Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Directorate of
Intelligence

~~Secret~~

25X1

5 Articles
23 Briefs

File Copy
Do Not Remove

International Economic & Energy Weekly

25X1

12 December 1986

~~Secret~~

DI IEEW 86-049
12 December 1986

Copy 677

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Page Denied

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

25X1

International Economic & Energy Weekly

25X1

12 December 1986

iii	Synopsis
1	Perspective—East European Energy: Long-Term Dilemmas
3	Poland: The Gloomy Energy Outlook
7	Yugoslavia: Falling Oil Prices—A Mixed Blessing
11	Saudi Near-Term Oil Strategy
17	China: A Market Approach to Technology Diffusion
21	Mexico: Renewing Its Nonoil Export Drive
27	Briefs: Energy; International Finance; Global and Regional Developments; National Developments

25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1

25X1

Comments and queries regarding this publication are welcome. They may be directed to Directorate of Intelligence.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

25X1

International Economic & Energy Weekly

25X1

Synopsis

1 **Perspective—East European Energy: Long-Term Dilemmas**

25X1

East European energy officials undoubtedly are closely monitoring energy supplies as peak seasonal demand approaches. Occasional brownouts and sporadic fuel shortages can be expected during a normal winter, but harsher weather would produce severe disruptions in energy supplies to homes and industry.

25X1

3 **Poland: The Gloomy Energy Outlook**

25X1

Poland, one of the world's leading coal producers, faces an energy shortage brought on by stagnant, increasingly costly coal production, inefficient energy consumption, and unwillingness to cut hard currency coal exports to meet steadily rising demand. We believe that energy constraints will limit economic growth and contribute to declining trade performance during the next five years and threaten the regime's efforts to rebuild social accord through improved living conditions.

25X1

7 **Yugoslavia: Falling Oil Prices—A Mixed Blessing**

25X1

Yugoslavia has taken advantage of the oil price windfall mainly to boost oil imports and stimulate domestic performance rather than improve its hard currency balance of payments as Western creditors would probably have preferred. The short-term benefits of the fall in energy prices could give Yugoslav policymakers a false picture of the country's economic and financial position and ease pressures to address fundamental weaknesses.

25X1

11 **Saudi Near-Term Oil Strategy**

25X1

In our view, while Saudi Arabia's long-term oil market objectives remain intact, Riyadh's short-term strategy now emphasizes its revenue objective of maximizing earnings at higher and stable prices. Nonetheless, the loss of Oil Minister Yamani's experience and expertise will make Riyadh's petroleum policies more unpredictable at least over the near term.

25X1

17 **China: A Market Approach to Technology Diffusion**

25X1

China is attempting to increase the development and use of technology through a market in which technologies—both hardware and processes—are treated as tradable commodities. We believe that more progress in joint research and cooperation agreements between research and production enterprises will be needed before sustained economic growth through technological innovation is realized.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

25X1

21 **Mexico: Renewing Its Nonoil Export Drive**

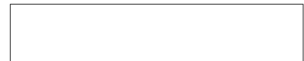
25X1

We believe that Mexico's traditional bias toward import substitution and protection of domestic industry will continue to constrain the President's ability to replace petroleum income with other exports.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5



25X1

International Economic & Energy Weekly

25X1

12 December 1986

Perspective

East European Energy: Long-Term Dilemmas

25X1

East European energy officials undoubtedly are closely monitoring energy supplies as peak seasonal demand approaches. After experiencing a critical energy crisis two years ago, the countries of the region have devoted more attention to stockpiling fuels and repairing power plants. Moreover, the startup of two nuclear reactors in Czechoslovakia and Hungary this fall and an end to drought-induced limits on hydroelectric generation in Yugoslavia and Bulgaria should augment energy supplies.

25X1

Even a successful stockpiling campaign cannot totally buffer the region against energy disruptions. Occasional brownouts and sporadic fuel shortages can be expected during a normal winter, but harsher weather would produce severe disruptions in energy supplies to homes and industry. Limitations on energy storage facilities leave little margin to cover surges in demand, and chronic bottlenecks in distribution systems often prevent energy from moving to areas of greatest need. Moreover, the region cannot depend on the USSR as much as previously, except possibly for natural gas.

25X1

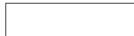
To avoid the annual concerns over winter energy supplies, the East European regimes must select some combination of strategies to reduce energy demand or boost supply. Each approach, however, poses intractable problems.

25X1

Efforts to promote conservation in the energy-guzzling, outmoded industrial sector face major difficulties:

- The regimes have always been reluctant to accept the difficult structural adjustment that using market-determined energy prices would entail.
- Adjustment to the debt problems of the early 1980s required sharp declines in investment—including expenditures on energy conservation—and the needs of such a program still far exceed available funds.

25X1

An alternative strategy is to boost the supply of energy. In this way, limited investment funds need only be focused on a few key sectors rather than diffused throughout the economy. Here there are several options. The nuclear route, despite Chernobyl', remains attractive because it diminishes dependence on either the USSR or other foreign oil suppliers, and reduces air pollution. Heightened concerns about safety, however, will raise the cost of the nuclear option as more safety mechanisms are installed and the plants are sited in more remote areas.


25X1

Another option is to cooperate on energy projects in the USSR. This approach also requires expensive investment in both oil and gas extraction as well as extensive pipeline networks. The regimes might be loath to subsidize the development of the

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Soviet oil and gas industry, especially now that world energy prices are so low. In addition, although the USSR has abundant natural gas, but Eastern Europe may be unable to bear the costs of restructuring their economies to substitute gas for oil and coal. 25X1

Frictions among the Soviet Bloc countries will complicate the implementation of long-term energy strategies. The regimes will tend to their own national interests first, frustrating efforts to develop regionwide solutions. Poor management of the CEMA power grid has already resulted in sharp disputes. One Hungarian official recently complained that Romania drew too much power from the grid last winter, making it hard for other CEMA countries to keep factories open and meet delivery commitments to non-Bloc customers. Exploitation of the Danube and other rivers will become a sore point as several countries vie for water for the competing uses of irrigation and power. Finally, because of Chernobyl', some regimes may not take kindly to CEMA partners building a nuclear plant near their border. 25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Poland: The Gloomy Energy Outlook

25X1

Poland, one of the world's leading coal producers, faces an energy shortage brought on by stagnant, increasingly costly coal production, inefficient energy consumption, and an unwillingness to cut hard currency coal exports to meet steadily rising demand. Warsaw's policies focus on the development of costly new energy sources and assign secondary importance to improved efficiency and conservation. As a result, Poland probably will seek to increase its energy imports from the USSR, but Soviet supplies are not likely to keep pace with Polish demand. We believe that energy constraints will limit economic growth and contribute to declining trade performance during the next five years. The possibility of worsening energy shortages also threatens to undermine the regime's efforts to rebuild social accord through improved living conditions.

Tightening Coal Supplies

The Polish economy runs on coal. In 1985 hard coal and lignite (a low-quality soft coal) accounted for 81 percent of total Polish energy consumption and 97 percent of electricity generation. Coal is also Poland's most important export, accounting for nearly 20 percent of hard currency export revenues in 1985. Hard coal production, however, has leveled off at 192 million metric tons since 1983. Plans call for production to stay at the same level for the next five years and to reach only 195 million tons by 1995. Polish mining officials cite the depletion of easily mined coal and more difficult geological conditions such as thinner seams and greater depths as the main factors in stagnating coal output and rising costs.

Because prospects for increased hard coal production are poor, Warsaw has begun to rely more heavily on lignite, especially for electric power generation. Lignite production has increased 53 percent since 1982, reaching nearly 58 million tons in 1985, and plans call for extraction of 74 million tons annually by 1990. Lignite production increased by 16 percent in the first nine months of 1986 and accounted for 30 percent of electricity generation. Growing environmental concerns, however, will limit lignite's role in filling the energy gap. The high cost of pollution control technology, for example, inhibits the broader use of lignite-burning power stations.

25X1

Other Sources of Energy

With no domestic alternatives to hard coal and lignite, Poland's demand for energy imports from the USSR will increase and require costly investment in equipment capable of transporting and using other energy sources. The extent to which the USSR can cover shortfalls in Poland, however, may be limited.

25X1

Poland currently receives 6 billion cubic meters (bcm) of Soviet gas annually, about one-half its total consumption, and plans call for Soviet deliveries to reach 7.4 bcm by 1990. Poland has begun receiving additional Soviet gas in exchange for coke exports and its participation in construction of the new Kobryn-Brest-Warsaw natural gas pipeline. Warsaw has also agreed to participate in the construction of the Yamburg gas pipeline, and will receive an additional 2 bcm annually in the 1990s as compensation. Despite the growing Soviet deliveries in 1985, gas still accounted for just over 7 percent of total energy use. Moreover, the high cost of conversion of industrial facilities will limit the use of gas as a substitute for coal.

25X1

25X1

Soviet oil deliveries, which account for more than 90 percent of Polish oil consumption, will at best maintain present levels during the current Five-Year Plan (1986-90). Poland imported 259,000 b/d of crude oil and about 46,000 b/d of petroleum products from the Soviet Union in 1985, slightly less than it received in 1980. Polish-Soviet trade plans call for Soviet exports to remain at about 260,000 b/d until 1990.

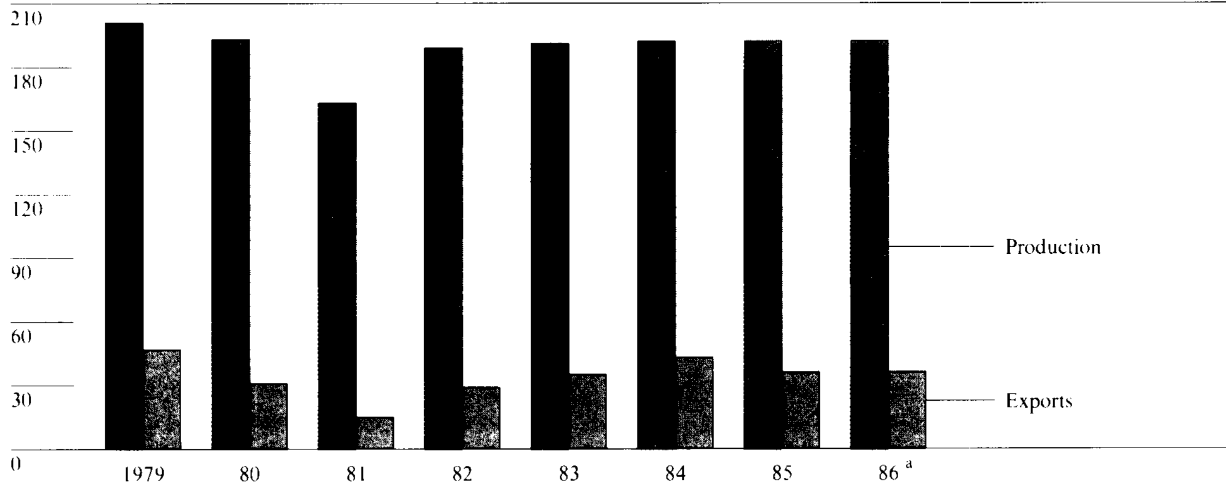
25X1

DI IEEW 86-049
12 December 1986

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Poland: Coal Production and Exports, 1979-86



[a] Planned.

311223 12-86

25X1

Poland purchases only a small amount of oil from Arab producers, and hard currency limitations will prevent Warsaw from taking advantage of currently low world prices. Ironically, lower world oil prices hurt Poland because they tend to depress competing demand and prices for coal. Although Warsaw's coal export volume increased by about 3 percent in the first six months of 1986, revenues have declined by about 16 percent, according to the US Embassy. A Polish Ministry of Finance official told the Embassy that lower prices for Polish raw material exports are a major factor in Poland's disappointing trade performance this year.

Poland expects to increase electricity imports from the Soviet Union in exchange for its participation in the construction of the Khmielnicki nuclear power complex in the Ukraine. Moscow may have difficulty honoring its electricity commitments in the wake of the Chernobyl' accident, however.

Warsaw is looking to nuclear power to meet the bulk of its future electricity needs, but construction delays and safety concerns in the wake of the Chernobyl' disaster have added to uncertainty over the contribution of nuclear power to the overall energy balance. According to a regional party newspaper, work on Poland's first nuclear plant was halted for several months this summer because of a shortage of high-quality building materials. Polish nuclear power experts are also reviewing monitoring and safety systems for the plant. The Poles are likely to seek additional outside assistance—probably from other CEMA countries—to address safety concerns and alleviate materials shortages, leading to higher import content and costs. Officials concede, however, that nuclear power will not make a significant contribution to Polish energy supplies before the late 1990s.

25X1

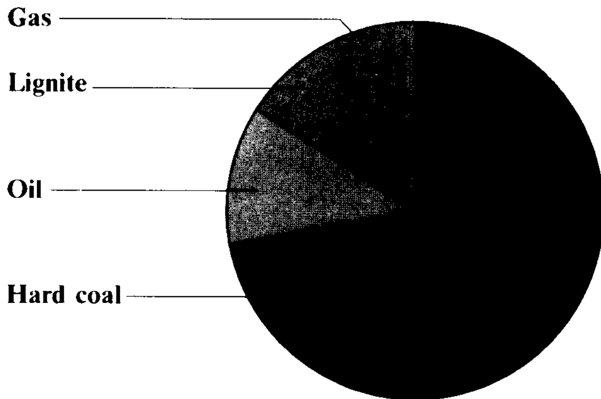
25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Poland: Primary Energy Sources, 1985 *Percent*



311224 12-86

Growing Demand

Projected increases in domestic energy production and imports appear insufficient to meet the growing demand for energy in industry and the household sector. The 1986-90 plan calls for industrial output to grow at an average annual rate of slightly more than 3 percent. Energy requirements will probably grow at least as rapidly because Polish industry is among Europe's least energy efficient. According to the official party newspaper, heavy industry uses 70 percent of total energy supplies while producing only 17 percent of national output.

The five-year plan calls for 10-percent growth by 1990 in the housing stock and a significant increase in electrical appliances. new housing units will require an additional 7-million-tons coal equivalent annually for heat and electricity, and electricity demand will grow more rapidly than supply, leading to a 2,500- to 3,000-megawatt deficit at peak demand times.

In addition to domestic demand, Warsaw needs to maintain a high level of coal exports for hard currency to fulfill its burdensome debt service obligations, to finance imports of modern capital equipment, and to meet heavy demand for Western consumer goods. Polish officials claim that domestic consumption takes priority over exports, but Warsaw cannot afford to reduce coal exports at a time when world coal prices, and thus export revenues, are falling.

25X1

The Search for Solutions

Warsaw's energy policy emphasizes large investments in new energy sources and production facilities and gives a backseat to energy conservation. Energy investment in 1986-90 is to increase by nearly 100 percent over 1981-85 with the opening of six new coal mines, construction of several conventional power and heating plants, participation in the construction of the Yamburg gas pipeline in the USSR, and the beginning of construction of a second nuclear power plant. While new investments are badly needed after the sharp drop in investment in the early 1980s, the program has drawn criticism from members of the Polish parliament for failing to promote restructuring of the economy and for providing inadequate incentives for conservation.

25X1

25X1

Warsaw has taken only limited measures to reduce wasteful energy use and gain tighter control over energy supplies. In April the regime increased retail prices for coal, gas, electricity, and central heating by 15 to 45 percent, and, according to the US Embassy, it plans to continue raising domestic coal prices over the next three years until they cover production costs. In August the government reduced coal allocations for farmers, who often sell their excess coal on the black market. In the most significant move to date, Warsaw last month raised producer prices for coal and coke in an effort to increase conservation and improve profitability in these heavily subsidized industries.

25X1

25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

In late September, Mining and Energy Minister Piotrowski, an army general who had been Minister since 1981, was replaced by Jan Szlachta, a coal mining specialist who brings needed expertise to this key ministry. Piotrowski's replacement may signal a shift toward increased emphasis on improved conservation and efficiency. Piotrowski was an advocate of rapidly increasing investment in energy production, and may have been removed for obstructing reforms in the mining and energy sectors. Nonetheless, Szlachta is unlikely to abandon Piotrowski's costly push for expansion of the coal mining sector.

25X1

Trouble Ahead

The conservation measures enacted by Warsaw to date will not lead to a significant reduction in energy demand or improvement in efficiency over the rest of the decade. Despite the consumer and producer price increases this year, according to one Polish economist, retail coal prices currently are only about 30 percent of production cost. The leading economic newspaper estimates that coal prices would have to rise by 20 percent annually to eliminate subsidies by 1990—given a gradual reduction in extraction costs. Ministry of Finance officials told the US Embassy that the regime plans to raise retail coal prices by 50 percent and producer prices by 25 percent next year, but Warsaw probably will proceed cautiously given public sensitivity to inflation. Moreover, Warsaw appears to be hesitant to cut energy subsidies and allow inefficient enterprises to go bankrupt.

25X1

Energy shortages are likely to be a major constraint on economic growth over the next few years. Poland will also be increasingly vulnerable to energy shocks triggered by bad weather. Consequently, Warsaw will have little choice but to continue to give priority to domestic coal consumption—limiting its ability to increase hard currency export revenues in the near term. Moreover, worsening energy shortages would add to consumer frustrations, depress work incentives, and undermine the regime's efforts to rebuild a social consensus through improved living conditions.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Yugoslavia: Falling Oil Prices— A Mixed Blessing

25X1

Yugoslavia has taken advantage of the oil price windfall mainly to boost crude oil imports and stimulate domestic performance rather than improve its hard currency balance of payments as Western creditors would probably have preferred. The drop in prices, however, has meant little relief for hard-pressed consumers, has probably resulted in reduced export earnings in key Middle East markets, and threatens to disrupt trade with the Soviet Union. Moreover, the short-term benefits of the fall in energy prices could give Yugoslav policymakers a false picture of the country's economic and financial position and ease pressures to address fundamental weaknesses.

Increased Linkages to World Markets

Through most of the 1970s the Yugoslav economy appeared immune to fluctuations in world oil markets. With the economy growing at a rate of 6 percent annually, consumption of crude oil rose from 147,000 b/d in 1970 to almost 321,000 b/d by 1979, replacing domestically produced coal as Yugoslavia's primary energy source. Domestic energy prices were kept stable, and few conservation measures were adopted. With the second oil shock in 1979, sharply higher oil import prices fueled inflation and exacerbated the country's worsening foreign payments problems. Subsequent restraints on oil imports led to gasoline rationing and contributed to periodic blackouts. In 1985 crude oil consumption remained more than 64,000 b/d below the peak 1979 level.

Despite efforts to become more energy self-sufficient, Yugoslavia has remained heavily dependent on imported oil. In 1985 oil imports of 175,000 b/d accounted for more than two-thirds of total crude oil consumption, or more than 20 percent of the country's total energy needs.

Prices and Terms Renegotiated

Since the first quarter of this year, Belgrade has negotiated lower oil import prices from its major suppliers, including the Soviet Union. Prices have fallen from an average of $28 per barrel in January to an estimated average of $12 to $14 by midyear. To tie prices more closely to world market trends, contract periods reportedly have been shortened, and Belgrade has purchased some oil on a net-back basis.

25X1

The reduction in oil prices, however, has not provided Yugoslavia with much more cash. Yugoslavia imports almost all of its oil under long-term compensation and barter agreements. Prices are fixed in dollars and linked to official OPEC prices. Iran, Iraq, Libya, and Algeria, for example, barter oil largely in return for Yugoslav goods and services—consumer items, machinery, and construction services. Libya and Iraq also barter oil for military arms and services. More than one-half of Yugoslavia's oil trade—either directly or indirectly—is with the Soviet Union and is conducted on a dollar clearing account in the context of total Yugoslav-Soviet trade.

25X1
25X1

Impact of Declining Prices

Yugoslav officials, while noting the benefits of lower oil prices, acknowledged earlier this year that a steep plunge in prices—below $25 a barrel—would harm foreign trade. They feared that Yugoslavia's oil-exporting trade partners would reduce their purchases of Yugoslav goods and services. To forestall such a drop in exports, Belgrade had two options: increase imports of oil and other goods from these countries, or reroute exports to new markets.

25X1
25X1

Belgrade's success in exercising its options has been mixed, varying by trading partners. Initial fears that Moscow would cut back on the level of Yugoslav

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

The Soviet Link

The USSR normally provides more than one-half of Yugoslavia's imports of crude petroleum, or about 40 percent of the country's total consumption. The Soviet share has remained relatively steady since 1981, when Yugoslavia's financial difficulties and the Iran-Iraq war left Moscow the dominant supplier. Purchases of Soviet crude oil in 1981-85 were valued at $6.2 billion, or about 40 percent of Yugoslavia's total imports from the USSR. The Soviet Union also supplies substantial quantities—28,000 b/d in 1985—of petroleum products to Yugoslavia.

The level of Soviet crude oil deliveries is fixed under annual and five-year bilateral trade agreements. The 1986-90 agreement calls for annual base deliveries of 111,000 b/d, compared with 90,000 b/d in 1981-85. The actual increase, however, is expected to be somewhat less. In recent years, Moscow has regularly granted Belgrade's requests for advanced deliveries of oil—most of which were not charged to the next year's quota—amounting to 20,000 b/d annually, a practice the Soviets say will end under the new agreement.

Yugoslav-Soviet trade is conducted on a dollar-denominated clearing account basis, with Soviet oil valued at official OPEC prices. Belgrade in return supplies Moscow with a variety of consumer goods, machinery and equipment, ships, and agricultural products. The arrangement has proved very favorable for Yugoslavia. It receives a guaranteed minimum level of crude oil at world prices in exchange for goods with a high domestic content that generally are not readily salable in Western markets.

Nearly all of the oil delivered under the bilateral agreement in recent years has been non-Soviet in origin, coming largely from Middle East producers. In 1985, for example, Middle Eastern suppliers accounted for virtually all of the 86,000 b/d of oil delivered to Yugoslavia on Soviet account. The Middle East oil is delivered largely in exchange for Soviet arms deliveries.

imports in 1986 to offset a growing trade imbalance appear unfounded. Both Moscow and Belgrade have asserted that the fall in prices is a mutual problem and will not lead to a reduction in the planned $5.5 billion trade level for 1986. To offset a growing Yugoslav trade surplus—initially projected at nearly $1 billion—Yugoslavia earlier this year agreed to increase its purchases from the Soviet Union by $500 million, and Moscow reportedly agreed to increase oil deliveries.

25X1

Efforts to maintain Middle East markets have been less successful. Exports of Yugoslav goods and services—including the signing of new long-term construction contracts—are believed to have fallen sharply this year. While we expect these countries to increase oil deliveries to Yugoslavia this year, we do not believe the increased volume will be sufficient to offset the drop in prices and support traditional levels of imports from Yugoslavia. These countries are trying to conserve oil reserves or find more attractive markets. In addition, some Yugoslav firms, disgruntled over redtape and tardy payments, have been reluctant to accept additional compensation in oil, opting instead to cut back on trade and new construction contracts.

25X1

25X1

25X1

The reduction in Middle East demand has not been offset by increased exports to developing countries and key West European markets, both of which have benefited from the fall in energy prices. Exports to hard currency markets were down 3 percent through October. Increasing protectionism and the mediocre quality of many Yugoslav goods are partially responsible, as are Belgrade's faulty trade policies. Yugoslav exporters and some officials blame the new foreign exchange law and an overvalued dinar for reducing incentives to export.

25X1

25X1

Little Help for the Balance of Payments

On paper the drop in oil prices is worth almost $1 billion to Yugoslavia. Belgrade is expected to receive an additional 60,000 b/d of oil (worth $350 million) in 1986, while reducing its total expenditures for oil by an estimated $650 million.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Yugoslavia: Imports of Crude Oil, 1981-86

Thousand b/d

	1981	1982	1983	1984	1985	1986 [a]
Total	**187**	**171**	**189**	**195**	**175**	**231**
Soviet	90	98	103	123	86	131
Of which:						
Direct	90	84	66	12	0	NA
From Middle East	0	14	36	111	86	NA
Middle East	96	72	86	72	88	100

[a] Estimated.

25X1

We estimate, however, that the net gain to Yugoslavia's hard currency balance of payments in 1986 will be much less, perhaps $200-300 million. More than one-half of the projected savings in oil expenditures will occur in clearing trade with the USSR, with little effect on hard currency payments. Moreover, the expected reduction in export revenues to the Middle East will offset a portion of the hard currency savings resulting from the reduced outlays for petroleum.

Belgrade could have further improved its hard currency payments position by reselling imported oil, but has apparently not done so. Lower oil expenditures are expected, however, to offset much of the deterioration in the trade account, producing a hard currency current account surplus in 1986 close to last year's $344 million.

Domestic Impact Mixed

Lower oil prices and increased supplies have clearly contributed to improved domestic economic performance. Growth rates are running ahead of both last year's rates and planned 1986 levels. Prices of petroleum products for industrial and agricultural use have been reduced significantly, restraining producer costs. Firms are reportedly well supplied with oil and gasoline stocks.

The consumer, however, has seen few direct benefits of lower petroleum prices. Record inflation at the retail level is running at a near-triple-digit pace. Retail prices of most petroleum goods, gasoline in particular, have not been lowered. Some officials fear that passing along lower costs would stimulate an upsurge in consumption. The difference between refinery and retail prices is slated to go to a special fund to support exports and agriculture. Price declines have been further moderated by long-term contracts and by the dinar's sharp depreciation against the dollar.

25X1

25X1

The impact of lower oil prices has varied widely by industry and region, threatening to further exacerbate large disparities in wealth. Those industries (electric power, food and chemical processing, and metal manufacturing) and those republics (Serbia, for example) that are large users/importers of petroleum have realized the greatest gains. In contrast, those industries that are less energy intensive and those republics that are large oil producers (such as Croatia) or heavily dependent on Middle East export markets (Montenegro, for example) haved fared less well.

25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Yugoslavia: Economic Indicators, 1985-86

	1985	1986
Gross social product *(percent)*	0.5	3.7 [a]
Industrial production *(percent)*	2.7	4.2 [a]
Producer prices *(percent)*	82.0	78.0 [b]
Retail prices *(percent)*	76.0	98.0 [b]
Personal consumption *(percent)*	0.0	4.0 [c]
Hard currency trade balance *(million US $)*	−1,771	−2,000 [d]
Hard currency current account *(million US $)*	344	340 [d]

[a] Data for January-October.
[b] Data for January-August.
[c] Estimated for January-October.
[d] Estimated.

Outlook

Lower oil prices on balance will continue to benefit the Yugoslav economy in 1987 but probably to a much lesser degree than in 1986. Increased oil stocks could permit Belgrade to reduce oil purchases next year, and lower prices should continue to help prop up domestic performance. The sharp, one-time stimulus from the steep price decline, however, is past, and several longer run factors could moderate any advantages:

- ***Declining Middle East Sales.*** Belgrade may lose further sales to Middle East markets. Alternative markets for specialized construction services are lacking, and Belgrade's ablility to penetrate new markets is limited. Depressed oil prices will probably further exacerbate payment and debt settlement difficulties with Libya and Iraq. Attempts to show more flexibility in trade and payment arrangements, such as seeking countertrade deals with third countries, are likely to be only partially successful.

- ***Lack of Domestic Reform.*** The gain from lower oil prices together with other favorable external factors—such as a weaker dollar and falling interest rates—could mask Belgrade's failure to address the economy's fundamental weaknesses and could ease pressure on the regime to pursue economic reforms.

- ***Continuing Soviet-Yugoslav Trade Imbalance.*** Moscow may cut back on its purchases of Yugoslav goods despite assurances to the contrary if Yugoslavia's trade surplus continues unchecked. Despite a series of high-level talks, trade difficulties apparently have not been resolved. 25X1 25X1 25X1 the Soviet Union would run a trade deficit of perhaps $500 million in 1986 and 25X1 25X1 as a result, bilateral trade next year could be reduced by $1 billion. Should this occur, Yugoslavia would be hard pressed to find alternate markets for industries highly dependent on the USSR. 25X1 25X1 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Saudi Near-Term Oil Strategy

25X1

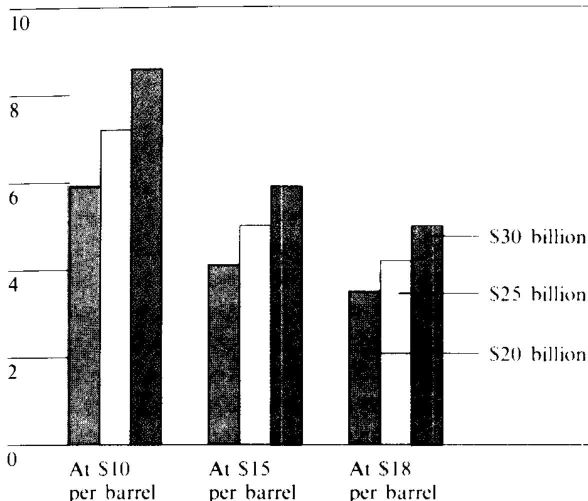
Despite King Fahd's decision to fire Oil Minister Yamani and seek an increase in oil prices to $18 per barrel, we believe the Saudis still base their oil policy decisions on a combination of economic, political, and security considerations:

- Increase near-term oil revenues to avert deep spending cuts and foreign reserve drawdowns.
- Capture a greater share of the oil market, preferably through producer cooperation.
- Ensure a growing long-term market for oil by making consuming countries more dependent on oil.
- Secure Saudi Arabia's dominant position within OPEC vis-a-vis Iran.

25X1

In our view, while Saudi Arabia's long-term oil market objectives remain intact, Riyadh's short-term strategy now emphasizes its revenue objective of maximizing earnings at higher and stable prices. The shift in emphasis stems mainly from Fahd's increasing concern about chronic budget deficits and growing criticism by senior princes and technocrats about fiscal mismanagement. Now that average world crude oil prices have fallen substantially from $28 per barrel, conditions that will improve the longer term outlook have largely been set in motion—world oil demand is higher and non-OPEC output has slowed. King Fahd probably believes that oil prices at $18 per barrel will ease Saudi revenue problems without endangering this year's favorable oil market trends. We believe, given current market conditions, Saudi Arabia will have a difficult time raising prices to $18 per barrel at least in the next six months. Moreover, the dismissal of Oil Minister Yamani—and the loss of his knowledge of the oil market and negotiating skills within OPEC—probably will make Riyadh's petroleum policies more unpredictable, at least over the near term.

Saudi Arabia: Crude Oil Production Necessary To Reach Selected Revenue Targets



311255 12 86

25X1

Revenues: Same Problem, New Approach

Fahd is concerned that current oil prices will not generate enough revenues for the upcoming fiscal year 1986/87 Saudi budget and does not want to draw down financial reserves much further. We estimate that liquid reserves are about $55 billion. Riyadh reportedly will announce projected government expenditures of about $40 billion, although actual spending will probably be less. Nonoil income is expected to provide some $10 billion, leaving about $30 billion in oil revenues needed to balance the budget. Over the next year, we believe Saudi oil strategy will be dominated by efforts to achieve this oil revenue target. The King's production and price goals of 5 million b/d and $18 per barrel would yield roughly this amount.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Other combinations of oil prices and output that would earn Riyadh close to $30 billion are probably less desirable from Fahd's viewpoint. At current prices or lower, for example, the Saudis would have to produce more than 6 million b/d to generate the revenue target. This would almost certainly trigger another price war, making it more difficult to achieve the revenue goal. If prices were to fall below $10 per barrel, the output necessary to earn $30 billion in 1987 might exceed current productive capacity.

Riyadh at the OPEC Meeting

King Fahd's apparent strategy for the OPEC session in Geneva that began 11 December is to encourage the group to adopt his price objective of $18 per barrel. He may have already succeeded; OPEC's price committee recently announced it would recommend that target to the full ministerial session in Geneva. Now that the target appears to be a common objective rather than merely a Saudi one, Riyadh is in a better position to ask the group to make the necessary production cuts to support this price. We expect acting Saudi Oil Minister Nazir will try to pressure other members to accept most of the burden through a 10-percent cut in overall OPEC output, according to US Embassy reporting.

Despite some positive signs going into the meeting, we believe the Saudis will have difficulty garnering strong OPEC cooperation in supporting prices. Some OPEC officials are billing the December meeting as perhaps the cartel's most difficult session ever, and any Saudi inflexibility would make agreement even more elusive. The Saudis probably will not be willing to make unilateral production cuts or resume the role of swing producer. If the group comes close to a realistic scheme to raise prices, however, Riyadh may be willing to lower output slightly if its share of OPEC production remains near the current 25 percent. Even this would be difficult for Fahd, because such an effort could result in a reduction in oil revenues.

Can Fahd Succeed?

In our judgment, based on our forecast of market conditions in 1987, OPEC will have a difficult time raising oil prices to $18 per barrel at least over the next six months. At current prices, we expect demand for OPEC oil next year as a whole to average near current OPEC production—including natural gas liquids—of about 19 million b/d. Low seasonal demand in the spring, however, will probably hold demand below 18 million b/d during the first half of 1987. Thus, if OPEC does not decrease output during this period, prices could fall considerably. Prospects of lower prices would probably lead to higher-than-anticipated stock draws, which would increase downward pressure on oil prices. We estimate primary oil stocks on land at the end of September stood at 4.3 billion barrels, about 200 million barrels above year-earlier levels. Under these conditions, a replay of circumstances in 1986 could evolve, with prices temporarily falling rapidly to as low as $10 per barrel.

25X1

25X1

In our judgment, to raise oil prices to $18 per barrel in the near term would require a decision by OPEC to hold down oil output. We believe the cartel needs to:

25X1

- Cut output by 1-2 million b/d from current levels early next year. This should boost prices during peak winter demand and create the expectation of higher prices for the rest of the year, thus discouraging a large stock draw. The group would also need to ensure strict compliance with the new guidelines to prevent price erosion.
- Seasonally adjust output. Further cuts in the spring would be needed to maintain the higher price.
- Abandon netback pricing arrangements if a fixed-pricing scheme is to be initiated.

In any event, these output decisions must be made early to avoid excessive speculation and market volatility.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

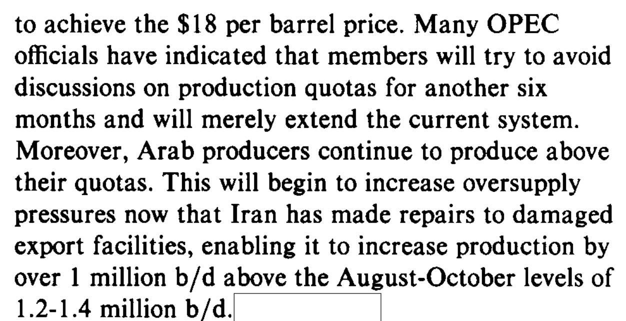
Key Indicators of Saudi Oil Strategy

If King Fahd is serious about pursuing a price support strategy in coming months we would expect the Saudis to begin taking more concrete actions that could be detected both in OPEC forums and in the marketplace. So far, we have seen no firm indications that Riyadh is ready to make such a commitment. We have identified, below, actions that would provide advanced notice whether the Saudis are indeed willing to support prices, or whether they see higher prices as an eventual goal, and will seek to sustain market share as the best way to maximize revenues.

Price Support Approach	***Market Share Approach***
Phase out netback contracts and encourage the same from other members.	*Continuation of netback contracts, or renewal of discounts to maintain export volume.*
Reduce Saudi oil production toward its quota of 4.35 million b/d.	*Sustain Saudi output at or near current levels of 5 million b/d.*
Increase bilateral contacts with Persian Gulf producers, including Iran.	*Remain inflexible, using a take-it-or-leave-it attitude at December's OPEC session.*
Maintain pragmatic, flexible position at OPEC meetings.	*Leave Geneva with a weak or unsound agreement, postponing discussions on difficult issues.*
Make legitimate attempt to agree on fluctuating OPEC ceiling, individual quotas, and on crude oil price differentials.	*Increase security measures at key oil installations. Maintain technical ability to raise output within a wide range.*
Support Iranian insistence that Iraq be included in OPEC quota system.	

25X1

Little Help From Other OPEC Countries. Despite endorsement of higher prices, other OPEC countries do not appear prepared to take the steps necessary to raise and hold prices near $18 per barrel. On 10 December several OPEC delegates indicated publicly that they believe OPEC had little chance of reaching agreement on a new production allocation scheme during the current meeting. Some OPEC country officials have reported that they believe it is too early—because of market conditions—to try to reach the price objective, while others reportedly believe that a reduction in the group's output is unnecessary



to achieve the $18 per barrel price. Many OPEC officials have indicated that members will try to avoid discussions on production quotas for another six months and will merely extend the current system. Moreover, Arab producers continue to produce above their quotas. This will begin to increase oversupply pressures now that Iran has made repairs to damaged export facilities, enabling it to increase production by over 1 million b/d above the August-October levels of 1.2-1.4 million b/d.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Saudi Arabia: Crude Oil Production and World Average Oil Prices, August 1985-November 1986

Note change in scale

Crude Oil Production[a]

World Average Crude Oil Prices

[a] Includes Neutral Zone production.

311256 12 86

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Implications

Despite the King's desire for price stability, we believe the market over the next six months or so will return to the volatility experienced in the first half of this year, with prices averaging $10 to $14 per barrel. How far prices fall will depend on what the Saudis do after the OPEC meeting. Because OPEC is unlikely to take the steps necessary to hold down output, probably the best revenue option available to Riyadh is to continue producing at least 5 million b/d and allow prices to erode somewhat during the next several months. Although this would temporarily yield oil export revenues at an annual rate of less than $25 billion, the alternative—substantially boosting output—would push prices well below $10 per barrel, and make matching even this level of earnings very difficult. Nevertheless, the King may decide to pursue the latter route to teach other OPEC members that lowering output to support higher prices is less painful financially than a price war. 25X1

In the less likely case where the Saudis decide to compromise at the OPEC meeting and OPEC countries agree to lower output by about 1 million b/d, prices could rise to the $15 to $18 range in the near term. After midyear, if OPEC kept output near 18 million b/d, prices would probably remain above $15 per barrel. 25X1

We believe the King's objectives are more easily attainable after next year. Market forces will continue to work in OPEC's favor. Increased demand and flat or declining non-OPEC output will boost demand for OPEC oil. If the cartel keeps output near current levels, we believe prices could rise to near $18 per barrel by early 1988. 25X1

While we believe considerations about Iran have played a relatively minor role in Saudi oil policy in the past, the role of the Iranians in the future is less certain. 25X6

25X6

25X6 Fahd has been able to avoid a confrontation with Tehran so far, and, for the near term, he probably will do little to dispel Iran's perception that Fahd's support of higher prices and Yamani's dismissal were conciliatory gestures to Iran. Any alliance between the two at the meeting, however, probably will hinge, in large part, on Riyadh's position on Iraqi production. Nevertheless, Riyadh probably will oppose an expected Iranian move to include Iraq in any new allocation scheme. Any OPEC production accord will be complicated by the substantial increase in Baghdad's export capacity expected in mid-1987. Any Saudi unwillingness to address this issue could indicate that Riyadh is not seriously committed to sustaining higher prices. 25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

China: A Market Approach to Technology Diffusion [1]

25X1

China is attempting to increase the development and use of technology through a market in which technologies—both hardware and processes—are treated as tradable commodities. Initial market activities suggest mixed results. Beijing is disappointed, for example, that most transactions involve low-level technology sold to smaller enterprises. But China also claims that transactions through the new technology market have improved production and increased economic productivity. We believe that more progress in joint research and cooperation agreements between research and production enterprises will be needed before sustained economic growth through technological innovation is realized. In addition, overreliance on market-oriented research is shortchanging the basic research needed for innovation in the long run.

Learning To Manage the Technology Market

China is counting on technology to transform its aging industries and boost production, but lack of incentives and procedures for diffusing technology have kept research achievements from being used effectively—or at all—in the past. To improve the contribution of science and technology to economic growth, Beijing has encouraged greater commercial exchange of technology within China. According to statements by Chinese officials, this technology market is intended to introduce new technologies, both domestic and foreign, and facilitate their transfer to industry—particularly to medium- and large-scale enterprises. Beijing further expects the technology market to promote the rational flow of knowledge and personnel and to improve the quality of Chinese products for both domestic and international consumption.

implementation of measures to spur technology trade has encountered several problems. Beijing is having difficulty resolving the issue of how to place a value on technology that satisfies ideological concerns and, at the same time, provides incentives for technology development. One S&T official suggested that price should depend on the economic results from applying the technology to production, while the party's theoretical journal called for laws preventing "technology monopolies, waiting for a good price to sell, and other indecent tendencies."

25X1

Sales of unreliable technologies, selling technologies for excessive profit, plagiarizing technologies, fraud, and broken contracts have alarmed Beijing and discouraged potential technology buyers. Chinese officials report that these problems caused a sharp decrease in the number of technology transactions during the first half of 1986 compared with the same period in 1985. Moreover, some universities and research institutes have resisted the directive that personnel be permitted to earn additional income through work on outside projects in their spare time by refusing to allow them to keep the money. Also, managers whose products already are in great demand fail to see the need for improving either their product or production processes.

25X1

25X1

To alleviate these problems, Beijing is creating new oversight groups and drafting legislation covering pricing, contracts, and other aspects of technology development and sales. Beijing may find it difficult, however, to balance the need to curb market abuses with the need to provide adequate incentives for technology transfer. The proliferation of groups involved in managing technology trade also raises the potential for greater managerial confusion. Nonetheless, we believe that many of these initial problems will lessen as organizations gain experience in the market. Because Beijing's continuing economic reforms provide additional incentives for technology innovation, more enterprises should be interested in applying technology to industrial problems.

25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

China's Technology Market

Beijing has adopted policies that allow market forces—supply and demand—to influence technology development and sales. The goal is to use technology to spur economic growth and development by channeling research results into production. Until recently, state authorities dictated what research was to be done and who would receive the results. Results were turned over to the factory for which they were intended at no cost, but generally not made available for use or sale to others. No one was responsible for determining how useful the research had been; according to Chinese officials, most research was never used.

Who is involved? *Research institutes, civilian and military factories, individuals, foreign firms, industrial ministries, and state commissions. Beijing is now requiring most research institutes to become self-supporting, forcing them to look to industry for contracts. Factories are also encouraged to seek new technology to improve production. Small and medium-sized Chinese enterprises have been most active in technology transactions, but large factories, individuals, and foreign firms also develop and sell technology. Most of the technology transactions reported in the Chinese press refer to indigenous technology, but foreign firms are also involved in the technology market through technology sales and participation in joint research projects. Central government organizations oversee market activity.*

How does it work? *Technology development and exchange activities are conducted through: technology fairs or exhibits; joint research projects involving research and production units; sales of the rights to use a technology; joint ventures for the production of a new product; contracts for technical services; technology shareholding, in which a research institute helps manage a new technical process in a factory in return for a share of the output value; personnel exchanges; and training.*

25X1

What kind of technology? *Technologies traded range from food-processing equipment to production technology for pulp board to microprocessor-controlled instruments. The market stimulates sales of: equipment, such as precision temperature gauges for the metallurgy industry, or a production line for making components for video recorders; processes, such as the use of cementing techniques for artificial marble; and methodologies, ranging from how to conduct feasibility studies for technologies to ways of improving quality control.*

25X1

25X1

Where are market activities conducted? *Throughout China; over 3,000 technology fairs were held in 1985 alone. Some organizations have established permanent sites for fairs or exchanges; other forums are temporary.*

25X1

25X1

Market Performance: The Disappointments . . .

Initial activities suggest the market is not meeting several of Beijing's major goals, although some benefits are occurring.

Low-Level Technology. Despite the dramatic increase in the number of technology transactions, most have involved relatively low-level technology related to daily life rather than more advanced innovations needed to promote industrial development. Chinese journals and foreign observers suggest that both buyer and seller often look for a technology that can be applied quickly and with little effort, and tend to avoid advanced equipment and processes that require more effort to integrate into an existing facility. Some of the items displayed at technology fairs—such as herbal cigarettes—would not qualify as technological achievements outside China.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Technology Transactions: What's in a Number?

Reliable totals for the value and volume of technology transactions through all of China's trade forums are unavailable; estimates are contradictory and misleading. State Science and Technology Commission Chairman Song Jian, for example, said the value of technology transfers in 1985 exceeded 2.3 billion yuan ($720 million), a threefold increase over 1984. For one national technology trade fair in 1985, however, the Chinese press reported transactions totaling 8 billion yuan ($2.5 billion). These numbers are often inflated by including tentative arrangements such as letters of intent and agreements in principle. Provincial reporting frequently overstates much of the activity that swells national totals. One article, for example, reported on a so-called technology fair held during the annual mule and horse fair; technology sales figures apparently included purchases of wheat, sugar, and logs.

Few Large Enterprises. Most contracts for research have come from smaller enterprises, which have limited resources to pay for outside assistance; the large enterprises Beijing sees as priority areas for technological transformation tend to rely on in-house research staffs rather than establishing cooperative links to new sources of technology. Managers also are concerned that implementing a new technology will adversely affect production; they are judged on short-term output and profits, while improvements based on technology may be demonstrated only over the long term. Beijing plans to give 1,000 large and medium-sized enterprises special tax benefits to encourage their participation in technology transformation.

Limited Personnel Transfers. mobility of S&T personnel—an important means of transferring technology—remains a sensitive issue. Job centers and exchanges are able to match talented people with prospective employers, but home organizations are reluctant to let skilled workers go. Additional prodding from Beijing apparently is necessary to complete job transfers.

. . . And the Benefits

On the positive side, we believe the market overcomes some of the defects of relying heavily on the government for the management of S&T, and offers certain benefits:

- Increasing the diffusion and application of research results, particulary in rural and border areas that desperately need technology.
- Stimulating the development and use of technology needed by industry.
- Promoting awareness of the need to choose technologies carefully, with improvements in planning for technology development and use, at least at the national level.

The market has led to some import substitutions, with savings of foreign exchange, and Beijing expects exports of technology to result as well.

25X1

Beijing publishes glowing reports on the effect of commercial technology transfers on production. Some gains undoubtedly have occurred, although we do not know how China counts technology items, determines a causal link between a technology and an increase in output, or measures the economic impact. Many of the successes reported in the Chinese press may refer to quick fixes that produce immediate results because of the poor technology base in many factories; but transfers of the low-level, often inefficient, older technologies involved in most market transactions probably contribute only very modest economic gains. Progress in joint research and cooperative agreements between Chinese organizations, and implementation of the many technology transfer agreements signed with foreign firms in recent years, will be needed before sustained economic growth through technological innovation is realized, in our view.

25X1

25X1

25X1

Forecast for the Technology Market

25X1

25X1

For the technology market to develop into an important tool for stimulating significant technology development, transfers, and use, more encouragement and guidance from Beijing are needed. Additional measures—such as the establishment of pilot facilities to

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

test technologies and tax reductions for technological transformation—probably will be needed to encourage the participation of larger enterprises and to stimulate projects involving the more advanced technology needed to boost industrial development.

25X1

In the long run, we believe reliance on the market poses several risks for Beijing. Overemphasizing market-oriented research on consumer goods is seriously shortchanging basic research needed to support innovation in the future. The opportunity to earn extra income by engaging in market activities is also diverting some of China's most talented people—including students trained abroad—from teaching responsibilities, raising the possibility that China's already weak educational system will increasingly be unable to provide an adequate supply of well-trained scientists and technicians.

25X1

What US and Western Suppliers Can Expect

The market offers foreign firms new forums for exhibiting their wares. In addition, as Chinese firms increase their familiarity with technology transferred through the market, they might become more realistic about the transfer process and more knowledgeable partners in joint ventures. On the other hand, as Chinese firms gain experience with problems involved in technology transfer—including large initial capital outlays or temporary disruptions of production—they probably will exert additional pressure on potential foreign partners to bear more of the burden. China also intends to reduce duplication of imports by promoting awareness of technology already available within China, which may shrink opportunities for selling China some technologies over the long run.

25X1
25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

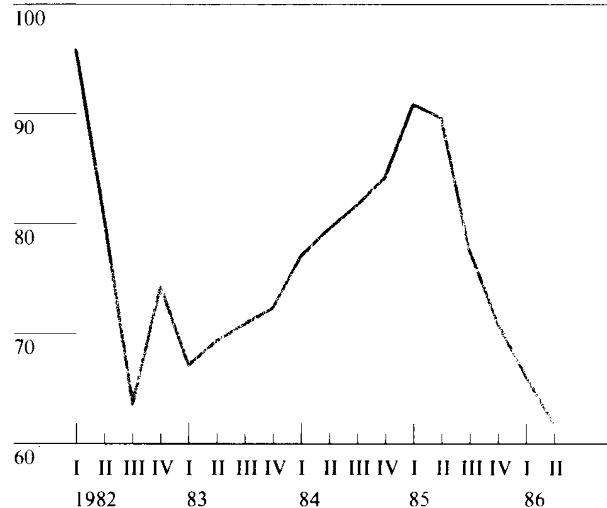
Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Mexico: Renewing Its Nonoil Export Drive

25X1

We believe that Mexico's traditional bias toward import substitution and protection of domestic industry will continue to constrain the President's ability to replace petroleum income with other exports. Despite President de la Madrid's commitment dating back to 1982 to open the economy to increased trade, everyone, including Mexico's foreign creditors, have concentrated almost exclusively on Mexico's ability to increase petroleum exports and reduce imports. Initial attempts at maintaining a competitive exchange rate, eliminating regulatory barriers, and providing financial credits quickly dissipated in early 1984 as the domestic economy recovered and election politics derailed pressures on businessmen to become internationally competitive. Now, however, with Mexico's recent entry into GATT and a pledge of up to $500 million in World Bank loans to promote nonoil exports, the focus has shifted back. Even though Mexico City again appears to be making significant progress in encouraging exports by undervaluing the peso, giving exporters preferential access to credit, and allowing exporters to retain foreign currency earnings, we believe that many of the same roadblocks are likely to obstruct the President's efforts to build on this momentum.

Mexico: Real Effective Exchange Rate, 1982-86



311277 12-86

25X1

De la Madrid's Initial Efforts

In 1982 de la Madrid began to implement his plan to boost nonoil exports. His commitment was reinforced by the need to implement an IMF-supported program and to improve Mexico's trade balance:

- The peso was sharply devalued in 1982 and some of the more onerous foreign exchange restrictions were eliminated.
- Regulations covering export licenses were gradually liberalized and export tariffs were reduced or eliminated.
- The budgets of Bancomex, the foreign trade bank, and FOMEX, the government's export promotion fund, were sharply increased to provide additional loans to private businesses.

25X1

De la Madrid's program together with a strong rebound in US economic growth achieved positive results during the early years of his term. In 1983 nonoil merchandise exports grew 32 percent from $4.8 billion in 1982 to $6.3 billion. Manufactured exports exhibited the most impressive gains, indicating that the President's program to revive private industry and provide incentives for export was working. Nonoil exports rose a further 21 percent in 1984.

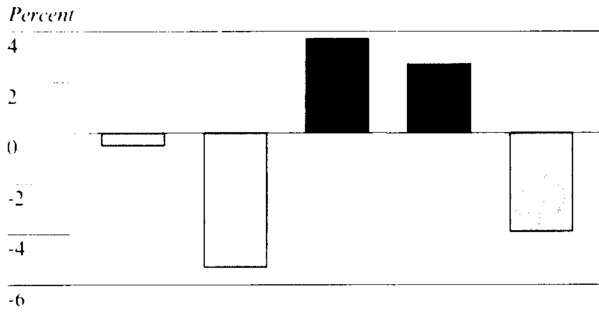
25X1

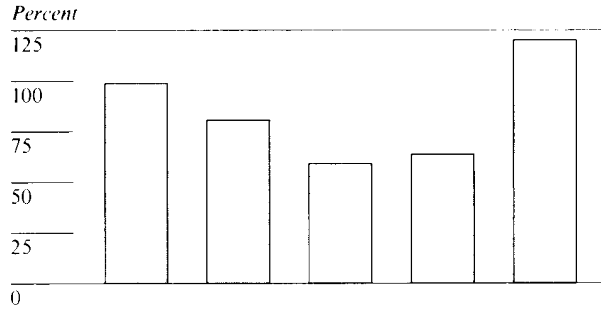
Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

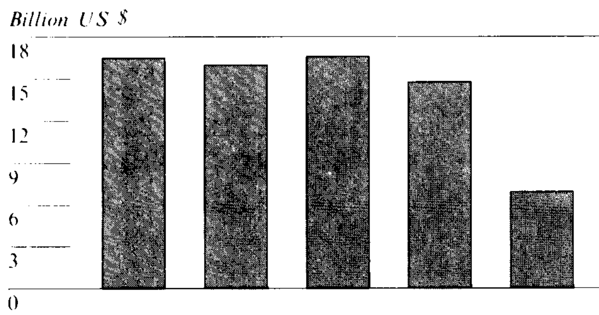
Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

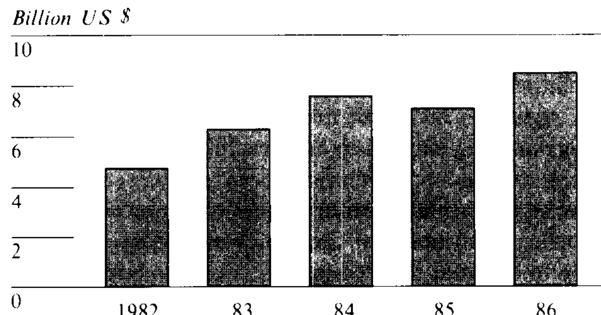
Mexico: Selected Economic Indicators, 1982-86

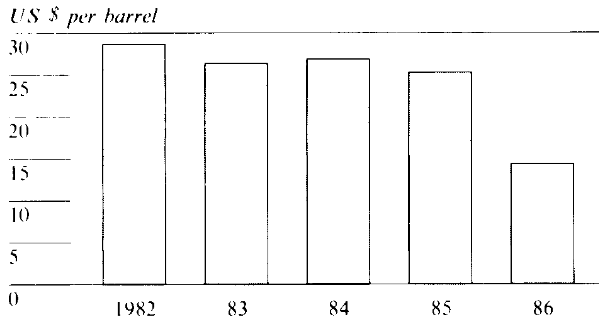
Note change in scale











311216 12 86

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Mexico's Current Account Balance, 1984-88

Million US $

	1984	1985	1986	1987 [a]	1988 [a]
Current account	**4,238**	**542**	**−1,240**	**−1,160**	**630**
Trade balance	12,942	8,406	3,706	4,250	5,370
Merchandise exports	24,197	21,866	15,506	17,250	19,670
Petroleum	16,602	14,767	6,987	8,090	9,590
Other	7,595	7,099	8,519	9,160	10,070
Merchandise imports	11,255	13,460	11,800	13,000	14,300
Public sector	4,790	4,354	4,300	5,200	6,200
Private sector	6,465	9,106	7,500	7,800	8,100
Services balance	−8,704	−7,864	−4,946	−5,410	−4,730
Interest payments	11,716	9,917	7,549	8,410	8,130
Public	9,337	8,012	6,119	7,050	6,970
Private	2,379	1,905	1,430	1,350	1,160
Maquila [b]	1,155	1,282	1,442	1,620	1,820
Net tourism	1,304	1,052	1,350	1,490	1,600
Other	553	−281	−189	−110	−30

[a] Projected.
[b] Income earned from the border assembly operations.

25X1

Political Backsliding

Despite the initial success of the program, pressure began mounting from business and labor groups to pursue a path of domestic economic growth, cap inflation, and slow the government's move to reduce protection of domestic industries. As Mexico began gearing up for important local and gubernatorial elections in 1985, the President increasingly placed added emphasis on these domestic considerations:

- As the economy began to grow in late 1984 and early 1985, domestic producers once again turned back to producing for the more lucrative domestic market.

- Quotas continued to protect most industries against competition from imports, allowing prices of most of Mexico's tradable goods to rise even faster than the general price level, making them less competitive overseas.

- Mexico's exchange rate became increasingly overvalued during this period as government officials sought to stem the inflationary impact of previous devaluations, further reducing the attractiveness of the country's exports.

25X1

Meanwhile, economic growth among Mexico's major trading partners had turned sluggish. Despite a new program in April 1985 to give import preference to exporters and provide direct financing for export goods, nonpetroleum exports dropped almost 7 percent by yearend to slightly more than $7 billion.

25X1

Reviving the Trade Issue

The dramatic drop in Mexican petroleum revenues during the past year and a half has refocused de la Madrid's attention on the need to boost nonoil exports. In a show of support for Mexican exporters, the

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Mexico's Export Base

Mexico has traditionally exported a wide variety of goods, although oil began to dominate earnings after the mid-1970s. We believe that future expansion in nonoil exports will depend largely on manufactured goods. Based on past trends and current policy directions, auto parts and engines, electronic and mechanical equipment, processed foods, chemicals, telecommunications equipment, synthetic fibers, and possibly small computers will grow fastest. Border assembly plants, which export finished products under special tariff concessions, have particularly strong export potential, as long as favorable US tariffs are not rescinded. Domestic agricultural policy and external constraints will hinder the growth of food exports, although sales of coffee, cocoa, beef, and shrimp should rise. Most of the increase will be directed toward the United States, which purchases about 80 percent of Mexico's nonpetroleum exports.

President has moved decisively on a number of fronts. Late last year, Mexico City successfully negotiated a bilateral agreement with the United States—which purchases 60 percent of Mexico's exports—sharply increasing Mexican access to US markets in return for Mexican promises to eliminate unfair export subsidies. In August of this year, Mexico formally became a member of GATT in spite of objections by smaller, less efficient domestic producers. In addition, Mexican economic officials earlier this year again introduced comprehensive inducements to urge domestic producers to divert resources toward the export market:

- More than $4 billion in public funds was earmarked for the Mexican Foreign Trade Bank to help finance companies moving into the export market.
- Measures were announced allowing exporters to retain foreign currency earnings, rather than turning them over to the government.
- Exporters have been given preferential access to domestic credit lines and foreign exchange allocations, as well as being granted exemptions from domestic taxation and bureaucratic procedures.
- Mexican Central Bank officials have kept the peso undervalued, thus making Mexico's exports more competitive internationally.

25X1

The results have been impressive. Nonpetroleum exports have risen 20 percent since last year. Although the bulk of the increase has been in agricultural goods, up 50 percent, exports of manufactured goods also rose by a healthy 25 percent. While much of the rise can be attributed to shrinking domestic demand and a good harvest that has made more goods available for export, government financial inducements and devaluation of the peso also have played a major role,

25X1

Dim Prospects for Continued Progress

De la Madrid's ability to sustain the momentum of these initiatives will depend largely on his capacity to gain the confidence of the private business sector. while some Mexican businessmen are responding to the President's programs, many are reluctant to make a long-term commitment because they consider government incentives to be only temporary. Many businessmen still complain that lack of domestic credit and high interest rates are preventing them from making the kinds of investments needed to become internationally competitive. Moreover, US Embassy reporting indicates that businessmen are not convinced that Mexico City is dedicated to providing the financial support and stable economic environment needed to induce large investments in export-oriented production.

25X1

25X1

So far, de la Madrid has not made great strides in attracting foreign investment needed to bring in new technology and capital to help make Mexico's industries more competitive. Government officials have been reluctant to make changes in the country's restrictive foreign investment laws to encourage new international ventures. In addition, recent regulations boosting the domestic content of products manufactured by foreign companies—in many cases this requires these companies to establish supplier firms in Mexico—has substantially hiked the costs of investment.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Public- and private-sector commitment to boosting nonoil exports probably will slip again as Mexican officials move to stimulate the domestic economy in 1987 and 1988. As the economy grows, Mexican businessmen—who have been using excess industrial capacity to raise exports—are likely to trim overseas sales to supply domestic demand. Faced with the specter of triple-digit inflation during the period, economic policymakers may be tempted to slow the depreciation of the peso and maintain relatively tight controls on domestic credit. As the 1988 presidential election draws near, we predict that credit allocations to domestic industries are likely to be used more as a political tool—rather than going to companies with the highest export potential.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Briefs

Energy

Spot Oil Market Developments

Spot oil prices fluctuated within a narrow range in the two weeks preceding the December OPEC meeting. North Sea Brent and West Texas Intermediate crudes are now selling at about $14.60 and $15.00 per barrel, respectively. The average world oil price is now about $14.25 per barrel. Stable prices have benefited a number of non-OPEC producers by keeping their export prices competitive with spot quotes. Egypt, for example, has seen its production rebound to over 900,000 b/d from a summer low of 600,000 b/d. UK production, however, has temporarily declined by about 300,000 b/d because of a pipeline leak in the North Sea. OPEC production will be the key in determining prices over the next several months. The group's output, which continues to exceed the November quota level by over 1 million b/d, would have to be cut within the next few months to push prices up to the Saudi $18-per-barrel target.

25X1

25X1

New Kuwaiti Export Pipeline

Kuwait has signed a turnkey agreement with a US firm to construct a 500-kilometer, 42-inch pipeline that will join the Saudi East-West crude oil export pipeline. The pipeline, expected to be completed by late 1987, will have a capacity of 1 million b/d and will cost approximately $1.4 billion. The connection to the Saudi East-West pipeline will enable Kuwait to divert nearly all of its crude exports to the Red Sea, reducing the opportunity for Iranian air attacks on its crude carriers in the Persian Gulf. Kuwaiti exports of petroleum products, which account for at least half of current sales, will still have to transit the Persian Gulf. The new line will give Kuwait greater flexibility in its export options, but it will not increase the total amount of oil exports available through the Red Sea terminal at Yanbu' al Bahr.

25X1

25X1

Soviet Chernobyl' Units Operating Intermittently

TASS reported this week that units at the Chernobyl' nuclear power facility had returned to normal operation: unit 1 is reported to be working at full capacity, unit 2 at 50-percent capacity units 1 and 2 were shut down, suggesting the major problems that have plagued these two units since October have not been resolved. The units have operated only intermittently since then, A number of possible conditions might be preventing the Soviets from restoring units 1 and 2 to full service. Corrosion problems may have occurred during the six-month shutdown. The outages may also be related to modifications—needed at all 14 Chernobyl'-type reactors—being made at the plant to prevent a recurrence of the accident. The Soviets may also have experienced unacceptably high levels of radioactivity in contaminated water from the cooling pond. For each month those units are down, the total supply of electricity is reduced by about 1 percent—a loss that other Soviet power plants cannot make up during peak winter demand.

25X1

25X1

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

International Finance

Latin America Increases Debt-Equity Swaps

Latin American governments gradually are expanding the programs for converting some of their large outstanding foreign debt into equity. Under such programs, foreign creditors either trade their US dollar debt to Latin central banks for local currency for use in purchasing equity or they sell the debt at a discount to other interested foreign or domestic investors who similarly intend to acquire equity in local enterprises. Chile and Mexico so far have implemented the most successful swap programs in the region by offering investors especially attractive terms. Each probably will convert nearly $1 billion of its foreign debt by the end of 1986, . The Brazilian Government has been studying ways to liberalize its rules for debt-equity swaps since early this year, and its recent approval of foreign investment in the Brazilian stock market may be a significant step in that direction. Argentina has drafted a tentative swap scheme and, according to the financial press, may relax some of its constraints on investors before enacting the program. Ecuador, too, is considering regulatory changes needed to permit debt to equity conversions. Despite the growing appeal of these arrangements, swaps are not likely to lead to a major reduction of Latin foreign debt until debtor governments ease foreign investment restrictions and create more stable economic policy climates for investment.

25X1

25X1

25X1

Financial Communications Systems Delayed

An upgrading and expansion of the world's largest international financial communications network—SWIFT (Society for Worldwide Interbank Financial Telecommunications)—has been delayed for the third time at least until fall 1987. SWIFT—which carries more than 800,000 messages a day between some 2,100 banks in 47 countries and is growing at 20 percent per year—was to be replaced by SWIFT II beginning in March 1987. SWIFT II will expand the capacity of the system, upgrade encryption, and introduce a distributed communications and computer network that will allow most bank-to-bank communications to continue even with the loss of key facilities. As network traffic levels approach SWIFT's message-handling capacity, the network is becoming more vulnerable to disruptions. Lacking a distributed network structure, SWIFT I routes all bank communications through one of three operating centers—the loss of any one could cause a network shutdown.

25X1

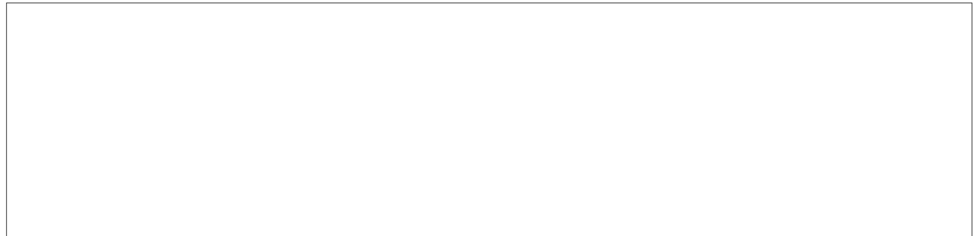
25X1

Global and Regional Developments

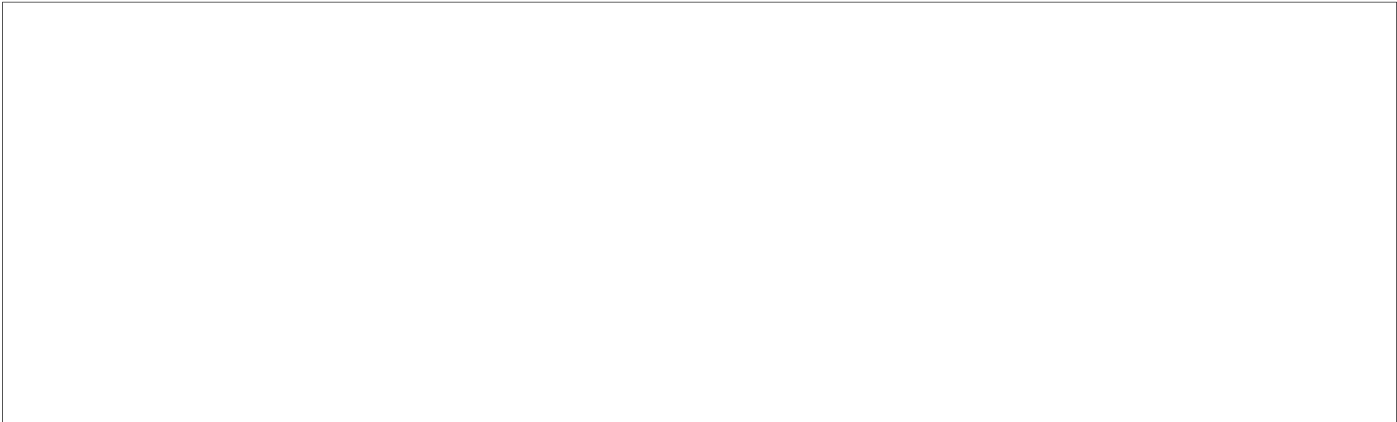
25X6

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

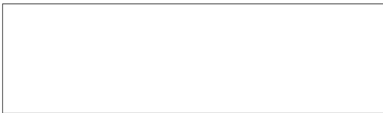


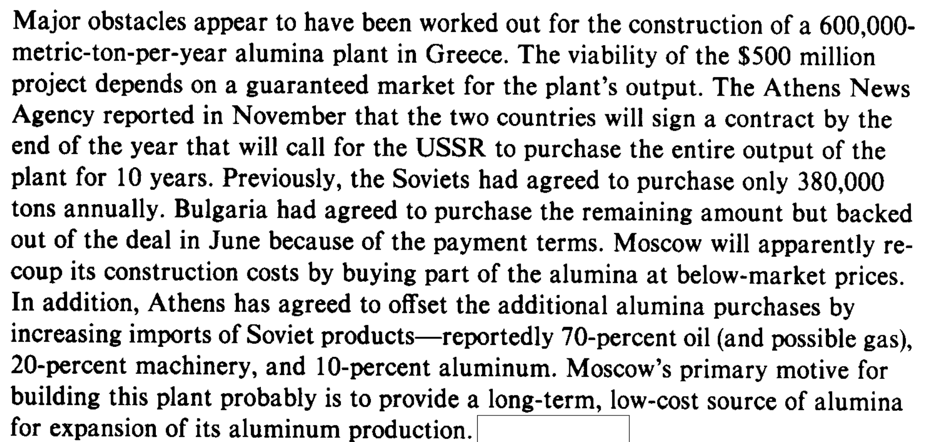
25X6



25X6

Impasse Solved on Soviet Alumina Plant in Greece





Major obstacles appear to have been worked out for the construction of a 600,000-metric-ton-per-year alumina plant in Greece. The viability of the $500 million project depends on a guaranteed market for the plant's output. The Athens News Agency reported in November that the two countries will sign a contract by the end of the year that will call for the USSR to purchase the entire output of the plant for 10 years. Previously, the Soviets had agreed to purchase only 380,000 tons annually. Bulgaria had agreed to purchase the remaining amount but backed out of the deal in June because of the payment terms. Moscow will apparently recoup its construction costs by buying part of the alumina at below-market prices. In addition, Athens has agreed to offset the additional alumina purchases by increasing imports of Soviet products—reportedly 70-percent oil (and possible gas), 20-percent machinery, and 10-percent aluminum. Moscow's primary motive for building this plant probably is to provide a long-term, low-cost source of alumina for expansion of its aluminum production.

25X1

25X1

National Developments

Developed Countries

Japanese Growth Slows in Third Quarter

The Economic Planning Agency reported last week that real GNP growth slowed to 0.6 percent in the third quarter—a drop from the 0.9 percent recorded in the previous three months. The slowdown stems largely from a reduction in government inventory accumulation—following a runup in the second quarter when Tokyo was purchasing gold to mint coins commemorating the 60th anniversary of

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

the emperor's reign, a fall in export volume, and a slowdown in government capital spending. The deteriorating economic picture, while disappointing to Tokyo, is probably not severe enough to generate a shift in the government's commitment to fiscal austerity over the next few months. Moreover, the budget for FY 1987, which begins on 1 April, will be finalized within the next few weeks.

25X1

Japan Refines Recommendations for Boosting Domestic Demand

The preliminary report of the committee charged with implementing last spring's Maekawa recommendations argues strongly for policies to stimulate housing investment and consumer demand—even if such measures require an easing of fiscal austerity. The draft report, which came out in late November, also recommended accelerating industrial restructuring, largely by facilitating the shrinkage of basic industries such as steel and shipbuilding. The committee noted such measures were necessary because Japan could not rely on yen appreciation alone to reduce the trade surplus to acceptable levels. Despite these recommendations, we see little sign that Tokyo will follow through on anything other than modest economic stimulus unless the economy fails to strengthen by late next year. The key indicator may well be unemployment. Although the Maekawa Committee noted that in the next few years new jobs in services would probably be sufficient to replace those lost through industrial restructuring and overseas investment, language in the draft urging the maintenance of employment suggests that Tokyo is becoming more concerned about the domestic political and economic fallout from yen appreciation.

25X1

25X1

Impact of Japanese Tax Reform

Tokyo's planned tax cut for early next year will give a modest boost to the lagging economy, but only if the Finance Ministry agrees to delay a revenue-enhancing indirect tax and to refrain from slashing government expenditures to make up for lost income. The reform package calls for $28 billion in personal and corporate income tax cuts, matched by revenues from a new indirect tax and the elimination of a previously sacrosanct tax exemption for interest on small savings accounts. Despite Tokyo's claim that the tax cuts will help fulfill its commitment to increase domestic demand, the real impact on the sluggish economy and on Japan's trade surplus will depend on several as yet undecided issues. Our econometric model of Japan suggests that, if tax hikes are delayed until 1 January 1988 and there are no expenditure cuts, the package would add 0.3 percentage point to economic growth in 1987 and 0.4 percentage point in 1988. The Finance Ministry's estimate for 1987 is 0.5 percentage point. Even under the Finance Ministry's more optimistic scenario, the impact of the tax changes on Japan's trade surplus would be minimal in the next few years. Over the longer term, however, the sharp cuts in personal tax rates should boost consumer spending.

25X1

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

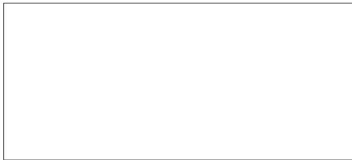
Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Japan Exploring Innovative Reactor Technology

Mitsubishi Heavy Industries is developing a demonstration molten-salt reactor—a long-term project that they believe has commercial potential in Third World nuclear markets. Unlike standard reactor technology, the uranium fuel is an integral part of the reactor's primary coolant—fuel preparation is simpler and spent fuel can be continuously reprocessed while the reactor is operating. The engineering concept is based on US research in the 1950s, but corrosion and contamination control problems led to commercial development of water-cooled reactors. Despite these large technical obstacles, the molten-salt reactor generates a higher power density and fuel burnup, has a much lower operating pressure, and in some aspects is safer to operate. Once its technical problems are overcome, these advantages combined with the potential of being less expensive than water-cooled reactors could make the molten-salt reactor an attractive alternative.

25X1 25X1 25X1

Liberalization of Italian Capital Movements



The Italian Treasury has decided to accelerate capital market liberalization and to relinquish Italy's special rights within the European Monetary System (EMS). the government in March will drop its 15-percent deposit requirement on foreign investment by Italians and, by the end of next year, will maintain the lira within the same fluctuation band observed by other EMS members. Although senior Treasury officials reportedly are motivated by recent success in selling bonds overseas and by their desire to unify the EMS, the decision, in our view, is as much a concession to Bonn. The West Germans have tied Rome's demand for a more unified EMS to Italian action on capital liberalization and fluctuation of the lira. We also believe the Bank of Italy may argue for a delay in capital liberalization, particularly if the lira weakens this winter.

25X1 25X1 25X1

Spain Eases Foreign Investment Controls

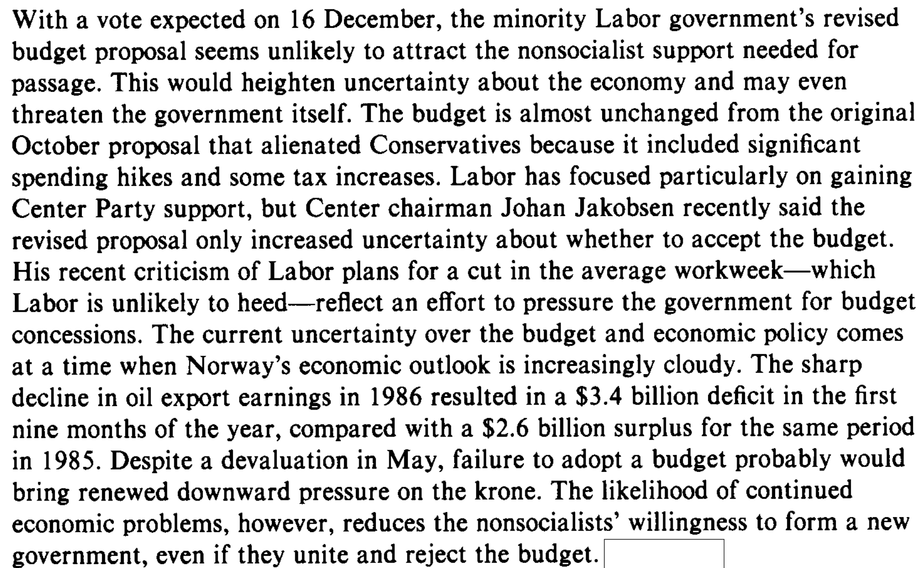
In another step to bring its capital regulations in line with those of the EC, Madrid is relaxing controls on Spanish foreign investment—especially portfolio investment. Under a new decree, Spanish investors may invest up to 30 percent of total assets in foreign stocks and bonds traded on domestic exchanges. The decree also authorizes foreign companies with operations in Spain to list their stock on the Spanish exchanges, and it is likely that bond trading will soon follow. While generally pleased, the financial community is disappointed with the investment limits and a provision allowing rejection of investment applications based on their consequences for the domestic economy. Nevertheless, we expect Madrid to move forward with investment reform. The new decree has the potential to improve the domestic capital market. It should also reduce the upward pressure on the peseta—caused by Spain's current account surplus and record foreign exchange reserves—which has aggravated inflation, hurt export competitiveness, and contributed to Spain's deteriorating trade balance with its EC partners.

25X1 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Dim Prospects for Norwegian Budget

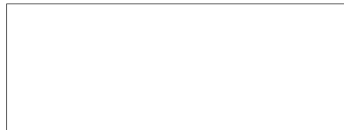


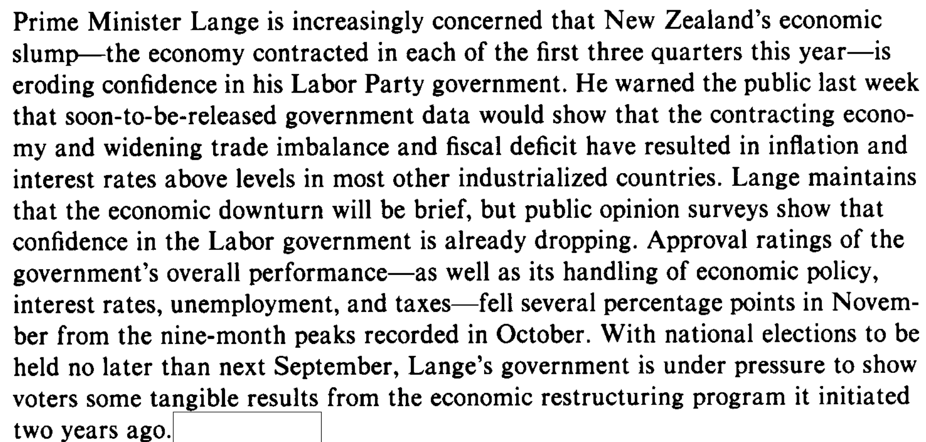
With a vote expected on 16 December, the minority Labor government's revised budget proposal seems unlikely to attract the nonsocialist support needed for passage. This would heighten uncertainty about the economy and may even threaten the government itself. The budget is almost unchanged from the original October proposal that alienated Conservatives because it included significant spending hikes and some tax increases. Labor has focused particularly on gaining Center Party support, but Center chairman Johan Jakobsen recently said the revised proposal only increased uncertainty about whether to accept the budget. His recent criticism of Labor plans for a cut in the average workweek—which Labor is unlikely to heed—reflect an effort to pressure the government for budget concessions. The current uncertainty over the budget and economic policy comes at a time when Norway's economic outlook is increasingly cloudy. The sharp decline in oil export earnings in 1986 resulted in a $3.4 billion deficit in the first nine months of the year, compared with a $2.6 billion surplus for the same period in 1985. Despite a devaluation in May, failure to adopt a budget probably would bring renewed downward pressure on the krone. The likelihood of continued economic problems, however, reduces the nonsocialists' willingness to form a new government, even if they unite and reject the budget.

25X1

25X1

Economic Slump in New Zealand





Prime Minister Lange is increasingly concerned that New Zealand's economic slump—the economy contracted in each of the first three quarters this year—is eroding confidence in his Labor Party government. He warned the public last week that soon-to-be-released government data would show that the contracting economy and widening trade imbalance and fiscal deficit have resulted in inflation and interest rates above levels in most other industrialized countries. Lange maintains that the economic downturn will be brief, but public opinion surveys show that confidence in the Labor government is already dropping. Approval ratings of the government's overall performance—as well as its handling of economic policy, interest rates, unemployment, and taxes—fell several percentage points in November from the nine-month peaks recorded in October. With national elections to be held no later than next September, Lange's government is under pressure to show voters some tangible results from the economic restructuring program it initiated two years ago.

25X1

25X1

Less Developed Countries

Venezuelan Footdragging on Economic Adjustment

President Lusinchi's reliance on obtaining a consensus on difficult policy decisions helped delay by one month his promised "turn of the rudder." Last Saturday when he announced his economic adjustments he tacitly admitted his government had not yet arrived at a comprehensive set of measures. The adjustments announced include a major devaluation, but pave the way for tighter foreign exchange controls.

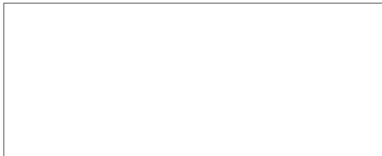
25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Lusinchi also announced minor financial incentives for certain sectors of basic industry. To make the economic package palatable, Lusinchi retained price controls on basic consumer goods and granted 25-percent wage increases to organized labor and the military. These half measures may, in the short term, help stabilize the nation's fiscal and external accounts, but over time will delay a more rational allocation of resources and discourage the private investment that would engineer an economic recovery. 25X1

Peru Devalues



A $100 million drop in reserves during the last week of October and a trade deficit for that month probably prompted Lima last week to announce a de facto devaluation and a timetable for an official devaluation schedule to begin in January. On 3 December, President Garcia announced that the dollar exchange rate—both the official and financial rates—will be devalued 2.2 percent per month next year. On the previous day, Lima had announced that all but essential imports will be exchanged at the higher financial rate and that a greater number of exports will receive this premium rate—tantamount to a 25-percent devaluation for many products. A steady process of de facto devaluations this year has allowed Garcia to nominally maintain his promise to not devalue the currency. Garcia froze the official exchange rate with the dollar in July 1985 when he took office to buoy confidence in the domestic currency, but local exporters have complained about the steadily worsening overvaluation. With inflation running about 4 percent monthly and likely to accelerate, the currency will become increasingly overvalued despite these moves. 25X1

25X1

Libya Developing a Cashless Society

Tripoli is moving ahead with a program announced this fall to do away with the use of money in local consumer transactions. Domestic bank accounts have been frozen and cash withdrawals prohibited. 25X1 workers' salaries are directly credited to their bank accounts. Consumers make purchases using vouchers for the exact amount of the transaction—the buyers' bank account is debited and the sellers' account credited; no cash is exchanged. The regulations are already being widely flouted, but the regime plans to mount a major effort to ensure compliance. These restrictions are the latest indication that Tripoli is not interested in easing unprecedented dissatisfaction with the regime's mishandling of the prolonged decline in Libyan oil revenue. 25X1

Philippine Government Assets for Sale

According to press reports, President Aquino has established a cabinet-level committee to oversee the sale of approximately 285 companies and various properties acquired by government banks when loans made during the Marcos administration went into default. Manila will be seeking local and foreign buyers for such businesses as hotels, food processing, textiles, and shipping that the government estimates are worth up to $7 billion. The sales meet a precondition the World Bank placed on a $300 million economic recovery loan for government financial institutions to remove nonperforming assets from their balance sheets.

25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Although Aquino reportedly hopes that recent cabinet changes demonstrate that her government is stable, foreign investors are likely to delay making sizable purchases of these assets until they see further evidence that the outlook for investment in the Philippines has improved. 25X1

Indonesian Military Budget Cuts

According to the [ ] to cut its defense budget further, including living allowances for junior officers and enlisted personnel. Defense expenditures had been slated to be rolled back 7 percent in 1987, but the reductions were targeted initially at hardware appropriations. In the case of the Navy, the proposed pay cuts come on top of cutbacks in the quantity and quality of shipboard food, and [ ] believes naval personnel will increasingly resort to smuggling to supplement their income. Although we see no indication that the military believes it is bearing a disproportionate share of the fiscal burden, trimming pay and benefits could undermine the military's loyalty at a time when the risk of antiregime rioting is growing because of the deteriorating economy. 25X1 25X1 25X1 25X1

Jobs Scarce for Indonesia's Youth

[ ] senior Indonesian officials are worried about the economy's inability to absorb the 2 million young people entering the labor force each year. Employment prospects in the private sector are dim, and, because of budget austerity, the government plans to hire only about 200,000 new employees in 1987—approximately the same as this year and far less than the 500,000 in 1985. Moreover, according to US Embassy reporting, economic growth is likely to be flat this year and next, while the World Bank estimates that 5- to 6-percent real growth is necessary to generate jobs for all the entrants into the labor force. Although Jakarta plans another public campaign calling on Indonesians to "sacrifice for the national good," [ ] officials are worried that unfulfilled career expectations could lead to antiregime violence by Indonesia's increasingly restive youth. 25X1 25X1 25X1 25X1

Concern About the Economy in Burma

Public distress over the government's handling of Burma's deepening economic crisis is growing, according to the US Embassy, but as yet there is no indication that dissatisfaction will translate into open protest against the Ne Win government. Higher prices and shortages are hurting most consumers, and lack of foreign exchange has cut production of import-dependent goods, providing a boost to the already pervasive black market. Popular resentment is rising over privileged access to scarce products by high-ranking government and military officials. In addition, the middle and upper classes feel threatened by Rangoon's clumsy interference in the economy—including periodic raids on black-market shops, new restrictions on the operation of foreign companies, and vague new legislation against "illegally" acquired property. 25X1 25X1

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

25X1
Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Page Denied

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5

Declassified in Part - Sanitized Copy Approved for Release 2012/01/25 : CIA-RDP97-00770R000100700001-5