—keeping Prime Minister Hawke's campaign promise—and will increase popular social welfare programs. Keating plans to balance the budget by holding the line on defense spending and selling off more than $700 million in government assets, including the national telephone company and airline, a step the ruling Labor Party has yet to approve. Treasurer Paul Keating apparently designed the budget for the broadest possible appeal, possibly to improve his chances of succeeding Hawke as Prime Minister. The lid on taxes and the absence of cuts in social programs will probably add to the government's popularity. Keating nonetheless faces potentially divisive opposition within his party to the sale of government assets. Two Labor Party state governments as well as Labor-affiliated unions have already passed resolutions against the sales. This controversy probably will not be resolved before the Labor Party's national congress in mid-1988. Further strains within the Labor Party over the budget were evident this week; according to press reports, Finance Minister Peter Walsh condemned the budget as insufficiently addressing Australia's $67 billion foreign debt and chronic government overspending on social programs. 25X1

Less Developed Countries

Philippine Labor Calls for Wage Hikes

A broad spectrum of Philippine labor organizations last week petitioned Labor and Employment Secretary Drilon to enact an across-the-board wage increase equivalent to 50 cents per day, according to US Embassy reporting, that would amount to a 17-percent pay increase for those earning the minimum wage. The leftist Labor Advisory Consultative Council and the moderate Trade Union Congress of the Philippines cited a recent gasoline price hike and government plans to raise military salaries after last month's coup attempt as justification for the wage increase. Manila probably recognizes that stricter enforcement of the current minimum wage, equivalent to $2.75 per day—which many workers complain acts more as a wage ceiling than a base—would go far toward addressing workers' grievances, but implementation is hampered by government inefficiency. Although businesses are mounting a campaign against government wage-setting, we believe that Manila will try to avoid a politically risky showdown with labor—such as the 26 August transport strike—by seeking an increase in the minimum wage of up to 50 cents per day. 25X1

Thailand Acts on Protecting Intellectual Property

The Thai Cabinet last week approved measures to strengthen intellectual property protection and ease tensions in US-Thai economic relations, according to the US Embassy in Bangkok. The Prem government will try to expedite parliamentary approval of trademark and copyright legislation and a crackdown on trade in counterfeit goods. Prime Minister Prem also wants "preliminary" discussions with Washington on protection of pharmaceutical patents, which are not covered in the proposed legislation. We believe Parliament may balk at the Cabinet's attempts to push through legislation, however, because of strong nationalist sensitivities and because of infighting in Prem's coalition. A faction of the Democrat Party—the coalition's largest party—probably will seek to exclude computer software from copyright protection. Substantive measures on pharmaceuticals are probably at least a year away. 25X1

Economic Effects of Indian Drought

India's economy is beginning to feel the extended effects of drought. The dry spell has irreversibly damaged the country's summer crops, particularly cotton, fodder, and groundnuts—an important source of cooking oil. Reduced supplies of cotton have led to shortages and higher prices for inputs to the textile industry—which provides about 10 percent of India's export earnings—prompting firms to restrict exports in order to meet domestic demand and to lay-off workers in order to cut costs. New Delhi is attempting to reduce economic hardships facing the population by expanding food for work programs, releasing greater amounts of food stocks to hold down prices in some areas, and increasing food subsidies. New Delhi is planning to implement new taxes in order to cover the cost of drought relief efforts, including a 5-percent tax on non-essential imports, a surcharge on all taxable income and corporate profits over $4,000, and higher airfares. The government is also working to discreetly secure relief assistance from the United States, Japan, and other Western countries as a short-term means of bridging the gap between supply and demand of critical items. [redacted] 25X1

Flood Relief Efforts Continue in Bangladesh

Receding flood waters in some of the most heavily affected areas of Bangladesh coupled with increased political pressure has prompted the government to accelerate relief distribution efforts. According to press reports, President Ershad has established a committee to coordinate movements of emergency supplies and a control room at the Chittagong port to expedite the distribution of foodgrains, relief supplies, and other essential imports. According to the US Embassy in Dhaka, government efforts to keep prices down by ensuring an adequate supply of foodgrains and discouraging hoarding have been successful. Even so, the government will probably divert funds from other development projects into rural employment programs and infrastructure rehabilitation. According to IMF estimates, economic targets for the fiscal year which began 1 July will be severely affected—the flood damage is equivalent to roughly 8 percent of GDP, the foreign payments situation will deteriorate even further because of the need for food imports, and foreign aid disbursements will increasingly favor food rather than development aid. [redacted] 25X1

Liberia To Privatize Oil Industry

Liberia has announced that it will privatize its inefficient and money-losing oil parastatal, but the country probably will accrue few financial gains from the transaction. According to press reporting, a Western company will assume responsibilities for the Liberian Petroleum Refining Company, including control of the refinery, two major storage terminals, and a crude oil and product jetty. The US Embassy reports that the company also has pledged substantial investments in Liberia's rubber and timber industries. According to the Embassy, President Doe ignored reports about the company's questionable international standing and uncertain financial resources, and disregarded advice from some government officials that Liberia sign an agreement with a more reputable firm. [redacted] 25X6
[redacted] 25X6
[redacted] Although Doe almost certainly expects his 25X6
government to receive substantial economic gains from the privatization, it is more likely that the company's dubious record will drive out other, more reputable companies now involved with Liberia's petroleum industry. [redacted] 25X1

Afghan Regime's Anticorruption Drive

Recent Afghan press reports have highlighted the government's efforts to reduce corruption in the economy and in aid-distribution programs. According to one account, the Kabul city prosecutor's office has undertaken extensive operations this year to crack down on overcharging at retail shops, cooperatives, gasoline stations, and other establishments. Government officials also claim to have uncovered irregularities in the distribution of Soviet relief aid in some provinces. [redacted] 25X6 25X6

[redacted] Kabul's anticorruption campaign is almost certainly an effort to win popular support. Charges of corruption against provincial government officials also may be an attempt by central government authorities to counter growing opposition from provincial members in the Communist party. Corruption in the economy has long been endemic in Afghanistan and the regime's reform efforts are unlikely to have much of an impact. [redacted] 25X6 25X1

Communist

Innovative Soviet Software Supports Industrial Automation

The Soviets have developed a software package to design and produce the complex cams used to mechanically control the motion of automatic lathes. The software will generate numerical control (NC) programs to produce cams for nearly 30 different models of automatic lathes. The capability to easily produce control cams, normally a very complex and labor-intensive process, has the potential to enhance productivity in many Soviet machine-building and metalworking sectors because automatic lathes are much more widely available than NC machines. By using a single NC machine equipped with this software to produce new cams, a plant can quickly reset all its automatic lathes to make new parts, thereby increasing flexibility Moreover, this approach to automation avoids the need for new machinery and the learning problems associated with installation, debugging, and worker retraining. [redacted] 25X1

Laos Unifies and Devalues Exchange Rates

Vientiane recently replaced its complex, multitiered exchange rate system with a flat rate in what may be the first in a series of measures to modernize the Lao economy. Previously, the Lao kip was valued officially from 35 to 270 per dollar, depending on the type of transaction. The new official rate of 350 kip per dollar is now almost the same as the black-market rate, eliminating a source of growing criticism from key aid donors, international lenders, and some Lao officials. The devaluation alone will probably have little immediate impact because much of the country's consumer economy already operates at the black-market exchange rate. Nevertheless, Vientiane is eager to improve the economy's performance, and, in our view, may consider additional measures to halt corruption, stem capital flight, and attract foreign investment. [redacted] 25X1

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