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International Economic & Energy Weekly

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14 November 1986

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19 **Israel: Declining Fortunes for High-Technology Industries** 25X1

Israel has long touted the development of a high-technology industrial base as the long-term panacea for its foreign payments deficits, unemployment problems, and stagnant economic growth. Although high-technology industry still makes an important contribution to the economy, its structural shortcomings and continued funding problems will prevent it from achieving Israel's ambitious objectives. 25X1

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Perspective

Sub-Saharan Africa: Growing Debt and Fading Markets [redacted] 25X1

The external debt of Sub-Saharan African countries has received increased attention in international forums recently, largely on the initiative of the African states themselves. The debt—totaling some $82 billion in 1985—has grown rapidly over the past 15 years to become a key issue in the region's serious economic problems and in its relationship with official and private creditors. We expect the issue of Africa's economic crisis will be raised with greater frequency over the coming months as the region's debt dilemma continues. [redacted] 25X1

The region's debt problems have worsened with chronic current account deficits attributable both to high oil prices through 1985 and to stagnant export earnings since 1980. [redacted] in addition to adverse external circumstances, inappropriate domestic economic policies have helped to restrain economic growth. Consequently, Africa's debt burden, in our view, has outpaced the continent's capacity to service the debt. [redacted] 25X1 25X1

Although the region's debt is not large by global standards, it has serious economic, financial, and political implications for each of the 45 countries. Most states are caught in a dilemma: they cannot meet their debt service requirements on existing terms; yet, failure to meet these obligations may jeopardize the inflow of new funds from abroad necessary to maintain or improve the region's capacity to repay. Moreover, there is often adverse political fallout over the domestic belt-tightening that this debt servicing can impose. [redacted] 25X1

We believe Africa's debt situation will remain serious for the foreseeable future. Africa's ability to service its debts will continue to be hampered by weak export markets over the longer term, despite market gains for some products. In any given year, the burden of servicing the debt will depend not only on the level of hard currency earnings, but also on Africa's success in rescheduling debt service payments. Prospects for private capital inflows are not bright, and the flows could become negative before the end of the decade. In these circumstances, official bilateral and multilateral sources will continue to bear the brunt of supplying foreign loans and other capital to Africa. Accordingly, Africa's economic fortunes will depend greatly on the support mechanisms that these sources can develop. [redacted] 25X1

We anticipate that African countries will make increased representations to the United States—given its leading role in endorsing economic recovery programs that emphasize freer market systems and a reduced role for government—for economic assistance over the next several years as these states try to solve their debt and other economic problems. We believe many African states view Washington's endorsement of their economic adjustment efforts as an implicit promise of increased support. While increased African requests for help would provide continuing opportunities for the United States to expand its political and economic influence on the continent, there is the risk that many African states are likely to be acutely disappointed should US and other Western aid fall significantly short of their expectations. [redacted] 25X1

[redacted] 25X1

Sub-Saharan Africa: Increasing Budget Discipline for 1986/87 [redacted] 25X1

Most Sub-Saharan African countries appear to be continuing belt-tightening, cutting back on planned government expenditures as well as trying to raise tax revenues, albeit with only modest success. Nearly all the countries of the region continue to have budget deficits, but the deficits are increasingly being programed to be reduced relative to GDP, and thus brought more in line with available domestic resources. In the meantime, the African governments are relying heavily on foreign loans and grants in FY 1986/87 to finance the budget deficits. Although Sub-Saharan Africa's budget austerity creates economic hardship for its people, we do not foresee significant new waves of unrest in the region. [redacted] 25X1

Balanced or Surplus Budgets

At least two of the better performing African countries plan to show a surplus or to balance their budgets in the current fiscal year. Even so, their budgets reflect a cautious approach:

- Following record revenues in 1985/86, because of sharply increased receipts from diamond exports, ***Botswana*** has presented a conservative 1986/87 budget with a surplus of $140 million. Revenues are expected to rise 18 percent in nominal terms to $576 million; expenditures are programed to grow by 17 percent to $436 million, according to press reporting.

- ***Cameroon***'s 1986/87 budget is in balance at $2.3 billion, according to press reporting. The budget is, however, lower in real terms than that of 1985/86, having grown by 8 percent, compared with a 15-percent inflation rate. [redacted] 25X1

Budgets Consolidating Recent Economic Gains

After good economic performance last year, some countries' 1986/87 budgets seek to consolidate the gains and to promote future economic expansion. For example, ***Ivory Coast*** has boosted its planned investment spending for 1986, after cutting it by one-third in 1985. In the wake of a 4-percent economic growth rate last year, ***Kenya***'s planned expenditures are up 16 percent to more than $2.4 billion, compared with an expected inflation rate of 10 percent. Revenues are projected to grow by 25 percent to nearly $1.8 billion. The planned deficit of $655 million is slightly smaller than the actual 1985/86 deficit. The budget contains strong support for agriculture and private-sector economic activity with duty concessions and new credit schemes. [redacted] 25X1

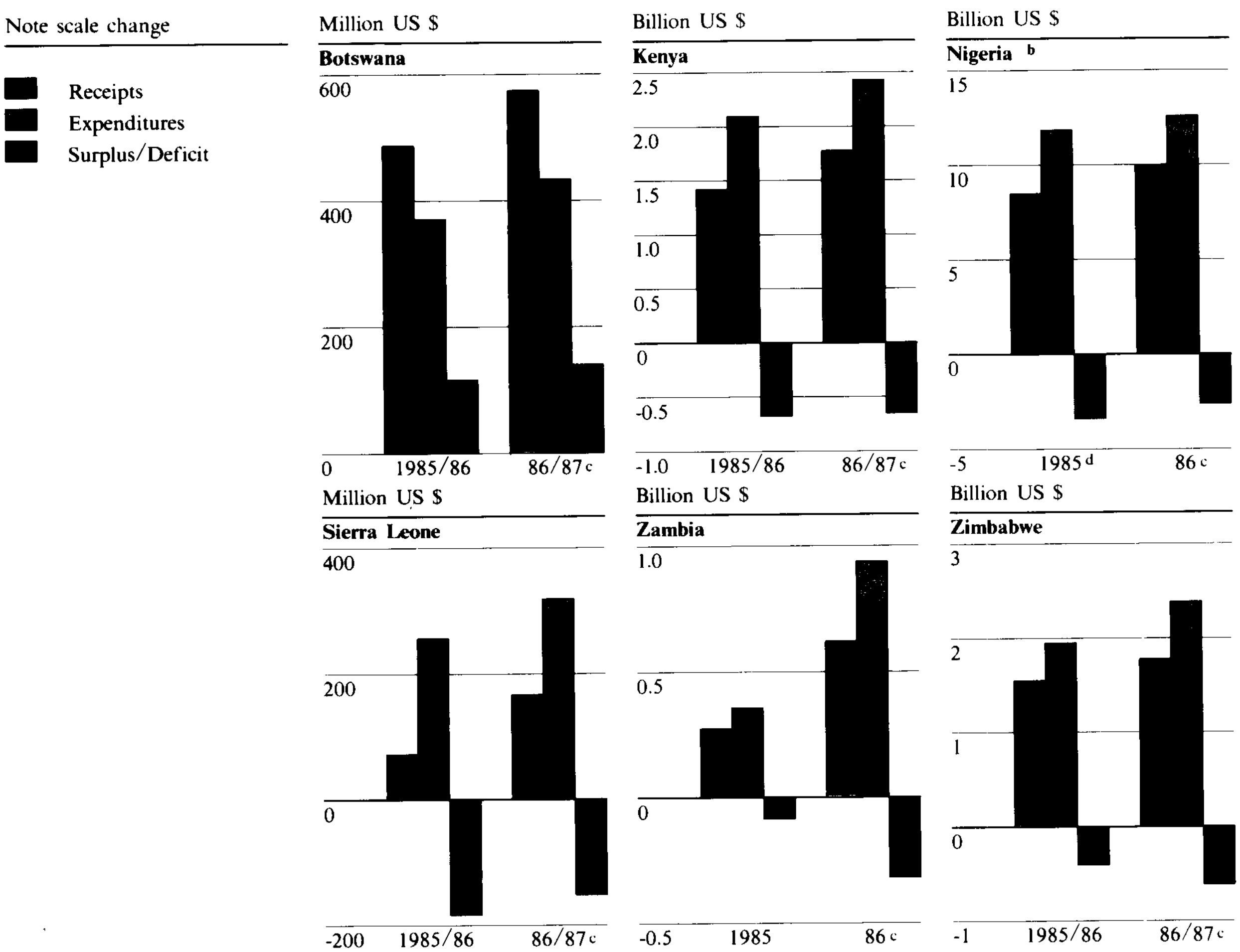
Budgets Driven By Economic Reform

The budgets of most other African countries are providing a framework to accommodate and support substantial economic reform. For example:

- ***The Gambia***'s budget incorporates IMF-supported measures agreed to in June 1986 in connection with a $15 million standby arrangement. Revenues are projected to rise 22 percent, largely from improved collection methods and the boost in local currency export taxes that accompanied a major devaluation of the dalasi subsequent to its February 1985 floating. Measures to curb public spending include layoffs of more than 1,000 government employees. Nevertheless, recurrent spending is projected to rise by 44 percent, contributing to an overall deficit of some $23 million, about 18 percent of GDP. The Gambian authorities expect to finance the deficit from external grants and partly from a $28-31 million World Bank structural adjustment loan.

- ***Malawi*** projects an overall budget deficit of $44 million, after foreign grants of $29 million. The deficit will, however, be only 3.9 percent of GDP, compared with 6.2 percent in the 1985/86 fiscal year. Revenues are programed to rise by 13 percent to $310 million, while spending growth will be held to only 5 percent.

Selected African Countries: Government Budget Profile [a]



[a] Values in national currencies have been converted to US $ at 1986 exchange rates.
[b] Nigerian expenditures include revenue allocations to states.
[c] Budgeted.
[d] Estimated.

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- ***Nigeria***'s 1986 budget, announced in December 1985, called for a 22-percent reduction in the overall deficit to $2.6 billion, after the allocation of a share of federally collected revenues to the states. The subsequent collapse of oil revenues has caused a marked departure from the original program, with the budget situation tighter than before, in our view, particularly since the announcement in June 1986 of a two-year economic adjustment program.

- ***Sierra Leone***'s overall deficit is projected to fall to $152 million in FY 1986/87, compared with $184 million in FY 1985/86. A major element in the deficit reduction will be the abolition of gasoline subsidies that accounted for 50 percent of last year's deficit.

- ***Tanzania***'s 1986-87 budget reflects the economic reform measures that facilitated a $78 million IMF standby arrangement in August as well as continued donor support. The budget calls for a 33-percent currency devaluation and generous producer price increases of 30 to 80 percent. However, the programed overall deficit will be $543 million, which, based on incomplete data, is substantially higher than that of FY 1985/86. Foreign grants and loans are expected to provide $428 million toward financing the deficit.

Budgets Less Influenced By Economic Reform

In our judgment, the budgets of at least two countries do not reflect significant economic reform this year:

- ***Uganda***'s FY 1986/87 budget calls for a deficit of $250 million, more than three times the previous record deficit in FY 1985/86. Planned total spending is up by 119 percent, but below the expected inflation rate of 150 percent. Revenue increases are even smaller in real terms, being scheduled to rise by 90 percent. According to press reporting, Kampala intends to finance the deficit by borrowing internally and through the sale of properties confiscated earlier from Asian residents. Foreign donors are reportedly disappointed in Uganda's budget program and are skeptical about the means of financing the deficit.

- ***Zimbabwe***'s budget expenditures are programed to rise by 22 percent to $2.4 billion—compared with an expected inflation rate of 15 percent—because of the government's social programs, military expenditures, debt service, and the costs of special events such as the Nonaligned Movement summit last September. Revenues are projected to rise by only 15 percent to $1.8 billion. According to press reports, Harare faces limited prospects for revenue growth because of already high tax levels and an expected slowdown in economic growth to 3 to 4 percent this year, after 7 percent in 1985. 25X1

Impact of Falling Commodity Prices

For a number of African countries the actual budgets will depart substantially from the programs because of the impact of declines in the prices of exported primary commodities on government receipts. The oil-exporting countries will be particularly hard hit because of their almost total dependence on oil receipts:

- ***Angola*** expects to lose roughly $1 billion with a 50-percent drop in export earnings this year, according to press reporting. As a result, the annual budget drawn up in December 1985 has since been cut in half. 25X1

- ***Nigeria***'s original 1986 budget was based on a $25 per barrel oil price. Oil prices currently average $14 per barrel after slumping to $10 earlier. Lagos's export earnings are expected to fall by 30 percent this year, according to press reporting.

- ***Congo*** and ***Gabon*** have also announced expenditure cuts in the face of declining oil revenues.

Nonoil exporting countries have both been gainers and losers from commodity price movements: 25X1

- ***Kenya***'s FY 1986/87 budget reflects the double windfall of lower oil import prices and higher coffee export prices. Although coffee prices have declined from their first quarter 1986 peak, they remain above last year's levels.

- According to press reporting, falling cotton prices have created a shortfall in ***Togo***'s 1986 budget, after an earlier projection of a surplus. [redacted] 25X1

The Political Fallout

In our view, although African states face political risks from budget austerity and from economic reform measures in general, we do not expect the latest round of budget programs to trigger significant new waves of unrest in the region. In the past, there have been isolated protests against budget measures in Congo, Ivory Coast, and Zaire, according to US Embassy reporting. Some critics of Nigeria's reform measures fear a loss of economic privileges while socialist-oriented officials in Zambia and Tanzania reportedly do not favor the reduced role of government in economic activity implicit in budget reform. We believe, however, that African leaders will, for the most part, continue to implement budget austerity and other economic reform, particularly because Western donors and international financial institutions regard these changes as requirements for the continued economic assistance that will help the African states to rehabilitate their economies. [redacted] 25X1

[redacted] 25X1

USSR: Reduced Grain Import Needs [redacted]

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Soviet agricultural performance has improved this year and may well exceed the record 1983 production, an accomplishment General Secretary Gorbachev will undoubtedly highlight as a turnaround in the agricultural sector.[2] The improved performance is due to continued growth in the livestock sector combined with increased production of several major crops. Recently, Politburo member Yegor Ligachev predicted that the Soviet grain crop would be roughly 210 million metric tons. The figure, however, is a preliminary estimate as harvesting is still not completed and final results will not be known for some time. Our estimate based on meteorological data, satellite imagery, and fertilizer production statistics suggest a grain crop closer to 195 million tons. A higher figure would indicate, among other factors, greater success with the intensive technology program than we have estimated. Depending on the final grain outturn, the need for imported grain will fall to between 10 million and 25 million tons, compared with the 30 million tons imported during the 1985/86[3] marketing year (MY). [redacted]

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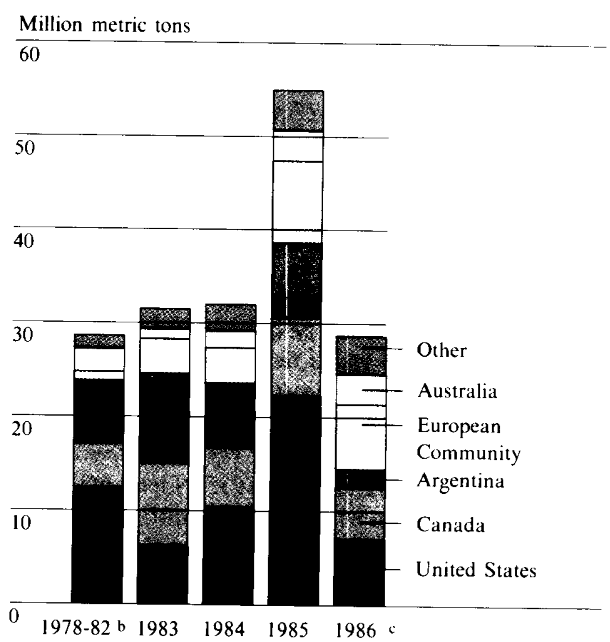
USSR: Grain Imports, 1978-86 [a]



[a] Data based on a market year ending in June. Includes wheat and coarse grains.
[b] Annual average.
[c] Estimated.

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Crop Developments

Despite a mixed performance in various areas, the Soviets appear to have done well overall with their grain harvest this year. Meteorological data and photography show that, following a promising start last fall, the outlook for 1986 Soviet grain yields worsened through the spring and summer because of adverse weather in some key grain-growing regions. In addition, the area sown to grain this year continued the drop begun in 1980 as the Soviets further expanded the area left fallow. According to recent photography, however, very good yields in some late maturing spring grain regions have brightened prospects for what appeared to be a poor grain crop. In addition, Moscow has benefited from a large-scale "intensive technology" program, aimed at boosting average grain yields by almost 1 ton per hectare on fertile

[redacted]

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[2] Estimates of the value of total agricultural production are derived from the gross output of crops and livestock products, less feed, seed, and waste, using 1970 average realized prices. [redacted]

25X1

[3] The grain marketing year is July-June. [redacted]

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The Soviet "Intensive Technology" Effort

The USSR expanded its massive intensive technology program in grain production this year. Intensive technology as defined by the Soviets includes many farm management practices routinely performed in the West—the use of high-yield varieties; planting after fallow; implementing efficient transportation schedules; and greater use of agrochemicals. The program began in 1984 on selected test sites totaling only 20,000 hectares and impressive results encouraged expansion to almost 17 million hectares in 1985 and to 29 million hectares—roughly one-fourth of the total grain area—this year. Recent plans call for intensive technology to encompass 36 million hectares next year and 50 million hectares by 1990. 25X1

Soviet comments on the success of the intensive technology program must be approached with caution. Reported grain yields from areas under intensive technology—averaging 40 to 50 quintals per hectare, roughly 20 quintals higher than on comparable lands—are selective and not representative of results over the entire area. In 1985, Soviet officials credited the program with adding 16 million metric tons to Soviet grain output. We believe this figure, however, represented the increased output on the lands where intensive technology was employed but did not take into account offsetting production declines in areas from which resources were pulled. Net production gains probably did not exceed 5 million tons. 25X1

lands. We judge that net production gains of 10-15 million tons were achieved this year with intensive technology. 25X1

In a recent Kremlin speech, Politburo member Yegor Ligachev stated that the Soviet grain crop would be roughly 210 million tons—a harvest that would be the fourth largest ever and about 17 million tons more than the average for 1976-85. This figure, however, is a preliminary estimate. Harvesting is only now being completed in Western Siberia, and it will be some time before actual results are known. 25X1

Given the evidence from imagery and meteorological data, we would have expected a grain crop closer to a 195-million-ton level. If the final Soviet figure is closer to the 210-million-ton mark, it would suggest:

- The Gorbachev-backed intensive technology program to increase grain production has been more successful than we estimated.
- The Soviets have made gains in cutting the substantial harvest losses that have plagued agriculture in the past. 25X1

In addition to a good grain crop, the USSR is likely to achieve near-record production of several major forage crops. As of 6 October, the last reporting date, with some 93 percent of the crop in, the forage harvest was running about 5 percent ahead of the record 1983 pace. Because harvested forages comprise slightly more than one-half of the nutrient content of the livestock ration, the outlook for feed supplies into next year is very good. Prospects for other crops, however, are mixed. Output of sugar beets, sunflower seed, and cotton is expected to be less than last season, but the vegetable and potato harvests are expected to be well above last year's depressed levels. 25X1

Soviet Grain Requirements and Imports

Whether the harvest reaches the 210-million-ton level or is somewhat less, it is likely that the Soviets will import much less grain during the current marketing year than they have in recent years. Indeed, Moscow could import as little as 10 million tons or as much as 25 million tons. 25X1 25X1

Uncertainty over the exact size of the grain harvest is not the only factor accounting for the relatively wide range in import expectations. Initiatives in the agricultural sector over the past few years have reduced the amount of grain required in meat production. Soviet farmers have been encouraged to boost forage production as part of a greater campaign to increase

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USSR: Grain Production,[a] 1976-86

Million metric tons

	1976-85 Annual Average	1981	1982	1983	1984	1985	1986 [b]
Total	**192.7**	**158.2**	**186.8**	**192.2**	**172.6**	**191.7**	**195.0**
By crop							
Wheat	88.8	81.1	84.3	77.5	68.6	78.1	85.0
Coarse [c]	92.8	69.4	91.8	101.9	90.5	100.0	97.0
Other [d]	11.1	7.7	10.7	12.8	13.5	13.6	13.0
By republic							
RSFSR	106.4	78.8	105.2	111.5	92.4	106.6	106.0
Ukraine	41.3	36.1	41.9	36.5	41.7	40.5	42.0
Kazakhstan	24.4	23.8	19.5	23.2	15.9	24.2	27.0
Other	20.6	19.5	20.2	21.0	22.6	20.4	20.0

[a] Measured in bunker weight; that is, gross output from the combine, which includes excess moisture, unripe and damaged kernels, weed seeds, and other trash. For comparison with US or other countries' grain output, an average discount of 11 percent should be applied. In 1986, the USSR for the first time in 5 years released grain production data.
[b] Estimated.
[c] Coarse grains comprise rye, barley, oats, corn, and millet.
[d] Other grains include pulses, buckwheat, and rice.

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the amount of overall feed per animal while reducing the share of grain. With the probable shift in feed composition that a large forage harvest will support, the level of grain imports needed to meet Soviet livestock production targets could be reduced by as much as 2-3 million tons. In addition, if Moscow continues to restructure livestock herds in favor of animals that are not heavy grain consumers, the demand for imported grain could fall by another 2-3 million tons.

Moscow also seems to be reducing the amount of grain required for other uses:

- Lower alcohol production could trim overall grain needs by as much as 1 million tons.
- Recent increases in the availability of other foods have reduced overall consumption of grain products such as bread and cereals.
- The decision to reduce the area sown to grain in favor of fallow has resulted in a 2-million-ton decline in the use of grain for seed.

Grain Purchasing Activity

Soviet grain purchases to date total about 10 million tons. Adequate supplies of livestock feed mean that Moscow does not face any great pressure to increase the pace of its grain purchases. Financial constraints may also be holding down grain buying. Low world oil prices have cut into Moscow's principal hard currency earner; sales of oil to the West this year are likely to be only about one-half the peak level of $16 billion just three years ago. Thus, the USSR is only covering immediate grain needs while awaiting even lower prices. With the current abundance of global grain stocks, prospects are good that already low grain prices will fall further.

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USSR: Nongrain Crops, 1981-86

	Area [a] (*million hectares*)	Yield (*quintals per hectare*)	Production (*million metric tons*)
Sunflowers			
1981-85 (annual average)	4.2	11.9	5.0
1984	4.0	11.5	4.5
1985	4.1	12.9	5.2
1986 [b]	4.1	12.0	4.9
Sugar beets			
1981-85 (annual average)	3.5	218.0	76.3
1984	3.5	247.0	85.4
1985	3.4	241.0	82.1
1986 [b]	3.4	214.0	74.0
Vegetables			
1981-85 (annual average)	1.8	161.0	29.2
1984	1.8	170.0	31.5
1985	1.8	157.0	28.1
1986 [b]	1.8	159.0	29.0
Potatoes			
1981-85 (annual average)	6.8	115.0	78.4
1984	6.8	125.0	85.5
1985	6.5	113.0	73.0
1986 [b]	6.7	121.0	81.0
Cotton			
1981-85 (annual average)	3.2	28.1	9.1
1984	3.3	25.8	8.6
1985	3.3	26.4	8.8
1986	3.3 [b]	24.2 [b]	8.0

[a] Area figures are derived from production and yield values published in *SSSR v tsifrakh v 1985 godu*.
[b] Estimated.

[redacted]

Impact of Chernobyl'

Analysis of data from a wide variety of sources indicates that the Chernobyl' nuclear accident in April had a negligible effect on Soviet grain production.

- *Agricultural land in the evacuated zone is minor compared with the overall area of Soviet crop production.*
- *Very little grain is produced within the affected area, which consists largely of forest, grassland, and swamps.*
- *According to Soviet press reports and photography, planting of spring crops was not delayed and, as of mid-July, field work on both farms and private plots appeared to be normal outside the evacuated area.*
- *Grain harvested from regions close to the evacuated area may be slightly contaminated by wind-blown radioactivity, but can be mixed with clean grain during milling to reduce contamination to acceptable levels.* [redacted] 25X1

Implications

Ample grain supplies worldwide mean that the USSR could obtain most of its import needs from non-US sources if it so chooses. We believe, however, that Moscow will favor coarse grains this year.[4] If so, the United States may again supply a substantial share of Moscow's corn needs because it is more reliable than the other major corn suppliers, has much greater supplies on hand, and can export year round. Moreover, US corn prices are fully competitive. Recent purchases of EC and Canadian barley and feed wheat and Yugoslavian corn, however, may signal a decision to avoid US corn. [redacted] 25X1

Moscow's failure to exploit the US subsidy offer on almost 4 million tons of US wheat—even while purchasing Canadian and EC wheat—indicates that Moscow will continue to buy from other, cheaper wheat suppliers before coming to the United States. 25X1

[4] Coarse grains include corn, barley, oats, rye, sorghum, and millet.
[redacted] 25X1

Given the outlook for sizable wheat availability from other wheat exporters and their readiness to better US price offers, Moscow may not purchase any US wheat this marketing year. [redacted] 25X1

Soviet hard currency outlays for grain will, in our view, be substantially less than the $3.2 billion spent during the past marketing year. Because grain prices are expected to drop as much as 10 percent from the current average level of $90 per ton, we believe Moscow could cover the upper end of our estimated need for grain with less than $2 billion. [redacted] 25X1

[redacted] 25X1

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United Kingdom: Gambling on a High-Technology Future [redacted]

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Prime Minister Thatcher's Conservative government is making a concerted effort to develop high-technology industries as a way to revitalize the manufacturing sector and reduce unemployment—the Tories' major liability in the next election. So far, her policies have had a minimal effect; Britain continues to lag the United States and Japan in this area and is struggling to stay in competition with the rest of Western Europe. Although we see no policy that would dramatically improve short-term prospects for British high technology, we believe Thatcher's policies, by addressing some of the underlying problems, are improving the long-term outlook. [redacted]

State of British High Technology

Since 1972, the United Kingdom has accounted for about 10 percent of the OECD's high-technology exports. While these have risen from $9 billion in 1975 to $26 billion last year, Britain's high-technology trade surplus, after peaking at nearly $5 billion in 1980, fell sharply to near balance in 1984 before recovering to $2 billion last year. Despite a relatively good export performance, the high-technology sector has fallen far short of London's expectations in terms of its benefits to the economy. As a share of GDP, high-technology output fell from 5.7 percent in 1975 to 5.1 percent in 1983. Probably more distressing to British officials, however, has been the sector's poor employment performance. Far from generating large numbers of new jobs, high-technology employment has fallen about 15 percent between 1975 and 1985, to 1.3 million. [redacted]

Specific Industries

Performance of the various industries in Britain's high-technology sector has been mixed:

- Despite relatively fast growth and good profitability during the late 1970s, the ***electronics*** industry has declined relative to its competition. Some estimates put the current value of British electronics production at less than half that of West Germany, or about 70 percent of French production. The United Kingdom has essentially abandoned the consumer electronics area to foreign producers.

- British ***telecommunications*** technology is equal to its European counterparts, but Britain ranks only fifth in the OECD in telecommunications production.

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- In the ***business machine*** sector, office machine exports have done well, moving the United Kingdom into second place behind the United States. Britain is losing ground in computers, however. Since 1976 Britain's share of OECD exports has dropped by one-third to about 7 percent and the software industry is in danger of extinction.

- The United Kingdom is one of the world's premier ***aerospace*** producers. Thanks to Rolls-Royce, Britain is a close second behind the United States in engine technology and typically accounts for about 30 percent of the OECD's jet engine exports. Britain no longer produces commercial aircraft on its own, but through the European Airbus consortium holds a 12-percent share of the OECD export market.

- Britain is one of five countries that dominate world trade in ***pharmaceuticals,*** primarily because of Britain's strong research position in biotechnology. Consistently accounting for 13 to 14 percent of OECD pharmaceutical exports, it has been the third-leading exporter since 1976, behind the United States and West Germany. 25X1

- The United Kingdom remains a strong competitor in ***scientific equipment*** and ***basic chemicals.*** Over the last decade it has increased its share of OECD exports in both categories while consistently running trade surpluses. Employment in both industries, however, has plunged by approximately one-third since 1975. [redacted] 25X1

[redacted]

United Kingdom: High-Technology Industries' Performance

	1975	1980	1981	1982	1983	1984	1985
Exports *(billion US $)*	**8.9**	**24.2**	**21.4**	**21.5**	**20.9**	**22.4**	**25.8**
Aerospace	1.6	6.1	4.6	4.8	4.2	4.1	4.8
Business machines	1.0	2.6	2.1	2.3	2.8	3.7	4.6
Telecommunications equipment	0.6	1.2	1.3	1.2	1.2	1.1	1.2
Consumer electronics	0.3	0.5	0.4	0.3	0.3	0.4	0.5
Other electrical equipment	2.2	5.2	4.6	4.8	4.3	4.4	5.0
Pharmaceuticals	0.8	1.7	1.7	1.7	1.6	1.6	1.8
Scientific equipment	0.9	2.4	2.4	2.4	2.5	2.6	3.0
Basic chemicals	1.5	4.5	4.2	4.0	4.0	4.3	4.9
Trade balance *(billion US $)*	**2.3**	**4.6**	**3.5**	**2.8**	**0.8**	NEGL	**1.8**
Aerospace	0.7	1.0	1.8	2.0	1.5	1.3	1.5
Business machines	−0.1	−0.4	−0.9	−1.1	−1.4	−1.4	−0.8
Telecommunications equipment	0.3	0.4	0.4	0.4	0.2	0.1	0.1
Consumer electronics	−0.2	−0.7	−1.3	−1.6	−1.6	−1.1	−1.1
Other electrical equipment	0.8	1.6	1.2	1.0	0.2	−0.6	−0.4
Pharmaceuticals	0.6	1.2	1.1	1.0	0.9	0.9	1.1
Scientific equipment	0.2	0.4	0.4	0.2	0.2	0.2	0.4
Basic chemicals	−0.1	1.1	0.9	0.8	0.8	0.7	1.1
Employment *(thousand persons)*	**1,486**	**1,417**	**1,319**	NA	**1,253**	**1,257**	**1,257**
Aerospace	242	236	243	NA	212	207	208
Business machines	51	53	45	NA	44	46	48
Telecommunications equipment	305	299	281	NA	278	283	280
Consumer electronics and other electrical equipment	468	467	414	NA	406	409	403
Pharmaceuticals	78	86	84	NA	84	84	85
Scientific equipment	155	107	99	NA	95	99	101
Basic chemicals	187	169	153	NA	134	132	132
Share of manufacturing employment *(percent)*	19.4	20.0	20.7	NA	21.7	22.0	23.1
Share of total employment *(percent)*	6.4	6.3	6.1	NA	5.9	5.9	5.9

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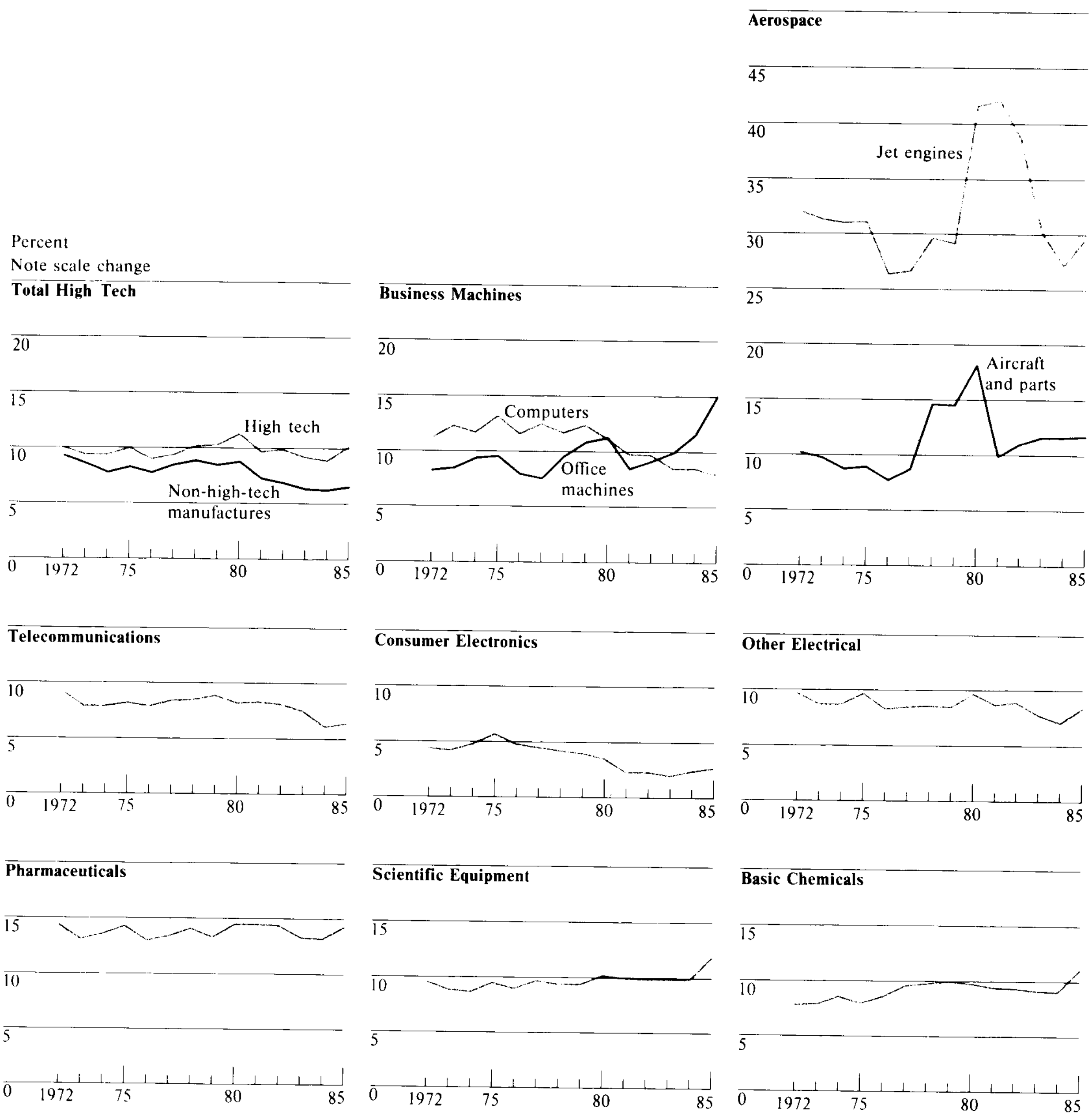
United Kingdom: Share of OECD High-Tech Exports, 1972-85



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Obstacles to High-Technology Development

Inadequacies of Universities and Training. While no consensus exists among British experts about which obstacles are the greatest, we regard education and training as the most intractable impediments to Thatcher's goal of a high-technology future. A number of academic studies argue that lack of productive links between universities and industry in the United Kingdom has resulted in university research often being unnoticed by industry or unrelated to industry's needs. There is currently little cooperation between industry and academia, and British universities turn out an insufficient number of technically skilled graduates. Britain graduates only about 8,000 professional engineers per year compared with 70,000 in Japan, 65,000 in the United States, and 30,000 in France. [redacted] 25X1

Inefficient R&D Spending. Although R&D spending has fallen slightly since 1980 in real terms, the United Kingdom still devotes more than 2 percent of GDP to research and development—about the same as its major competitors. One-half of government R&D spending goes to defense-related technologies, however. Critics argue that this spending produces relatively little technology with civilian applications, and, unlike the US case, does not win sufficient export orders for British industry. In addition, a large portion of British R&D goes for fundamental, rather than applied, research. Finally, in our view, past spending on some high-profile areas—notably nuclear power—has been out of proportion to the commercial sales that resulted. [redacted] 25X1

Shortage of Investment Funding. The growth of British high-technology firms also has been retarded by the lack of readily available financing. Over the last decade Britain has devoted only about 18 percent of GDP to capital formation, tying it with the United States for last place among the Big Seven. A high-technology seminar at Cambridge University recently charged that because banks lack a thorough understanding of new technology they pay inadequate attention to high-technology industries in their lending strategy. [redacted] 25X1

Oil and the Exchange Rate. We believe that Britain's emergence over the last decade as an important oil producer has had a negative impact on most of the manufacturing sector, including most high-technology industries. The shift from oil importer to oil exporter undoubtedly boosted the pound's value—hurting British competitiveness at home and abroad. While the pound's real effective exchange rate has retreated considerably from its 1981 peak, it remains well above its mid-1970s level. [redacted] 25X1

Technology and the "Thatcher Revolution"

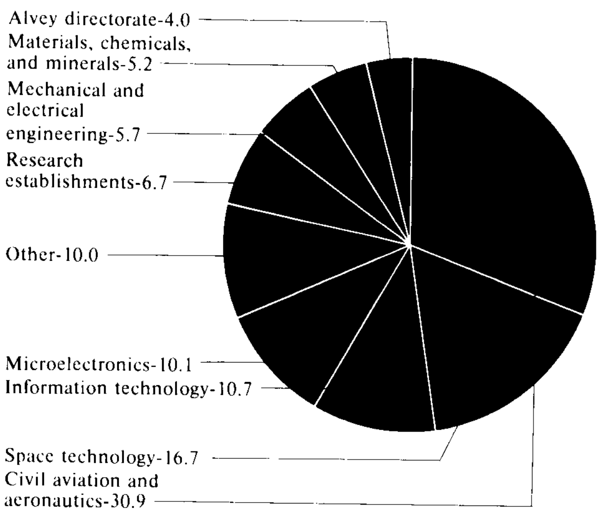
Prime Minister Thatcher has publicly labeled the development and widespread application of high technology as essential if Britain is to maintain its position as an advanced industrial nation. In promoting high-technology innovation, however, Thatcher's basic philosophy is to reduce the state's role in order to foster private-sector initiative. Consequently the number of government R&D workers was down to 61,000 in 1984, compared with 77,000 a decade earlier. Thatcher believes the best hope for increased commercialization of science is the development of the close university-industry links that are common in the United States. Nonetheless, spending on universities and polytechnical schools was cut by 18 percent between 1980 and 1984. [redacted] 25X1

London is also promoting international high-technology cooperation, believing that, if Europe is to compete with the United States and Japan, the approach must not be purely national. As a result the United Kingdom is very interested in participating in the SDI program and has become involved in West European high-technology research programs such as ESPIRIT in information technologies, RACE in telecommunications, and, most recently, EUREKA—a European-wide effort to promote civilian high technology. [redacted] 25X1

Research and Development Funding. Despite Thatcher's cuts, the government provided $5.7 billion in 1985, almost 50 percent of British R&D funding. This was about double the 1978 level in nominal terms

Department of Trade and Industry Research and Development by Activity, 1985/86

Percent



[redacted]

though little changed in real terms. The government changed the emphasis of its R&D support program in March 1985, however, making more funds available for collaborative research, advisory services, and schemes for improving technical skills, and less for individual company projects. [redacted]

Assistance for Innovation. As part of Thatcher's program, the Department of Trade and Industry has shifted away from aiding older, "smokestack" industries and is concentrating on newer, more innovative sectors. In dollar terms, government financial assistance for innovative technologies has more than doubled since 1982 and now exceeds $500 million a year. The government's major high-technology initiative offers grants of up to 25 percent of a firm's investment in introducing new technology in the areas of office automation, computer-aided design, and robotics. To promote information technology, London is planning to provide $280 million over the next five years to help fund the Alvey fifth-generation computer program, doubling the level of information technology research in the United Kingdom. [redacted] 25X1

Encouraging Foreign Investment. The United Kingdom is also encouraging multinational investment in high-technology industries. Since 1981, for example, the Scottish Development Agency has run a program to attract foreign investment and encourage overseas electronics firms to establish manufacturing and R&D activities in Scotland, attracting more than $200 million annually. [redacted] 25X1

Support For Training and Education. The Thatcher government is also attempting to increase the pool of people skilled in high technology. It has, for example, launched the London Center for Biotechnology to train manpower and do research in conjunction with industry and academia. London is also working with industry to train skilled workers for the information technology sector, making an additional $60 million available over the next three years for more higher education slots in information technology and engineering. [redacted] 25X1

Outlook for a High-Technology Future

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We do not believe there is one single strategy the Thatcher government could take that would quickly and significantly improve the outlook for British high technology. Scientists have traditionally been among the British elite, but engineers and entrepreneurs, the people needed to commercialize technology, have not. The government and industry will find it difficult to encourage the adoption of new technologies as long as such traditional cultural attitudes remain an important part of British life. [redacted] 25X1 25X1

The Thatcher government's initiatives have produced some positive results, but on balance we believe they have so far failed to significantly stimulate high-technology development. Efforts to cut government spending include reductions in the support for science and technology, and funding for EUREKA will come out of existing research programs. British scientists have begun a campaign to protest government science policy, pointing out that cuts in basic research will damage Britain's ability to develop new technologies. [redacted] 25X1

While Thatcher continues to believe that the private sector will take up the slack as direct government support falls, we do not think this is likely over the next few years. [redacted] 25X1 [redacted] 25X1 although many large firms are heavily involved in financing R&D, most still assume this is a government function. In addition, in the current macroeconomic climate in Britain, companies do not appear ready or able to support a near-term surge in civilian R&D spending. [redacted] 25X1

Ironically, Thatcher's free market principles could also have a short-term negative impact on some British high-technology producers by cutting into their domestic market. To reduce costs the Ministry of Defense is looking abroad for equipment it previously purchased from British firms, while British Telecom, since being deregulated, is doing the same. [redacted] 25X1

Implications for Thatcher and the Economy

The mediocre near-term prospects for the high-technology sector mean that it will not play a major role in British economic growth during the next two years. High-technology employment will probably remain stable while the sector probably will continue to increase its share of total manufacturing output. Looking ahead to the 1990s, the high-technology sector is likely to make a more significant contribution to economic growth and employment. It still will not make a dramatic impact, however, simply because it is too small—at 5.1 percent of GDP—to pull the rest of the economy. [redacted] 25X1

One of high-technology's major positive impacts on the economy could come through its effect on industrial relations. Trade unions have so far had little success in unionizing high-technology workers, and the example could spread to other emerging sectors—especially services—and further reduce the influence of British unions. [redacted] 25X1

We believe Thatcher's high-technology policies, like her other economic reforms, have set the stage for improved British economic performance in the long run, but she must stand for reelection no later than June 1988. Public impatience could risk a rejection of her programs and damage long-term prospects for technology development. The Thatcher government will be particularly open to criticism if unemployment remains high. Opposition leaders especially condemn Thatcher for pushing high technology while neglecting older industries where employment is shrinking. The Labor Party's main criticism is that Britain is being turned into a services economy of low-paying jobs, and that Tory policies are inadequate to prepare the United Kingdom to compete in world markets as North Sea oil production declines during the next decade. [redacted] 25X1

If Thatcher loses, a government led by either the Labor Party or the Social Democratic–Liberal Alliance, despite rhetoric about the need to promote high technology, probably would divert funds to older industries as a quick fix for joblessness. In our view, Labor in particular would be under pressure from unions to adopt policies to increase job security in older industries at the expense of assistance for technological innovation. [redacted] 25X1

[redacted] 25X1

Israel: Declining Fortunes for High-Technology Industries

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Israel has long touted the development of a high-technology industrial base as the long-term panacea for its foreign payments deficits, unemployment problems, and stagnant economic growth. After nearly a decade of rapid growth, however, many high-technology industries are now caught in a recession because of declining exports, scarce domestic investment funds, and the government's austerity program. Although high-technology industry still makes an important contribution to the economy, its structural shortcomings and continued funding problems will prevent it from achieving Israel's ambitious objectives.

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An Economic Cure-All?

A chronic foreign payments problem is the catalyst behind Israel's drive to develop high-technology industries oriented toward export markets. National security concerns also inspired the government to develop high technology for defense to maintain military superiority over its Arab adversaries. Highlighting the importance Israel places on defense, more than one-half the R&D budget is earmarked for military programs. Besides improving its near term self-sufficiency for sophisticated weaponry, Israel wants to expand its capability to export arms.

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Israeli policymakers and industrialists agree that building a civilian high-technology sector based on a scientifically and technically skilled work force is the key to increasing exports. Officials believe such exports will eventually solve foreign payments problems, boost employment, and promote economic growth. The government program calls for civilian high-technology-related exports to expand from $1.8 billion in 1984 to $4.4 billion by 1990.

High-Technology Takeoff

Israeli high-technology industries grew rapidly during the past 10 years on the strength of broad-based government support, robust foreign demand, and a ready availability of investment funds. Government R&D expenditures increased about 50 percent from 1976 to 1985 to approximately $390 million—accounting for more than 3 percent of GNP compared to about 2.7 percent in the United States. Bank-associated finance groups such as the Direct Investment Corporation, independent industrial groups, and public sales of stock also provided money. Larger

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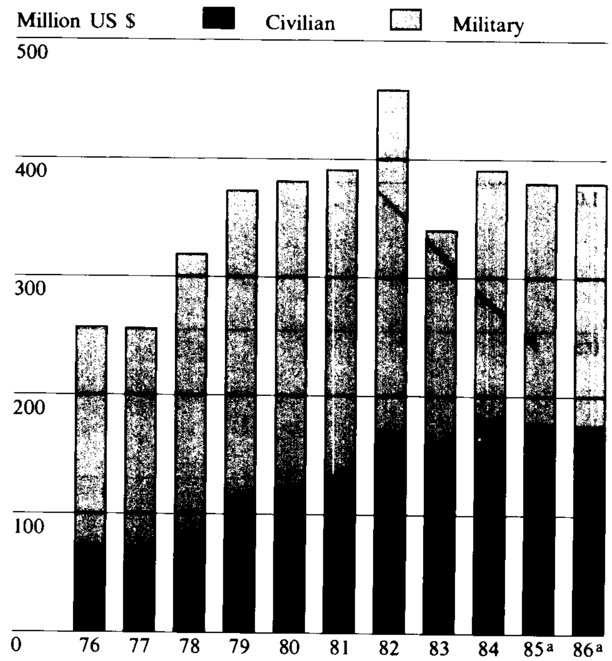
Israel: Research and Development Expenditures, 1976-86



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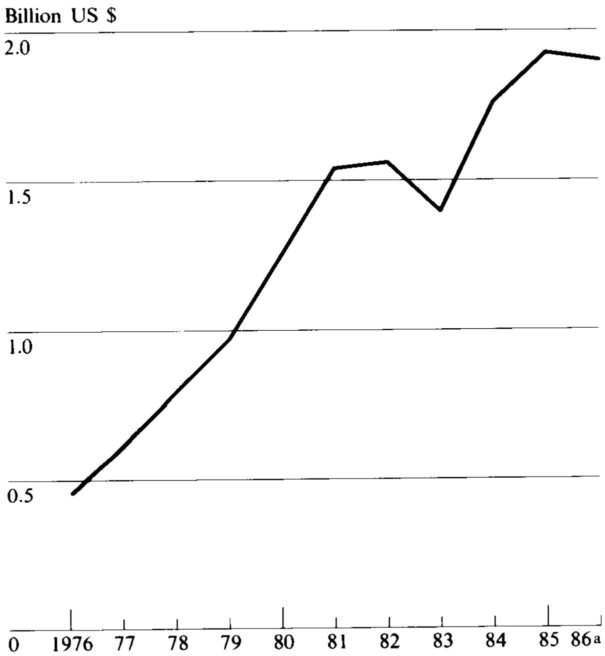
Israel: High-Technology Exports



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firms also reinvested a sizable share of company profits into their R&D programs. Foreign partners, particularly in the United States, took advantage of Israel's attractive loan and tax incentives and contributed funds.

High-technology industries became the major source of growth in export and employment. Flush with capital, the number of high-technology companies climbed from 154 in 1976 to about 770 today. As the industry grew, high-technology-related exports shot up from $456 million in 1976 to about $1.9 billion last year.

Growth Sputters

Since the formation of the National Unity government in 1984, high-technology industries have fallen on hard times, despite government programs to promote this sector. As part of Tel Aviv's stabilization program, former Prime Minister Peres opted to contain inflation and budget deficits at the expense of R&D spending in both civilian and defense-related high-technology industries. Budget expenditures for defense, Israel's largest industry, fell from $3.2 billion in the fiscal year ending in March 1983 to $2.6 billion in FY 1986. The sharp cut in military orders coupled with a scaled-down R&D budget helped throw many high-technology industries into a recession. A price freeze and a clampdown on loans and grants aggravated the cash flow problems of an industry that is critically dependent on new capital. 25X1

At the same time, a slowdown in high-technology exports has compounded the financial woes of many enterprises that need foreign buyers because of Israel's small domestic market. Many overseas customers are saturated with high-technology products. Meanwhile, competition for new market shares from other international suppliers, especially Japan, Taiwan, and South Korea, is fierce. The government did not help the situation when it reduced export subsidies by $77 million and maintained a fixed exchange rate earlier this year. As a result, the growth in high-technology-related exports is likely to come to a near standstill this year compared with about a 9-percent average annual growth rate during 1980-85. 25X1

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Shrinking profit margins or outright losses have forced many high-technology firms, especially in defense, to retrench. The resulting loss of high-technology jobs has become a major concern among officials associated with Israel's R&D programs, according to the US Embassy. Last year, high-technology employment fell 3 percent to 37,100. From the Israeli view, protracted unemployment could lead to a net emigration of many skilled workers whom Israel considers to 25X1

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be a vital asset. Moreover, Israel must provide attractive employment opportunities for new college graduates entering the labor force if it is not to aggravate an unemployment rate currently more than 7 percent nationally.

Outlook

With the prospect of continued weak foreign demand and a shortage of investment capital, high-technology exports will remain in the doldrums for at least the next year. Many of Israel's high-technology firms are too small and lack the sophisticated plant and equipment needed to compete internationally. Of the more than 700 existing high-technology firms, 4 percent control almost three-fourths of the export market. This situation makes Israel's export capability especially vulnerable to downswings should the largest firms suffer financial setbacks.

Without sufficient startup capital, new firms will find it extremely difficult to penetrate existing markets no matter how sophisticated or competitively priced their products are. Even the largest firms will be at a disadvantage because they lack the vital marketing expertise and overseas sales network needed to attract new customers or protect existing market shares from foreign competition. Although still an important performer—high-technology-related exports account for almost one-third of Israel's total sales abroad—we do not believe such exports will grow rapidly enough to eliminate Israel's trade deficit.

High-technology industries probably cannot count on the government to provide enough new business or other assistance to bail them out of their financial difficulties. Prime Minister Shamir so far remains committed to the stabilization policy of his predecessor. At this point, the FY 1987 budget seems likely to repeat the spending pattern of the previous fiscal year. Despite industry demands for a devaluation, the government will oppose major changes that would destroy fragile gains in economic stability.

Still, Shamir will be careful to balance austerity against the need to prevent a deeper recession that would provoke voter resentment—the latest popularity polls indicate unemployment remains a serious concern with the populace. The government approved a $109 million supplemental aid package last June that included $50 million in R&D funding, according to the press. The threat of more industrywide bankruptcies already has prompted the Minister of Industry and Trade to propose several export subsidies to the inner Cabinet, according to the Embassy.

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The lack of ready capital from other domestic sources will remain one of the main obstacles to high-technology development. The Tel Aviv Stock Exchange still has not fully recovered from the bank share debacle that led to its collapse in 1983. More important, the government has continued to monopolize the capital markets to ensure enough money is available to cover its deficits. Despite recent government moves to relax its control, including a recent decision to raise the share the private sector is permitted to borrow, it will be years before stock market reform reaches the point that it meets high-technology investment needs.

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Despite Israeli efforts to attract more foreign venture capital, the prohibitively high risk of starting a new firm in the face of intense competition has been a strong disincentive for foreign investors. Many foreign firms probably are also unsure of Israel's ability to make its tenuous stabilization policy stick over the long term. Moreover, the Arab boycott and the possibility of another Arab-Israeli war will remain overriding concerns in foreigners' reluctance to invest in Israeli high-technology industries.

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Implications for the United States

The new coalition government probably will lobby the United States for additional debt refinancing and other assistance to help Israel's foreign payments problems now that the bloom is off high-technology industries. By the end of 1986, Israel will have received another $750 million in emergency US aid, the second half of a total $1.5 billion package agreed to in 1985 and the main reason the balance of payments is now in the black.

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Tel Aviv also is likely to seek greater financial cooperation with the United States, specifically with the Binational Industrial Research and Development

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Fund, a jointly funded organization whose purpose is to support US-Israeli R&D partnerships with potential for commercialization. In addition, Israel may ask for a more rapid expansion of its Free Trade Agreement to allow high-technology products to enter the US market duty free. [redacted] 25X1

Tel Aviv also is likely to plead for more US aid—in addition to the $1.2 billion already provided—to help cover the cost overruns of the Lavi fighter aircraft. Largely because the program already employs about 5,000 workers—almost half of whom are scientists and engineers—the government is committed to the aircraft's development, which it hopes will attract foreign investment and create new export markets. Israeli officials believe that the program will generate $2 billion in aircraft orders and Lavi-related sales abroad, according to the defense attache in Tel Aviv. [redacted] 25X1

In addition, Israel will expect the United States to provide lucrative research contracts in keeping with the Strategic Defense Initiative (SDI) memorandum signed last June. The Israelis anticipate that SDI eventually will provide its financially beleaguered high-technology defense firms new sources of revenue and employment and generate spinoffs for the civilian sector in the form of research funds and commercial opportunities. Israel already has submitted several proposals for SDI contracts. [redacted] 25X1

SDI, however, will provide no easy fixes to Israel's problems. Because of the small scale of most high-technology firms, their orientation to specific military applications, and their weak financial base, Israeli SDI contracts are likely to be for small or specialized projects and software and thus make only a modest contribution to improving high-technology-related exports. [redacted] 25X1

[redacted] 25X1

Briefs

International Finance

Philippine Debt Rescheduling Delayed

[redacted]

According to press reports, negotiations between Manila and foreign banks to reschedule more than $8 billion in debt repayments have stalled. [redacted] 25X1 the bankers—convinced that sluggish domestic investment, not a shortage of foreign exchange, is the critical barrier to economic growth—are reluctant to agree to unusually low interest rates and long repayment terms. In addition, [redacted] 25X1 bankers are worried that such terms would set a precedent in negotiations with other major debtor countries. Although ample foreign exchange reserves—equivalent to about four months of imports—allow Manila to weather a delay, the deadlock comes at an awkward time for President Aquino. The pause in the rescheduling talks is yet another deterrent to businessmen who are holding off investing in the Philippines because of concern over widely publicized coup plotting and the economy's continued weak performance. [redacted] 25X1

Mexican Debt-Equity Swaps

[redacted]

Mexican officials believe they will be able to swap between $750 million and $1 billion of foreign debt for equity this year given the progress made so far. Since the program began in May, Mexico City has carried out 20 debt-equity swaps totaling $500 million. The swaps provide attractive terms for financing investments and repaying loans in Mexico—foreign companies buy public-sector foreign debt at a discount on the secondary market abroad and exchange the debt for pesos at a smaller discount from the Mexican Government. Under the program, foreign firms have invested $220 million in automobile plants, and another $130 million auto investment is pending. Additional investments have been made in hotels and assembly plants, but most of the remaining swaps were aimed at paying off foreign subsidiaries' loans from Mexican banks. In view of Mexico's restrictive foreign investment climate and limits on the use of the swaps, however, the program is unlikely to trigger significant new investments. Government officials may even cut back debt-equity swaps if inflationary pressures emerge as a result of the Central Bank's conversion of dollar-denominated debt into pesos. [redacted] 25X1

Asian Borrowing Declines

[redacted]

Medium- and long-term syndicated borrowing by Asian LDCs dropped to $6.8 billion in January-August 1986, from $8.9 billion for the same period in 1985. Hong Kong and South Korea reduced their foreign borrowings this year even though lenders have offered more favorable terms. [redacted] 25X1 Financial observers believe this reflects the benefits to both countries of lower oil prices and interest rates, and the stronger yen, which makes their exports to the US market more competitive with those from Japan.

Meanwhile, Malaysia and Indonesia boosted their borrowing in the Eurocurrency markets to $1.5 billion during the period, more than double the total for all of 1985 despite stiffer loan terms. The credit ratings of these debtors have plunged because of falling oil and commodity prices. Indonesia, for example, paid an average spread of 0.64 percentage point above LIBOR this year compared with 0.29 percentage point last year. Worsening loan terms—a doubling of the average spread and a shortening of the average maturity from 11 to eight years—contributed to China's slower commercial borrowing this year. [redacted] 25X1

Zaire Clarifies Economic Policies

[redacted]

President Mobutu told foreign creditors and donors last week that Zaire would meet all debt service commitments through the end of this year, but he wants to renegotiate Paris Club, IMF, and World Bank agreements for 1987. According to the US Embassy, Mobutu proposed sending a delegation to Washington later this month to begin talks with all concerned parties aimed at reducing Kinshasa's debt payments. The Embassy reports that Mobutu has instructed his new Finance Minister—who reportedly drafted the ruling party's recent economic proposals that prompted the IMF and the World Bank to suspend credit disbursements—to prepare Zaire's negotiating position. Mobutu's recent endorsement of well-publicized attacks on the austerity program suggests that he is under considerable pressure to win concessions from international lenders and that negotiations probably will be contentious. Mobutu abandoned economic reform programs several times in the past and is likely to threaten to do so again if IMF and Western backers do not relax their credit terms. [redacted] 25X1

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Bangladesh Pressed To Improve Loan Recovery Rate

[redacted]

Bangladesh may decide to make some politically sensitive economic reforms to avoid interruption of balance-of-payments support from the World Bank. The Bank wants Dhaka to improve agricultural loan recovery rates. According to the US Embassy, the present rate of recovery is only about 26 percent; the Bank would like a 60-percent rate before further funds will be disbursed—the IMF has imposed similar conditions. Dhaka's loan problems reflect crop failures, lack of institutional support for pursuing defaulters, and loans for political patronage. President Ershad announced before the recent presidential election that the government would soon implement an interest forgiveness program if the principal is repaid by February 1987. Dhaka probably believes that by initiating this program it will retain Bank and Fund support, even if it fails to improve recovery rates. [redacted] 25X1

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International Trade

[redacted] 25X6

[redacted] 25X6

Global and Regional Developments

Insects Potential Threat to African Crops in 1987

[redacted]

According to press reporting, a $35 million multinational effort has prevented insects from destroying crops in East, Central, and West Africa. The UN Food and Agriculture Organization (FAO) estimates that, in the Sahel region alone, extensive insecticide spraying may have saved enough grain to feed 1.2 million people this year. Only southern Africa still faces a possible current threat of insect damage. While spraying may have prevented a catastrophe this year, Africa still faces potential food shortages caused by its worst insect problem in 60 years. With next year's rains, eggs laid by this year's record insect populations will hatch. In addition, spraying in some West African countries was done improperly—actually increasing the likelihood of insect problems in 1987. To reduce the danger of food shortages next year and to avoid another costly rush to treat insects, donor nations may be asked to begin allocating funds and to pre-position resources now for insect control in 1987. [redacted] 25X1 25X1

National Developments

Developed Countries

Canadian Government Criticized Over Aircraft Contract

[redacted]

Ottawa's choice of a Quebec contractor in the hotly contested bidding for the CF-18 jet fighter maintenance program may cost the Mulroney government some of its western political support. The decision in favor of Canadair of Montreal—which could lead to contracts totaling $870 million over a 20-year period—has been labeled unfair by competing Bristol Aerospace. In economically strained Manitoba, where Bristol is located, politicians have pointed out that the government's own review of bids showed that the Winnipeg firm offered greater technical competence at a lower cost. Government officials, however, contend that the bids were very close and that the decision was based on the winner's ability to turn technological spinoffs into exportable products. Bristol executives have countered that such spinoffs were not an issue when bids were being tendered, but were only emphasized to justify the government's final decision. Under political pressure from both provinces, the Mulroney government apparently has opted to bolster its Quebec support and depend on the $725 million aid package already promised to farmers to maintain its standing in the west. [redacted] 25X1 25X1

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Japan Targets Life Sciences

Tokyo is seeking foreign participation in its Human Frontiers Program—a large life sciences research effort showcasing Japan's willingness to contribute to world science. According to the US Embassy, MITI and the Science and Technology Agency have agreed to cooperate, possibly at Nakasone's insistence, rather than continue to vie for control of the program. Both agencies see Human Frontiers as the core of Japanese biotechnology—a field that has been targeted as a key to future growth despite limited Japanese research capabilities. Prime Minister Nakasone has promised that Human Frontiers will receive "appropriate" funding in the fiscal year beginning 1 April 1987, but the Ministry of Finance has insisted that the program be funded within existing budget limits. This would require substantial cuts in projected expenditures of $10 billion over the first 10 years. European countries, which have also targeted biotechnology as a key to growth and have recently announced their own cooperative program, may be reluctant to participate in the Japanese program. Thus, the program's future may depend on the United States for funds and research capabilities as well as for an international dimension. 25X1

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London To Ease Fiscal Policy

London's announcement last week that it will increase government spending is undoubtedly designed to improve Tory electoral chances by boosting economic growth and improving Prime Minister Thatcher's image. In his annual Autumn Economic Statement, Chancellor of the Exchequer Lawson said the government will spend an extra $14.2 billion over the next two years on education, social security, health, and housing. While most observers expected the government to ease fiscal policy somewhat in the run up to the next election, the size of the increase took many by surprise. Expenditures will grow by 1.25 percent in real terms—the government originally planned to keep real spending constant. Lawson, claiming the government remains committed to fiscal responsibility, kept this year's public-sector borrowing requirement target at $10 billion—which is not likely to be met—but did not mention a target for next year. The spending hike will force Lawson to either abandon plans for a tax cut in the budget due in March 25X1 or raise the deficit target significantly. Political commentators are calling the Chancellor's statement a classic preelection budget ploy, while opposition spokesmen condemn it as an attempt to buy votes. [redacted] 25X1

West German Unemployment Developments

[redacted] 25X1

Seasonally adjusted unemployment in West Germany dropped slightly in October, shrinking for the eighth consecutive month. The downward trend in joblessness during 1986 has undoubtedly boosted the Kohl government's prospects in January's federal election. Beyond the election, however, Bonn probably expects little additional improvement. West Germany's five leading economic institutes and the President of the Federal Labor Bureau estimate that unemployment will remain above the politically sensitive 2 million level next year. Moreover, the Economic Ministry's forecasting unit believes that 3-percent annual real growth over the next five years—which it considers to be the maximum possible—will be insufficient to markedly reduce unemployment. The Ministry has concluded that major reductions in joblessness must await the demographic shifts expected in the late 1990s that will sharply reduce the labor supply. [redacted] 25X1

Less Developed Countries

New Egyptian Prime Minister

[redacted] 25X1

Under the increasing pressure of economic decline, President Mubarak has appointed Dr. Atif Sidqi as Prime Minister after arranging the resignation of Ali Lotfy and his Cabinet. Sidqi, like his predecessor, is an economist with no proven political skill. US Embassy officials have found him pro-United States, practical, and honest, but more of a team player than a star. Mubarak probably hopes that replacing the discredited Lotfy with another technocrat will convince the United States that he is serious about economic reform and deserves emergency assistance to help Egypt through its short-term cash crunch. Sidqi's political inexperience, however, may hamper efforts to forge a unified reform policy among senior economic ministers. One-third of the 32-member cabinet is new, including ministers for the important economic and finance portfolios. Moreover, if Sidqi cannot put his house in order soon, the changeover may seriously disrupt Egypt's negotiations with IMF and World Bank officials in pursuit of debt rescheduling and increased aid. [redacted] 25X1

Iranian Antiregime Activities Increase

[redacted]

Popular disturbances are increasing throughout Iran because of fuel rationing, food shortages, and growing war weariness. [redacted] 25X1 the imposition of gasoline rationing early last month led to protests in Tehran, Esfahan, Mashhad, Shiraz, Bandar-e Abbas, and Gorgan. Protesters clashed with security forces in some cities after blocking major intersections with their vehicles. 25X1 [redacted] residents in some poor neighborhoods in Tehran took to the streets at night to shout antiregime slogans and to protest food and fuel shortages. 25X1 In response to the unrest, [redacted] the 25X1 regime has eased some of its rationing guidelines, removed from office some clerics who have criticized the regime, and organized progovernment demonstrations. The growing unrest among the urban lower classes, until now the mainstay of the clerics' support, strikes at the regime's political base. Tehran might attempt to alleviate shortages by drawing down further its foreign reserves or by borrowing on the international market to finance more imports, but these steps are likely to bring only a temporary respite. The decline in public confidence is likely to sharpen divisions in the regime betweeen those who want to wind down the war and hardliners who want a major offensive to win the war quickly. 25X1

Tanzania Faces Wheat Shortage

With 50 percent of its 1986 wheat crop destroyed by army worms—roughly 25,000 metric tons—Tanzania lacks sufficient wheat stocks to last until the next harvest, according to the US Embassy. Tanzania has asked the United States and Canada for emergency food assistance. Canada already has promised 12,000 tons 25X1 of wheat now scheduled to arrive in January or February, according to an Embassy source, but Tanzania does not have the capacity to mill such large quantities. Until the remaining shortfall is made up by foreign donors, the government plans to sharply decrease the amount distributed monthly from government stocks, adding to the hardships imposed by austerity measures adopted under the new IMF program. This and the almost certain upswing in the unofficial market wheat prices will hit the urban poor—many of whom eat a morning and evening meal of only bread and tea—particularly hard. Although widespread civil unrest is unlikely, the Mwinyi government's slow response to the most recent economic crisis will cost it politically important urban support. 25X1

Shortages and High Prices in Kabul

A market survey conducted in Kabul in late October by the US Embassy indicates some important commodities—including wheat, milk, and kerosene—are in short supply. The survey also shows that the prices of bread, flour, vegetable oil, and fresh produce have increased substantially over the last two years. The shortages probably reflect hoarding by Kabul residents in preparation for winter and the 25X1 poor agricultural situation in northern Afghanistan. The Embassy believes, however, they may also be a sign that the Soviet capacity or willingness to support the Afghan regime through the provision of goods to Kabul is flagging; in recent years, imports from the Soviet Union have accounted for an increasing share of the goods available in Kabul markets. To improve the situation, the regime has begun to enforce regulations prohibiting the transport of foodstuffs out of Kabul. Government troops now operate checkpoints on all major roads and are inspecting all civilian vehicles leaving the city. The regime also is considering official price controls, according to the US Embassy. 25X1

Thailand Scales Back Eastern Seaboard Project

According to press and US Embassy reporting, Prime Minister Prem's financially pressed coalition government has pared down the expensive development program on Thailand's Eastern Seaboard. In a victory for technocrats who had opposed a controversial fertilizer plant on economic grounds, Bangkok withdrew its financial backing for the National Fertilizer Corporation—a move that is likely to end plans 25X1 to build the plant and a deep-sea port at Map Ta Phud. Construction on another port and an export-processing zone near Laem Chabang, however, is slated to begin in mid-1987. Faced with a tight budget, Bangkok is counting on the private sector to provide much of the financing for the facility and is hoping for increased Japanese investment as a result of the stronger yen. 25X1

South Korean Auto Sales to US Swell Trade Surplus

[redacted]

South Korea sold 17,000 Hyundai cars in the United States last month, raising the number to 130,000 since the line was introduced to the United States in March. A major forecasting firm predicts that South Korea will ship about 350,000 cars primarily to the United States next year, when Kia and Daewoo begin their export drive. South Korea is targeting the inexpensive car market once dominated by Japanese automakers. South Korean auto sales have set a record for a new import in the US market. They will account for one-third of the $1.7 billion increase this year in Seoul's bilateral trade surplus, which will reach about $6.5 billion. Seoul probably hopes that equity and marketing arrangements with US auto firms will limit trade complaints from Washington. Seoul has designated autos a strategic industry that could help absorb a rapidly growing work force; strong US sales are essential to South Korea's automakers, whose domestic and alternative foreign markets are limited. [redacted] 25X1

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Indonesia Denies Planning Exchange Controls

[redacted]

Speaking before a group of Indonesian financiers, Finance Minister Prawiro last month reiterated that Jakarta would not impose foreign exchange controls as a followup to the 31-percent devaluation in September. [redacted] some bank depositors were shifting their funds overseas for fear that the government might freeze bank deposits. His remarks, however, are not likely to assuage depositors' fears. The government's credibility is already low following its repeated insistence in September that no devaluation was contemplated. Some economists also contend that the devaluation was unjustified on economic grounds—suggesting that exchange controls might be necessary to support the cheaper rupiah. [redacted] 25X1 25X1 25X1

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Communist

China Cutting Back US Timber Imports

[redacted]

China—which bought 25 percent of US log exports in 1985 and early 1986—has cut back severely on US log purchases while increasing overall wood imports by 15 percent over last year. [redacted] China's total log demand exceeds domestic supply by 30 percent, and, despite ambitious plans to increase forest cover from 12 to 20 percent of China's land area, China will more than double its wood imports by the year 2000. [redacted] 25X1

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Chinese Conservation Fee for Agricultural Lands

[redacted]

For the first time, individual peasants and collective units that use cultivated land for nonagricultural purposes in Guangdong Province will be required to pay a user's fee into a land reclamation fund. Key state construction projects and enterprises with foreign involvement will be exempt. Guangdong officials plan to use the fund for reclaiming wastelands and barren hills; and, if successful, the idea could be adapted by other provinces. Because China's modernization—especially in industry and transport—requires the use of some cultivated land for expansion, Guangdong is probably using the fee to restrict the more prosperous peasants and units from building on the limited agricultural land. [redacted] 25X1

25X1

China Plans To Improve Patent Protection

[redacted]

Beijing plans to bolster its fledgling patent system. At a national meeting last week, the director of China's Patent Bureau said Beijing is drafting supplementary regulations governing patents for organic engineering, computer software, medicines, and chemicals. The official also said China is establishing a new training center and a nationwide computer system to handle patent information. China has received almost 29,000 applications—one-third from abroad—and granted 2,000 patents since initiating its system in April 1985. Foreign firms have been increasingly distressed at the lack of protection under current law in in such areas as software and agricultural chemicals, but relief will probably take some time. Moreover, Chinese officials recently told US Embassy officers that it may take five years before a copyright law is finished. More pressing concerns, including bankruptcy and labor reform legislation, may also delay consideration of patent regulations. [redacted]

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China Licensed To Produce West German Buses

[redacted]

The Chinese firm NORINCO recently concluded a licensing agreement with the West German firm NEOPLAN to build 10,000 intercity buses in China over the next 10 years. The buses will be powered by air-cooled diesel engines—normally used in armored vehicles—which NORINCO now produces under West German license. The deal also provides engineering and production assistance, to include modernization of the Chinese factory. In addition to having the right engine, NORINCO has the necessary hard currency—probably obtained from arms sales. NORINCO's expansion into bus production is a good example of the use of technology and excess production capacity in Chinese military production facilities for commercial gain. The civilian transport sector desperately needs intercity buses to ease passenger demands on the railroads. [redacted]

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China's First Natural Gas Cogeneration Plant

[redacted]

An imported US natural gas cogeneration power plant recently went on line at China's largest oilfield, Daqing. The 85-megawatt plant will use the field's excess natural gas to produce electric power and some of the byproduct steam will be reinjected into the wells to stimulate oil production. Daqing is an old field with a growing need for electric power to support water-injection techniques to maintain production. [redacted] The Chinese have purchased an identical plant for the Karamay oilfield in Xinjiang Province, and we believe there are good prospects for additional sales. [redacted]

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Vietnam Devalues Currency

[redacted]

Vietnam's devaluation of the official exchange rate from 15 to 80 dong per US dollar on 8 November will do little to restore the troubled economy. Although the move coincides with intensified efforts to implement a coherent economic reform program in preparation for the Sixth Party Congress in December, the black-market exchange rate is already more than 400 per dollar. Vietnam's leaders have been trying for the past year to reform the bureaucratic, corrupt, and overly centralized economy, but their piecemeal approach has succeeded mainly in spurring inflation and creating shortages of both consumer and producer goods. The leadership probably will replace numerous middle- and lower-level cadre at the Party Congress in an effort to spur the reform program, but prospects for restoring public confidence in the government's ability to manage the economy are dimmed by its dismal record to date. [redacted]

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