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International Economic & Energy Weekly

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20 January 1984

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DI IEEW 84-003
20 January 1984

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International Economic & Energy Weekly

25X1

20 January 1984

iii Synopsis

1 Perspective—Bread and Politics in the Middle East 25X1 25X1

3 Briefs Energy
International Finance
Global and Regional Developments
National Developments

17 Risks of an Oil Price Decline 25X1 25X1

23 Israel: Trade Union Stymies Austerity 25X1 25X1

27 Egypt's Worrisome Food Gap 25X1 25X1

31 West Germany: Soviet Trade Relations on Track 25X1 25X1

35 The Soviet Timber Industry 25X1 25X1 25X1

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

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International Economic & Energy Weekly

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Synopsis

1 **Perspective—*Bread and Politics in the Middle East***

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The riots in Tunisia earlier this month underscore the dangers facing several key financially troubled Middle Eastern states. Their fiscal problems generally can be resolved only through austerity measures that have often provoked violent reactions and broken government resolve

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17 **Risks of an Oil Price Decline**

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Eroding discipline among OPEC countries and prospects of a seasonal cutback in oil demand this spring could place downward pressures on prices.

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23 **Israel: Trade Union Stymies Austerity**

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Finance Minister Cohen-Orgad probably will not be able to carry out his austerity policies, largely because of a lack of support from the Histadrut, Israel's large labor organization

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27 **Egypt's Worrisome Food Gap**

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Agriculture, a cornerstone of the Egyptian economy, is suffering from inadequate investment and government policies that overlook many of the sector's pressing needs. Since continued high domestic demand and limited arable land provide little hope that Egypt's food gap will narrow, we believe that large imports of food will continue and that Cairo will be forced to pressure donors for increased food aid.

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31 **West Germany: Soviet Trade Relations on Track**

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Although Bonn has been concerned that frictions with Moscow over INF deployment and other security issues would spillover into the trade arena, West German–Soviet commercial relations appear to remain on a stable footing.

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35 **The Soviet Timber Industry**

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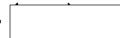
Although the USSR has the largest forest cover in the world and remains the leading producer of lumber, the Soviet timber industry has faltered since the mid-1970s because of transportation bottlenecks, a decrease in capital and labor inputs, and poor investment decisions. With worldwide supplies expected to tighten over the next decade, Moscow must overcome existing domestic production constraints if it is to take advantage of export opportunities. 

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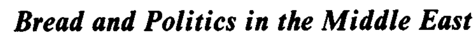
Perspective



Bread and Politics in the Middle East

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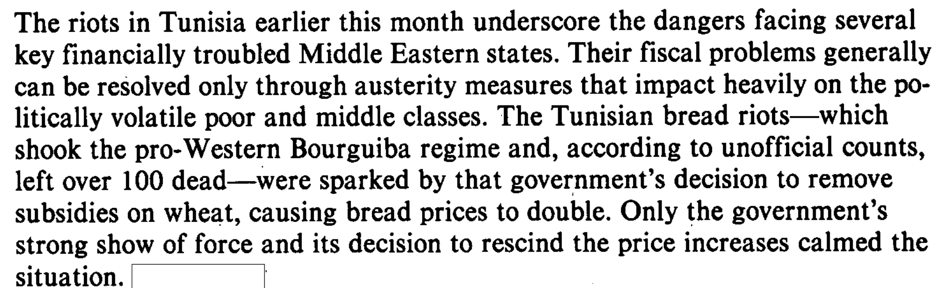

The riots in Tunisia earlier this month underscore the dangers facing several key financially troubled Middle Eastern states. Their fiscal problems generally can be resolved only through austerity measures that impact heavily on the politically volatile poor and middle classes. The Tunisian bread riots—which shook the pro-Western Bourguiba regime and, according to unofficial counts, left over 100 dead—were sparked by that government's decision to remove subsidies on wheat, causing bread prices to double. Only the government's strong show of force and its decision to rescind the price increases calmed the situation.

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Elsewhere in the Middle East, budgetary problems and the need to garner IMF and donor support to deal with balance-of-payments difficulties have dictated similar austerity measures. These actions, however, have often provoked violent reactions that have broken government resolve:

- The Egyptian Government's attempt to lower subsidies for bread and other staple commodities sparked bloody urban riots in 1977. As in Tunisia, the violence was ended by a combination of force and the repeal of the price hikes.
- In Morocco, substantial price increases—averaging 70 percent—for flour, sugar, and edible oil in 1981 resulted in labor strikes and violence that led to 100 deaths and 300 injuries. Rabat responded with a harsh crackdown and halved the price increases.
- Sudan's decision in 1982 to lower sugar subsidies by 60 percent led to demonstrations in Khartoum and several provincial towns that left 21 dead.

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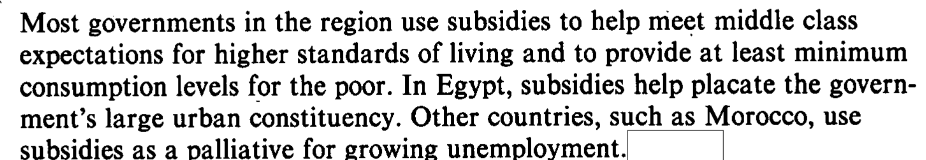

Most governments in the region use subsidies to help meet middle class expectations for higher standards of living and to provide at least minimum consumption levels for the poor. In Egypt, subsidies help placate the government's large urban constituency. Other countries, such as Morocco, use subsidies as a palliative for growing unemployment.

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Although many Arab governments are resigned to allocating large portions of their strained budgets to the subsidy system, they recognize that the system is inefficient and that it sacrifices their future economic development. In Egypt, for example, bread subsidies currently amount to about $900 million, or over 3 percent of GDP; the average Egyptian family buys about 30 pita-sized loaves per day, much of which is wasted. Cairo—prodded by key donors—has on

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three occasions since last summer gone to the brink of doubling bread prices but each time pulled back. Instead, Egypt has sought increased aid or a rescheduling of debt payments. Similarly, in Jordan budget resources have been hard hit by shortfalls in Arab aid, but preliminary proposals for 1984 call for keeping wheat subsidies intact while letting some development projects go unfunded. [ ]

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Recurring and deepening economic problems eventually will force more subsidy cuts by governments in the Middle East but only as a last resort. Serious risks exist for key donors like the United States that have "special relationships" with moderate states in the region. Failure by the United States and other donors to increase aid commitments combined with a perception that donors are pushing austerity measures will make them easy scapegoats for economic problems. Moreover, unrest over economic issues, especially when followed by harsh crackdowns by government forces, could provide opportunities for Islamic fundamentalists and leftists to cause further problems. [ ]

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Briefs

Energy

OPEC 1983 Production

Preliminary estimates indicate that OPEC annual crude oil production in 1983 fell to 17.7 million b/d, the lowest average in 16 years and 6 percent under the 1982 level. While Iran, Kuwait, and the Neutral Zone were marginal gainers for the year—picking up a combined total of over 400,000 b/d—Saudi Arabian production dropped 1.3 million b/d. Average daily production for the organization during the April through December period was 18.2 million b/d, offsetting the 15.9-million-b/d average for the first quarter. Although the average for the last three quarters was well above the production ceiling of 17.5 million b/d reaffirmed by OPEC last March, it was still 2 percent below the comparable 1982 period when the same overall quota was in effect.

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OPEC: Crude Oil Production *Million b/d*

			1983 [a]		
	Quota	1982	December	4th Qtr	Total
Total	**17.5**	**18.9**	**18.8**	**19.0**	**17.7**
Algeria	0.725	0.7	0.8	0.8	0.7
Ecuador	0.2	0.2	0.2	0.2	0.2
Gabon	0.15	0.2	0.2	0.2	0.2
Indonesia	1.3	1.3	1.4	1.4	1.3
Iran	2.4	2.4	2.4	2.4	2.5
Iraq	1.2	1.0	1.0	1.0	0.9
Kuwait	1.05	0.7	1.0	1.0	0.9
Libya	1.1	1.2	1.2	1.2	1.2
Neutral Zone	[b]	0.3	0.4	0.4	0.4
Nigeria	1.3	1.3	1.3	1.3	1.2
Qatar	0.3	0.3	0.4	0.4	0.3
Saudi Arabia	[c]	6.3	5.6	5.9	5.0
UAE	1.1	1.2	1.2	1.2	1.2
Venezuela	1.675	1.9	1.7	1.7	1.8

[a] Preliminary.
[b] Neutral Zone production is shared about equally between Saudi Arabia and Kuwait and is included in each country's production quota.
[c] Saudi Arabia has no formal quota; will act as swing producer to meet market requirements.

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Energy Industry Protests Canadian Procurement Policies

Petroleum companies operating in Canada are dissatisfied with the domestic procurement requirements of the Canadian Oil and Gas Lands Act (COGLA). Under COGLA, the government oversees the bidding process on Canada's large energy projects and attempts to maximize the participation of Canadian firms. According to press reports, several major petroleum firms complained at last week's industry-government meetings of unwarranted COGLA interference in bidding for energy equipment and services. [redacted] the government actions have added unnecessary delays and substantial cost overruns to offshore energy exploration. The industry is willing to provide Ottawa with bidding lists but objects to a new requirement that a company provide 48-hour advance notice before tendering contracts for 14 designated goods or services such as drill rigs, support vessels, and technical studies. Ottawa uses the time to review the bid and, in some cases, has pressured companies into choosing a domestic supplier. Moreover, companies have complained that Ottawa has coerced them into accepting higher levels of Canadian participation and increased involvement in affirmative action employment programs before they can obtain exploration leases on federal lands. [redacted]

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The companies believe they are taking sufficient efforts to establish a domestic energy supply industry in Canada and resent Ottawa's attempts to increase Canadian participation in order to "create an industry overnight." Moreover, the firms are concerned about the ability of Canadian firms to provide safe, cost-efficient equipment for difficult offshore energy projects. Ottawa, which supplies the companies with much of their exploration money, is unlikely to soften its stance. [redacted]

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France To Boost Gas Price

Gaz de France—the state gas company—is set to impose a 5-percent price hike on its customers in early February, and the company announced a second rate hike is likely in the fall. The price hikes are an attempt by Gaz de France to cut its growing losses, especially given the government's recent refusal to continue to pay the company a 13.5-percent surcharge on high-priced Algerian gas. The price hikes are likely to dampen gas demand and could thus exacerbate Paris's problems of disposing of increased gas deliveries from Algeria and the Soviet Union. [redacted]

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Soviets Boost Oil Exports

A third-quarter surge pushed Soviet exports of crude oil and oil products to OECD countries (including Finland) to 1.5 million b/d for the first nine months of 1983, nearly 10 percent more than the same period a year earlier. Nearly 90 percent of these exports were for hard currency. According to preliminary OECD data, Soviet shipments in the first half of 1983 were about the same as in 1982, but in the third quarter they rose 27 percent above third-quarter 1982. This volume increase will help offset the drop in oil prices. If Soviet oil deliveries to hard currency customers continued in the fourth quarter of 1983 at the average rate for the first three quarters, hard currency earnings would be only $200 million below the record $14.9 billion earned in 1982. The

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increase in Soviet oil exports to OECD countries reflects increased supplies made available to the Soviets as OPEC countries repay their Soviet debts with oil, the continued slow growth in production last year, and stock drawdowns.

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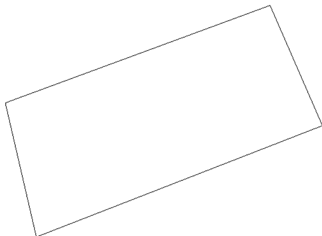
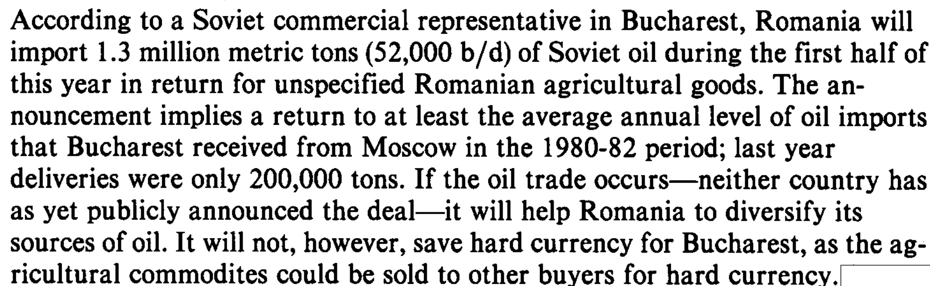
Romanian Expansion of Soviet Oil Imports





According to a Soviet commercial representative in Bucharest, Romania will import 1.3 million metric tons (52,000 b/d) of Soviet oil during the first half of this year in return for unspecified Romanian agricultural goods. The announcement implies a return to at least the average annual level of oil imports that Bucharest received from Moscow in the 1980-82 period; last year deliveries were only 200,000 tons. If the oil trade occurs—neither country has as yet publicly announced the deal—it will help Romania to diversify its sources of oil. It will not, however, save hard currency for Bucharest, as the agricultural commodites could be sold to other buyers for hard currency.

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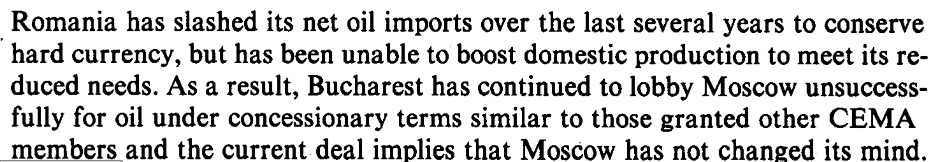

Romania has slashed its net oil imports over the last several years to conserve hard currency, but has been unable to boost domestic production to meet its reduced needs. As a result, Bucharest has continued to lobby Moscow unsuccessfully for oil under concessionary terms similar to those granted other CEMA members and the current deal implies that Moscow has not changed its mind.

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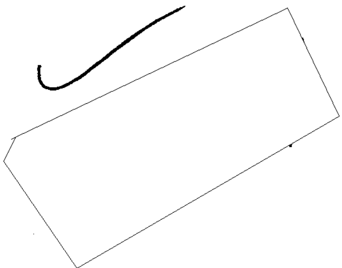
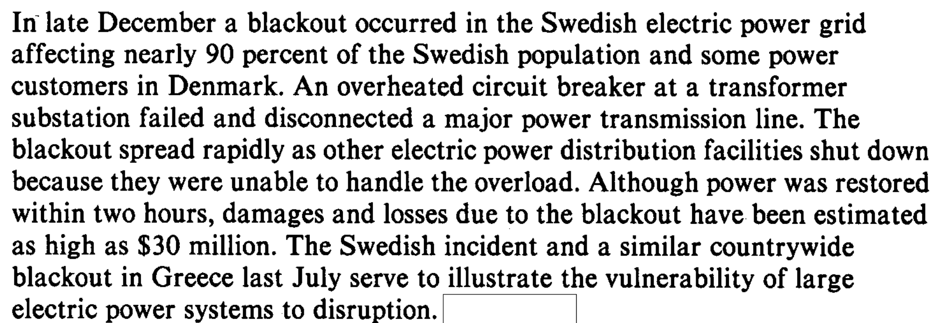
Countrywide Electricity Blackout in Sweden





In late December a blackout occurred in the Swedish electric power grid affecting nearly 90 percent of the Swedish population and some power customers in Denmark. An overheated circuit breaker at a transformer substation failed and disconnected a major power transmission line. The blackout spread rapidly as other electric power distribution facilities shut down because they were unable to handle the overload. Although power was restored within two hours, damages and losses due to the blackout have been estimated as high as $30 million. The Swedish incident and a similar countrywide blackout in Greece last July serve to illustrate the vulnerability of large electric power systems to disruption.

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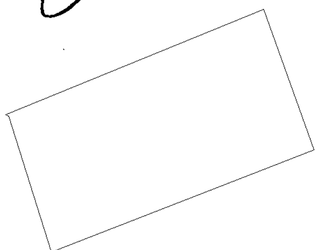
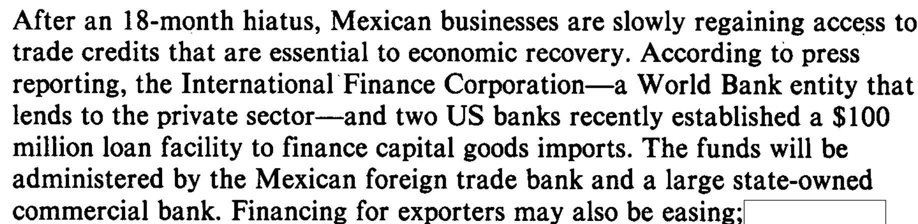
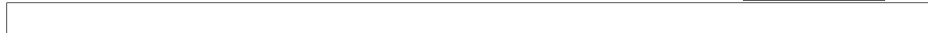
International Finance

Mexico Reopening Trade Credit Lines





After an 18-month hiatus, Mexican businesses are slowly regaining access to trade credits that are essential to economic recovery. According to press reporting, the International Finance Corporation—a World Bank entity that lends to the private sector—and two US banks recently established a $100 million loan facility to finance capital goods imports. The funds will be administered by the Mexican foreign trade bank and a large state-owned commercial bank. Financing for exporters may also be easing;



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Creditors are still unwilling to lend directly to private enterprises and instead are turning to the Mexican Government to act as an intermediary. Trade financing is essential to boost imports from $8 billion in 1983 to its goal of $14 billion in 1984 and for Mexican exporters to increase sales of nonoil products.

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Japanese Financial Aid to the Philippines

Tokyo will convert two-thirds of the $235 million in official project aid already pledged for 1984 into quickly disbursing commodity loans, Japan will delay disbursements, however, until Manila signs a letter of intent with the IMF. Agreement with the Fund has been stalled by a dispute over exchange-rate policy and irregularities in Central Bank accounts. Japanese aid will not be released until March at the earliest

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Nakasone has taken a personal interest in the financial situation in the Philippines and has been anxious to be responsive to requests from the United States to help Manila.

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Yugoslav Debt Negotiations

Western government creditors agreed in principle last week to refinance on favorable terms all officially backed loans to Yugoslavia that are coming due this year. This refinancing is contingent, however, on Belgrade's first meeting the terms of the IMF for a standby loan. The major points still in dispute with the IMF are proposals to raise interest rates to the level of inflation and centralize control of foreign exchange.

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The Western governments' offer—along with a similar offer from commercial banks—gives Yugoslavia an opportunity to improve its financial position substantially this year. Creditor insistence on the tough IMF criteria, however, shows strong reservations about Belgrade's ability to manage the economy. The regime recently made minor concessions to the IMF, but there is substantial political resistance in Yugoslavia to centralized management of foreign exchange and to higher interest rates. Belgrade will have to compromise, however, to secure the debt relief.

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India Forgoes IMF Funds

Prime Minister Gandhi has announced that India will not seek the final $1.16 billion of a $5.26 billion Extended Fund Facility (EFF) arranged with the International Monetary Fund in late 1981. This will free the IMF resources for loans to other countries. Neither we nor the IMF expect that India will encounter payment difficulties in 1984 despite a projected current account deficit of $3.1 billion. Reduced foreign borrowing will ease debt servicing problems

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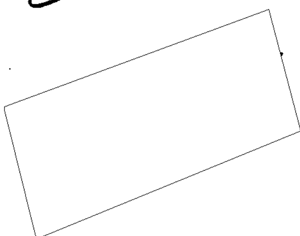
later in the 1980s when we expect India will face increased international financial strains. With national elections required by January 1985, Gandhi may be planning to increase domestic spending and borrowing for politically advantageous programs beyond what the IMF would have allowed. After April, IMF leverage over Indian economic policy will be greatly reduced because all EFF disbursements will have been completed. 25X1

Portugal-IMF Relations



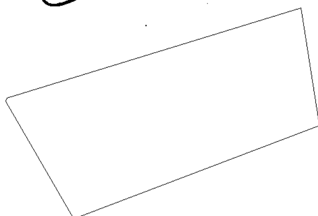
Central bank officials have informed the US Embassy that the Portuguese economy last year did better in some, but not all, respects than required by the terms of Lisbon's standby loan agreement with the IMF. Lisbon estimates last year's current account deficit at about $1.7 billion, smaller than the $2.0 billion allowed by the Fund. Foreign debt increased only slightly to $13.8-13.9 billion—well under the IMF's limit of $14.6 billion. The debt structure improved as well, as short-term debt dropped from $4 billion to $3.4-3.5 billion, while medium- and long-term debt rose by $700 million to $10.4 billion. Lisbon estimates the volume of domestic credit was below the IMF ceiling at yearend; higher interest rates caused domestic credit growth to slacken in the fourth quarter. 25X1 25X1

The Soares administration, however, has not yet fulfilled all the conditions in its letter of intent to the Fund and is attempting to negotiate easier targets for 1984. According to central bank officials, the lack of progress on changing labor and banking laws, bringing prices in line with the costs of production, and improving control over public-sector enterprises prompted a rebuke from the IMF last November. Lisbon is probably postponing layoffs and price hikes on goods produced by state-owned firms until this spring, when it hopes to receive a $150 million structural adjustment loan from the World Bank. 25X1

Thailand's Deteriorating Foreign Payments

The current account deficit rose more than 100 percent in 1983 to $2.3 billion, according to preliminary government estimates. Thailand's worsening external finances stem largely from a 6-percent drop in export earnings combined with a 22-percent rise in imports. Exports have been hurt by low international commodity prices and by the rising value of the Thai currency, which is fixed to the US dollar. Bangkok last month moved to curb imports by restricting import financing and raising interest rates. Should this fail to slow the growth of imports, however, the current account deficit is likely to remain close to $2 billion in 1984 and will increase pressure for a politically controversial currency devaluation while increasing 1984 foreign borrowing requirements. 25X1 25X1

New IMF Program for Somalia



Somalia and the IMF are in the final stages of negotiating a three-year, $83 million Extended Fund Facility. Mogadishu also is seeking a Compensatory Financing Facility worth $20-30 million this year. In return for financing, the IMF is prescribing an accelerated dismantling of the socialist economic policies maintained by the Siad government for the past 15 years. The government is promising to deregulate prices and abolish import and export

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licensing. Moreover, the IMF program calls for increased private-sector access to credit while sharply limiting public-sector borrowing. The Fund is requiring the legalization and expansion of the parallel foreign exchange market to include all transactions except debt and other official payments; this probably is an interim step to another devaluation.

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The willingness of Western creditors to finance only part of Somalia's growing current account deficit has prompted negotiations with the IMF. Reduced foreign exchange earnings are unlikely to recover until Saudi Arabia lifts its ban on imports of Somali livestock; Riyadh claims they are diseased. Moreover, Mogadishu, which has received its final shipment of oil under a 1982 Saudi grant, must begin purchasing oil on the world market unless a new accord is negotiated. Growing food shortages and drought conditions are increasing food imports.

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Global and Regional Developments

EC Retaliates Against US Trade Curbs

The EC last week decided unilaterally to implement trade restrictions against a number of US products in response to the US move last summer to restrict imports of specialty steel. Despite four months of negotiations with the United States, the EC claims it was unable to arrive at a mutually acceptable compensation arrangement. The new restrictions include raising the duties on methanol, vinyl acetate, and fire and burglar alarms between 6.4 and 6.7 percentage points. According to EC estimates, imports of these goods amount to roughly $57 million annually. In addition, the Community is imposing quotas on styrene, polyethylene, skis, hunting rifles, and other sporting goods. The quotas are expected to cut EC imports of these items by about $23.5 million or one-third. The restraints go into effect 1 March and will last four years, the same duration as the US specialty steel restrictions.

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Despite calls from France for retaliation on agricultural products, other EC countries blocked such measures in the hope that the more limited product list would avoid triggering a US response. Moreover, the Community wants to continue negotiations with the United States over the next six weeks in an effort to arrange a mutually acceptable compensation agreement before the 1 March implementation date.

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EC Agricultural Trade Restrictions Against US

The EC Commission last week proposed that the Community place tariffs on imports of corn-gluten feed and other animal feed substitutes. Most of these products come from the United States and now enter the EC duty free. The Commission would place a tariff only on imports exceeding 4.5 million tons, and it is willing to negotiate under GATT auspices a trade compensation arrangement with the United States. The Commission argues that cheap imported substitutes aggravate the EC agricultural glut by displacing domestic grain and encouraging dairy surpluses.

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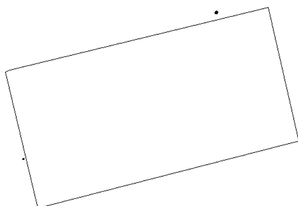
The EC Council probably will approve the proposals by mid-February, and GATT consultations could start by early spring. The quotas probably will have little immediate impact on US exports. Last year the United States sold less than 4 million tons of the products to the Community, but the EC apparently believes that US sales could rise in the future. Although philosophically opposed to the Commission proposal, the United Kingdom and West Germany probably will acquiesce in return for agreements by other EC members on changes in the Common Agricultural Policy. 25X1

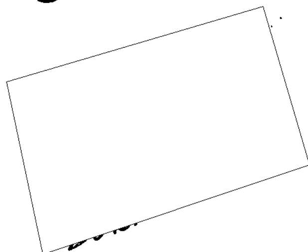
EC Commission Proposes Limited Farm Price Hikes



The EC Commission this week announced 1984-85 farm price proposals that provide for an average increase of only 0.8 percent in Common Agricultural Policy price supports, the smallest rise in six years. If adopted by EC agricultural ministers later this spring, the package would freeze prices in the three EC sectors most plagued with overproduction—cereals, milk, and wine. After translating the Commission's proposals from European Currency Units into national currencies, West German and British farmers will see their support prices drop the most—down 5.4 and 3.2 percent, respectively—while Greek and French farmers will experience the largest increases—up 3.4 and 3.2 percent, respectively. 25X1 25X1

The package of limited increases is part of a series of Commission-inspired austerity measures necessitated by the EC's current fiscal crisis. The Commission claims that the price proposals will save $140 million this year and must be enacted, together with other tough reforms it proposed last July, if the Community is to avoid running out of funds this year. The package has already been attacked by Community farm lobbies, and protests from farmers will likely intensify in coming months as the EC undertakes CAP reform. 25X1

Spanish-French Bilateral Trade Discussion



The US Embassy in Madrid reports that, during the December summit between Prime Minister Gonzalez and President Mitterrand, Paris proposed a special bilateral trade agreement that would supplement agreements Spain reaches with the EC as part of its membership application. In return for Madrid's agreement to six-year quotas on Spanish exports of fruits, vegetables, and wine, Mitterrand offered to accept quotas of equal duration on French exports that pose a threat to Spanish producers. As outlined, the proposal would technically violate the Treaty of Rome and would therefore require approval by the remaining members of the EC and the European Commission. Such an arrangement would reduce the benefits Madrid would receive from EC entry and could open the door to special demands by other EC members. Spanish officials have told US Embassy officials, however, that striking a deal that protects the interests of French farmers is necessary to move Spain's EC accession negotiations forward. 25X1 25X1

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New Sources of Strategic Minerals

Several recent ore deposit discoveries and technological advances could expand the world supply of strategic metals and minerals. *Oman* recently began mining chromite for the first time and has stockpiled ore equal to approximately 7 percent of annual US consumption. *India*, already the fifth-largest producer of manganese, has discovered a new deposit of high-grade ore. *South Africa* has discovered a new mineral, Hotsonite, which can be substituted economically for bauxite in aluminum production. In addition, an *Argentine* research company has been successful in extracting rare metals—including zirconium, beryllium, tungsten, titanium, and molybdenum—from ores using a high-temperature florination process. They are currently negotiating loans to build a plant to produce tungsten using the process. As a group, strategic metal prices have fallen 60 percent from their 1981 peak. Unlike most other metals, strategic metal prices have not rebounded during the current economic recovery and these new developments could help sustain the soft market.

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Argentina Back in Brazil Wheat Market

Argentina's recent sale to Brazil of 615,000 metric tons of wheat is a first step by the new Alfonsin government to expand agricultural exports and regain traditional customers. another 200,000-ton sale to Brazil is in the works. Argentina's share of the 4- to 5-million-ton Brazilian wheat import market fell from over 40 percent in the late 1970s to about 3 percent in the past three years as Argentina concentrated on the more lucrative Soviet market. To regain its position in the Brazilian market, Buenos Aires has undercut US prices and, we believe, has offered favorable credit arrangements. The United States has provided about one-half of Brazil's import needs in recent years.

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Brazil: Wheat Imports

Million metric tons

	Total	Argentina	United States	Other
1978/79 [a]	3.7	0.9	1.4	1.4
1979/80	4.8	1.5	2.2	1.1
1980/81	3.9	0.1	2.4	1.4
1981/82	4.5	0.3	3.0	1.2
1982/83	3.6	0	2.2	1.4
1983/84 [b]	4.0	0.8	1.7	1.5

[a] Marketing year, July-June.
[b] Estimated.

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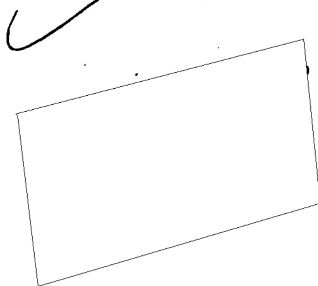
USSR Announces Economic Agreements With Angola



Moscow recently announced the signing of agreements with Angola to develop a fishing complex employing 6,000 persons and to cooperate in constructing oil depots, producing building materials, and starting farm machinery repair workshops. The value of the projects was not disclosed. The USSR has extended $440 million in economic aid to Angola since 1975, but only $32 million is believed to have been used. This announcement follows disclosure that the USSR and Cuba have agreed to provide more military aid to Angola. It suggests a coordinated effort to demonstrate firm backing for Luanda against increased pressures from Pretoria and South African–backed guerrillas. The new aid agreements, however, do not provide for badly needed imports for the deteriorating Angolan economy or for skilled technical services to revitalize idle industries. Luanda is continuing its efforts to obtain economic aid in the West.

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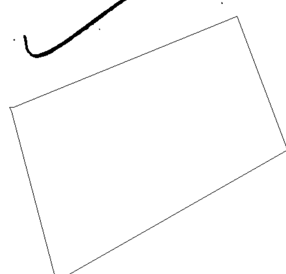
National Developments

Developed Countries

New Israeli Foreign Currency Controls



Finance Minister Cohen-Orgad on Monday announced new restrictions of foreign currency transactions to strengthen foreign exchange reserves. According to press reports, Israelis traveling abroad will be allowed to purchase only $2,000 in foreign exchange—a $3,000 limit had been imposed on 1 November. Foreign bank accounts will no longer be permitted, and foreign stock holdings—$700 million, according to the Bank of Israel—have to be liquidated within a year. Dealings in gold and gold futures are now prohibited.

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Cohen-Orgad took this action to provide foreign exchange to finance the growing trade deficit without having to draw down foreign exchange reserves. After using about $150 million in reserves last year, Israeli officials probably are afraid that additional reductions of their roughly $3.6 billion in reserves might cause commercial bankers to restrict lending to Israel. Enforcement, however, will be difficult, and we believe these measures will not improve the foreign payments situation by anywhere near the $1 billion Cohen-Orgad expects.

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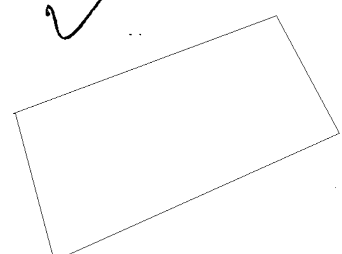
New Turkish Governor of Central Bank



Yavuz Canevi has been named Governor of Turkey's Central Bank, replacing military appointee Osman Siklar, who resigned two weeks ago. Canevi—Vice Governor of the Bank since 1981—is well known in the international banking community, but he was not Prime Minister Ozal's first choice for the post. According to the US Embassy, President Evren rejected the first nominee because of his lack of banking experience and his close ties to Ozal. We believe Evren may have taken this action to remind Ozal that he does not have absolute power over economic policy. Furthermore, we believe that Evren is somewhat uneasy about Ozal's recent decision to put the Central Bank and several key economic ministries under the jurisdiction of Deputy Prime Minister Erdem, a trusted Ozal colleague. Although Canevi is not an Ozal

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confidant, the Embassy reports no major policy differences between the two. Under Canevi, the Central Bank is likely to pursue a strict monetary policy designed to reduce Turkey's high rate of inflation. 25X1

West German Recovery Gains Strength

Industrial production rose 1.5 percent, and new orders jumped 2 percent in volume in November, as the West German recovery continues to gather steam. The pickup in activity pushed real GNP growth to an estimated 1.2-percent last year, higher than expected as recently as last fall. GNP declined 1.1 and 0.3 percent in 1982 and 1981, respectively. Further improvement is expected this year, with most growth forecasts clustered in the 2.5- to 3.0-percent range; exports and investment are expected to play leading roles. 25X1 25X1

West German Population Decline

According to a recent government report, the native West German population will decline by about one-third to 38.3 million by the year 2030 if present trends continue. The report went largely unnoticed, but Bavarian Minister President Franz Josef Strauss seized on the general issue of the falling German population in the 1984 budget debate to lambast the cabinet for its decision to cut maternity benefits. According to the government report, the native West German birth rate has been the lowest in the world since 1974. It is one-third lower than the rate needed to maintain the current population. By contrast, the non-German population in West Germany is expected to increase from the current 4.5 million to 7 million in the year 2000, or 12 percent of the population. By 2030, more than one person in four could be non-German because of their higher birth rates and net immigration. In terms of age groups, those under 18 will fall from 22.4 percent of the population to 15.3 percent in 2030 while the over-65 group will rise from 15.1 to 23.8 percent. The growing proportion of foreigners in the population has already led to increased frictions with native Germans, and this trend is likely to continue. The change in the age distribution will cause labor and military manpower shortages and shortfalls in social security financing. 25X1 25X1

Less Developed Countries

Jordanian Equity in Foreign Banks To Be Increased

The Jordanian Government has moved suddenly to limit foreign bankers' financial interests in banks operating in Jordan to minority ownership, despite earlier promises from the governor of the Central Bank that this would not occur. According to the US Embassy, former Prime Minister Badran issued a decree on 27 December, just before losing his job in a government reshuffle, that foreign banks are commercial enterprises and therefore should conform to Jordanian law requiring at least 51-percent Jordanian ownership. The new Minister of Industry and Trade sent letters on 15 January to the local offices of Citibank and Chase notifying them that they must comply with the law within three years. 25X1 25X1

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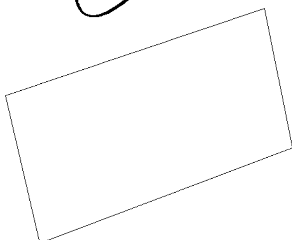
The government probably is trying to protect itself from domestic criticism that an important sector of Jordan's economy is under foreign control. If Amman continues to pursue this course, banking sources of the US Embassy say they probably will pull out of Jordan. In our judgment, Amman is risking bankers' good will that may prove important when seeking commercial loans to deal with growing foreign payments problems. 25X1

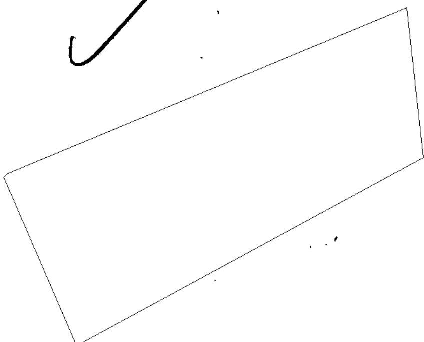
More Budget Austerity Ahead for Indonesia



President Soeharto has announced more budget austerity for the fiscal year beginning in April following a tight budget in FY 1983/84. Projected spending in FY 1984/85 will almost certainly fall in real terms, according to the US Embassy. The budget reflects a shift away from import-intensive capital investment to more domestically oriented spending programs and further gradual reductions in domestic fuel subsidies. Nonetheless, the government will increase military and civil servant wages 15 percent following a two-year wage freeze. According to one press report, the pay raise represents an effort to combat corruption among government employees, whose real wages will still remain below the level of three years ago. 25X1 25X1

Jakarta may find it necessary to tighten spending further as the new fiscal year progresses, particularly if its assumptions about oil prices and foreign borrowing are wrong. The government estimates oil revenues will account for about 50 percent of government receipts in FY 1984/85, down from 60 percent this year. Although the data underlying this estimate are not yet available, Jakarta probably based its calculation on an official OPEC oil price of $29 per barrel. Last year, Jakarta based revenue projections on a $34 per barrel price, an assumption that proved wrong even before the fiscal year started. Soeharto is also projecting a 20-percent increase in foreign aid and official foreign borrowing over last year's $3.5 billion. Although foreign bankers currently are willing to lend large amounts to Indonesia, a drop in oil prices would raise borrowing needs and dampen lenders' willingness to provide funds. 25X1

Malaysia Cuts Economic Development Spending



The Malaysian Cabinet has substantially reduced project spending for the remaining two years of its current economic development plan. The cuts follow last fall's austerity budget, which is designed to curb large budget deficits—15 percent of GNP in 1983—and slow the rapid growth of its foreign debt. Although Kuala Lumpur has not announced which projects will be affected, we expect cutbacks to involve a major highway extension, a Malayan Railways retracking/refurbishment project, a new oil refinery, and a domestic pipeline construction project. 25X1

Reduced development spending will slow the pace of transferring a substantial portion of the nation's corporate wealth from ethnic Chinese to ethnic Malays. Deputy Prime Minister Musa announced last month that the government's target of 30-percent ethnic Malay control by 1990 is no longer realistic and that other target dates in Malaysia's master economic plan will have to be pushed back 25X1 25X1

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Possible New IMF Agreement With Grenada

The IMF and Grenada's interim governing council held initial talks last month to consider a one-year standby loan of up to $4.7 million, according to US Embassy reporting. An IMF team is scheduled to visit the island later this month to negotiate the new agreement, but no disbursement is likely before April. Implementation of a new program—Grenada's two-month-old Extended Fund Facility was suspended following the collapse of the Bishop regime—may prove troublesome for the inexperienced government. The IMF apparently will require Grenada to generate a surplus in its budget for noncapital expenditures; last year's deficit was an estimated $4.4 million. Grenada's already high tax rates and its desire to attract private investment are likely to rule out significant tax hikes. Reduction of central government expenditures, however, will cause public layoffs, exacerbating the already serious unemployment and tarnishing the government's political image.

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Zimbabwe Requests Food Aid

Rapidly dwindling stocks of corn—the dietary staple—have prompted an urgent request to Washington for 50,000 metric tons of PL 480 food aid. The Mugabe government claims that without the aid shortages will appear in April, a few weeks before the next harvest reaches the market. Harare is coming up short partly as a result of the sale or donation last year of nearly 160,000 tons of corn to drought-stricken neighbors, including Zambia, Mozambique, and Tanzania. In addition, Zimbabwe probably will require additional food aid later this year. Rainfall has remained below normal, and even the most optimistic official projections call for a corn harvest sufficient for, at most, 10 months of normal domestic consumption. Moreover, the growing number of Mozambicans who have migrated temporarily to Zimbabwe in search of food are boosting demand.

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Soviet Loan Syndication Failing

Moscow's effort to reenter the long-term commercial credit market after an absence of almost four years is in trouble. In mid-November the Soviet Foreign Trade Bank named a leading West German bank to head up a $150 million general purpose syndication for the USSR. the loan is still in the preliminary discussion stage, and no major bank has agreed to participate. The lukewarm response by Western bankers probably reflects concern about East-West relations. Banks reportedly are wary of making long-term loans to the USSR because they believe the East-West political situation is too unstable. Moreover, bankers are questioning the USSR's need for hard currency. Unless the lead bank generates greater interest in the syndication quickly, the Soviet attempt to test the long-term loan market could become an embarrassment.

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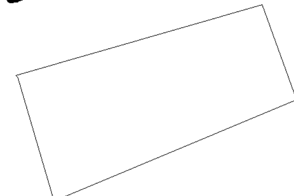
Soviet Trade Officials Executed



TASS announced last Friday that two former officials of the State Committee for Foreign Economic Relations had been executed for "systematically taking large bribes." These are the highest level officials to be executed for corruption since Andropov became the party leader. One was the former chairman of the association that provides foreign support for Soviet electric power stations. The other was the former director of the import office of the same association. The executions indicate that Secretary General Andropov's campaign against corruption is continuing. Andropov is the Chairman of the Presidium of the Supreme Soviet—the appellate body in capital cases of this kind—which denied an appeal for clemency for the two.

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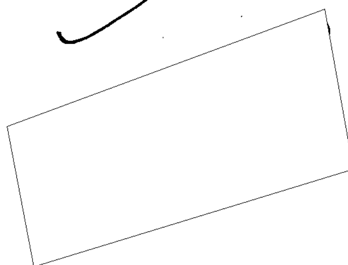
Planned Polish Price Increases



The regime's reduction in the size of planned increases in retail food prices sets back its austerity program and reflects a continuing lack of confidence. The government now plans increases in food prices on 30 January averaging only 10 percent instead of the originally projected 15 percent. Prices of many staple foods such as milk, sugar, and low-quality meats will not be raised under the new proposals in order to help minimize the impact on low-income groups. The prices of other items such as expensive cuts of meat—which generally are unavailable—are scheduled to increase more than originally proposed. Retirees already have been granted early pension increases, and the government is considering additional compensation for them and for low-income workers.

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The authorities are taking these actions to show their responsiveness to public opinion. The party newspaper reported criticism of the most recent plans by representatives of the unions and promised to forward the comments to the Council of Ministers, where the decision will be made. The authorities are likely to hope that they can improve their credibility by allowing and even encouraging a critical discussion of their policies. They also hope to show they have learned from experience not to surprise the workers with large, unexpected increases. The retreat on price increases, however, will make it more difficult for Warsaw to persuade Western creditors that it is committed to austerity.

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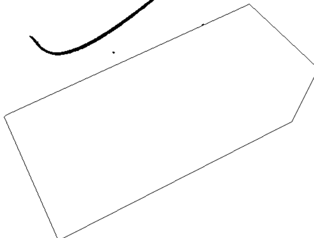
Bleaker Outlook for Romanian Consumers



Bucharest has announced exceedingly optimistic economic targets for 1984, supposedly to be achieved by increased labor productivity and worker discipline and more efficient use of energy and materials. The plan calls for a 7.3-percent rise in national income, and a 6.7-percent growth in industrial output. By contrast, in 1982 national income was officially reported to have grown only 2.6 percent and industrial output only 1.1 percent; 1983 data is not yet available, but the performance was probably not much better. Even more ambitious is this year's grain output target of 29 million tons, 30 percent above the officially claimed record level achieved in 1982. Bucharest also plans another sizable trade surplus of $1.7 billion, according to data supplied to the IMF last December.

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We doubt that Romania will be able to pull out of its economic tailspin this year. Severe cuts in hard currency imports in 1982 and 1983 have reduced the potential for industrial growth; Romania's economy is among the most sensitive in Eastern Europe to shifts in nonagricultural imports. In addition, agriculture has been hit by drought, livestock diseases, and reduced fertilizer supplies. Finally, Bucharest's campaign to retire 25 percent of its $10 billion foreign debt by 1985 will require the export of industrial and agricultural inputs that could be used at home, as well as the continued curtailment of badly needed imports of Western technology. The consumer—already suffering from severe food and energy shortages—will almost certainly bear the brunt of the regime's failure to meet the unrealistic economic goals. 25X1

Vietnam's Trade Deficit Narrows

Hanoi announced in December that substantially increased exports will cut its foreign trade deficit to $630 million in 1983—a 30-percent reduction from the previous year. The increase in exports is primarily the result of growing sales of light handicrafts and seafood to Communist and Western nations. This announcement follows recent official statements proclaiming near self-sufficiency in food and a major increase in economic growth. 25X1

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The increases in production and exports—largely the result of favorable weather, export promotion activities, and incentive measures introduced in 1979 to overcome severe food shortages—do not represent any fundamental improvements in the economy. Indeed, Hanoi's reversal of some of the incentive policies may cut short the growth in food production. Moreover, despite the improvement in the balance of trade, foreign exchange reserves are practically exhausted, and overdue payments of about $300 million on Vietnam's hard currency debt of $1.5 billion is precluding access to international capital markets. 25X1

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Risks of an Oil Price Decline

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Overproduction and low demand have kept downward pressure on oil prices and recently forced a number of producers to lower prices. Eroding discipline among OPEC countries and prospects of a seasonal cutback in oil demand this spring could place additional downward pressures on prices. Nigeria, OPEC's weakest link, continues to suffer economic problems that might prompt the new government to announce a unilateral price cut. If Nigeria or others move to increase their market share, a downward oil price spiral could ensue. The central factor working against such an eventuality would once again be Saudi willingness to cut production. At this point, Saudi Arabia appears willing to defend the current benchmark price but only if other producers adhere closely to their production quotas. The political situation in the Middle East remains unsettled, and market conditions could tighten if Iran or Iraq disrupt oil flows from the region.

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Current Situation

Overproduction and weak demand have put downward pressure on prices in recent months. OPEC crude production in the fourth quarter averaged about 19 million b/d, some 1.5 million b/d above the cartel's production ceiling. We estimate non-Communist oil consumption in the fourth quarter rose by about 1 percent, considerably less than most companies had anticipated. As a result, oil inventories at yearend remained in excess of company needs, and spot prices for most crudes have declined to about $1 below official prices.

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Our concern about a replay of last year's oil price drop is mounting, even though a number of underlying market conditions are working in favor of price maintenance:

- Unlike the sharp 6-percent decline in fourth-quarter oil use in 1982, oil consumption actually increased in the same period in 1983.
- Weather conditions in North America are decidedly colder than last year, boosting consumption of fuel oil and other heating fuels.
- The level of excess inventories is less than that of a year ago. Oil stocks at yearend stood at 90 days of consumption compared to 96 days at yearend 1982.
- OPEC crude production of 18.7 million b/d in December was about 500,000 b/d below year earlier levels.
- Spot oil prices have weakened, but the decline is not as sharp as last year. Spot prices for most crudes are now about $1 below official prices compared to a $3 to $4 spread early last year.

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Price Developments

Nonetheless, in addition to weak spot prices and growing financial pressures in many oil-producing countries, several other signals indicate a repeat of last year's oil price slide may be developing:

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- The Soviet Union reduced its price by $1 per barrel late last year and Egypt lowered its con-

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tract prices by $0.25 to $0.50 per barrel, effective 1 January. In addition, Cairo announced it would review oil prices monthly. Both countries are now undercutting comparable OPEC crudes by about $1 per barrel.

- Statoil, the Norwegian oil company, reduced the price of its Statfjord crude by $0.20 per barrel in early January.

- The British National Oil Corporation (BNOC) proposed freezing contract prices for first-quarter 1984 at current levels, but still faces some buyer resistance to its proposal.

- Indonesia's Pertamina is marketing crude oil under arrangements that effectively discount its oil by $1 to $2 per barrel in an effort to boost exports.

- Ecuador lowered its crude oil price by $0.70 per barrel in January.

- Iran recently signed crude contracts for as much as 1 million b/d with several major customers at prices pegged to spot prices, according to an oil industry source. Tehran also reportedly eased destination restrictions and will allow customers to swap crude to third parties.

- Oman effectively lowered the selling price of its crude $0.45 per barrel to Japanese and British buyers by extending the payment period, according to press reports.

Oil Price Indicators

Key factors to watch in the coming weeks that might portend a decline in oil prices are:
- *Continued OPEC crude production well in excess of the cartel's 17.5-million-b/d quota, with Saudi output in excess of 5.5 million b/d being a key factor.*
- *Absence of a sustained rebound in oil consumption.*
- *Falling spot crude prices that dip $2 to $4 below official prices.*
- *Exodus of buyers for North Sea crudes, forcing BNOC to step up spot market sales.*
- *A sharp decline in Nigerian production to well below 1 million b/d.*
- *Saudi hints that it is no longer willing to defend the benchmark.*
- *Increases in price discounts such as barter deals, credit terms, or linkages with spot price deals in countries such as Libya, Iran, and Nigeria.*

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Near-Term Demand Outlook

The near-term demand outlook will depend mainly on the pace of the economic recovery in OECD countries, inventory patterns, and seasonal weather conditions. Based on available information and projected weather patterns, we expect a modest increase in oil consumption in early 1984 in response to the continued economic recovery and further erosion in real oil prices. As a result, we expect non-Communist consumption to increase 2 percent in first-half 1984 over year-earlier levels. We estimate first-quarter consumption at about 46 million b/d with an expected seasonal decline in consumption to 43 million b/d in the second quarter. Our consumption forecast is consistent with most recent industry projections.

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If consumption predictions hold, inventory decisions will play the key role in determining the level of oil demand at least through first-half 1984. Oil companies still have leeway to reduce inventories because of overproduction and unexpectedly weak consumption in the fourth quarter. Prospects for continued price weakness likely will cause reductions in excess inventories in early 1984. We estimate that about 200 million barrels will be drawn down during first-half 1984. We anticipate that the inventory drawdown through March will approximate 2.5 million b/d, followed by little or no seasonal stockbuilding during the second quarter.

As a result, demand for OPEC oil, including about 1 million b/d of natural gas liquids, will approximate 18.5 million b/d in first-half 1984, or some 1.5 million b/d below fourth-quarter levels. Should the rebound in total oil consumption fail to materialize, demand for OPEC oil in first-half 1984 could fall 1 million b/d or more below the group's current production ceiling. Unless OPEC producers cut production accordingly, oil prices will fall.

Price Pressures in the Months Ahead

The key to the near-term price outlook will be producer cooperation. Although OPEC reaffirmed its nine-month-old production accord in early December, this action did little to improve compliance, and the cartel is not scheduled to formally consider changes until July 1984. Given the growing financial pressures in several producing countries and the political animosity between some members, OPEC could be hard pressed to maintain an effective production-sharing agreement in the months ahead. Competition between the United Kingdom and Nigeria for market share over the next few months could trigger price cuts by either country and set off a downward price spiral.

United Kingdom

In the absence of more discipline from OPEC countries, official oil prices of some non-OPEC producers—especially the United Kingdom—could again come under pressure. We expect London will attempt to hold prices through the first quarter, but a reduction in US domestic oil prices or a further weakening in spot prices that causes a major buyer exodus could force a British price reduction. Rapid acceptance of BNOC's price proposal by the major oil companies operating in the UK indicates that these companies at least have little desire to see prices fall. Indeed, recent press reports indicate that these companies may voluntarily limit oil output in coming months to reduce price pressures. The companies are aware that a British cut could trigger price cuts by other producers, especially Nigeria, because Lagos produces oil that competes directly with North Sea crudes. If some price reduction does become necessary, BNOC probably first will attempt to adjust prices of crudes other than Brent—now priced the same as Nigeria's Bonny Light—in an attempt to technically leave British and Nigerian prices at parity. Any unilateral reduction in oil prices by the Nigerians, however, probably would be quickly matched by the United Kingdom.

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Most equity producers in Nigeria view Buhari as experienced in oil matters; he served as chairman of the NNPC in the 1970s. We believe this experience will sensitize Buhari to the advantages of moving slowly on any pricing decision because he is fully aware of the impact of a price war on Nigeria's economy. Indeed, General Buhari has stated publicly his intention to remain in OPEC and that any change in its OPEC membership would come only after consultation with other cartel members. Given Buhari's oil experience, he may eventually use the threat of a price cut and production increase to seek financial assistance from other OPEC members.

The US Embassy in Lagos reports that last year Saudi Arabia loaned Nigeria $400 million to help offset declining oil revenues. OPEC's refusal to give Lagos a higher production quota or additional financial aid may ultimately prompt Buhari to cut prices.

Other OPEC Members

Several other OPEC countries faced with financial problems are under pressure to increase export earnings. We would expect that most of these producers would match any sizable Nigerian price cut:

- Venezuela can no longer meet its revenue requirements and comply with its 1.7 million b/d quota by drawing down inventories to keep exports high, The country's inventories have been reduced to such a low level that Caracas will need to increase production to maintain exports. Recent statements by Venezuelan oil officials indicate, however, that Caracas probably will not significantly exceed its assigned quota for fear that other producers will also increase their current production levels.

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- Iran probably will continue to tie crude oil export prices to the prevailing spot market price. Iran's new pricing arrangement could encourage other OPEC members who produce comparable quality crudes to negotiate similar deals rather than risk losing market shares.

- Libya was unable to sell much of its December production, and Libyan oil officials reportedly fear continued weak demand could precipitate a further reduction in liftings.

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Saudi Arabia—The Key Player

Saudi Arabia will play the key role in determining oil price developments from the producer side. Although the Saudis may believe OPEC oil is still overpriced, Riyadh is mindful of the dangers of an uncontrolled round of price cuts. Unlike last year, the Saudis have not issued public threats to reduce the price of oil and have, in fact, stated their support for the current price. As a result, we feel the Saudis currently view defense of OPEC's $29-per-barrel marker price as the best option available. Indeed, Saudi production has fallen gradually from its September 1983 peak of 6.2 million b/d to 5.6 million b/d in December; we expect January's output will approximate 5.2 million b/d. If demand for OPEC oil weakens during first-half 1984 as we now expect, Riyadh probably will be willing to cut output below 5 million b/d—perhaps as low as 4 million b/d—to defend prices. If, however, other OPEC countries do not adhere closely to their production ceilings and force Saudi output even lower, Riyadh may reconsider its options and the risk of a price collapse would increase.

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The Iran-Iraq Risk

Although we expect the market to remain weak over the coming months, the volatile situation in the Middle East could cause a rapid turnabout. Iraq's deteriorating economic situation, coupled with the recent acquisition of French Super Etendard aircraft with Exocet missiles, could prompt Baghdad to initiate attacks against oil shipping in the Persian Gulf in an effort to bring an end to the conflict with Iran. Such action might induce Iran to carry out its oft repeated threat to retaliate by closing the Persian Gulf to shipping or to strike out against the oil facilities of Iraq and its Gulf allies. Any major disruption to oil flows in the region could quickly tighten supplies and reverse market psychology.

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Israel: Trade Union Stymies Austerity

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Finance Minister Cohen-Orgad probably will not be able to carry out his austerity policies, largely because of a lack of support from the Histadrut, Israel's large labor organization. The "honeymoon" that developed when the Finance Minister took office in October is over. Strikes and work slowdowns have increased recently, and more are planned to demonstrate worker opposition to nearly 200-percent inflation and Cohen-Orgad's call for a 10- to 15-percent cut in real wages this year. An estimated 60,000 government workers—15 percent of public-sector employees—are now involved in such actions. Given its ties to the opposition Labor Party, there is little incentive for the Histadrut to compromise

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The Histadrut: A Powerful Institution

Founded in 1920, the Histadrut is not only an umbrella organization for 43 trade unions, but it is also the largest employer in Israel. Hevrat Ovdim, the division of the Histadrut that owns commercial enterprises, was established in 1924 to provide jobs for immigrants; it also represented the fulfillment of the socialist ideology of the Histadrut's founders that agriculture and industry should be owned by workers. Histadrut affiliates employ one in four Israeli workers, produce 90 percent of the country's agricultural products and 25 percent of the manufactured goods, and control 85 percent of domestic transportation. Management of these firms, however, is instructed to operate in the most efficient manner and to adhere to the same labor relations and wage agreements that Histadrut officials negotiate with the Manufacturers' Association, the umbrella organization of private firms.

With 90 percent of the labor force as members and a traditionally tight labor market—the average unemployment rate since 1968 has been 3.7 percent—the Histadrut has been able to dominate negotiations to win large real wage gains for its members. Real wages have risen at an average annual rate of 7.1 percent since 1975. In addition, the Histadrut has played a key role in the development of a pervasive system of indexation that protects Israelis from the ravages of triple-digit inflation.

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The Histadrut has always been the power base of the Labor Party. Its economic enterprises provided funds for the party organization and jobs for loyal members. In return, Labor governments protected the interests of the Histadrut in a symbiotic relationship that ended with the election victory in 1977 of Menachem Begin's Likud bloc and the installation of the first nonsocialist government in Israel's history.

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Israeli Wage Negotiations

Every other year a national agreement on wages and labor relations is negotiated between the Histadrut and the Manufacturers' Association. Although the government is not a party to the national agreement, it usually applies the agreement to public-sector workers. The national agreement constitutes the framework within which individual trade unions are supposed to negotiate. The agreement also includes the cost-of-living adjustment formula. Once each union has worked out details of an industrywide agreement, the terms are extended to all workers in the sector, including nonunion employees. Following agreement on industrywide contracts, individual firms and workers' committees bargain over such things as additional wages, annual leave, and promotions.

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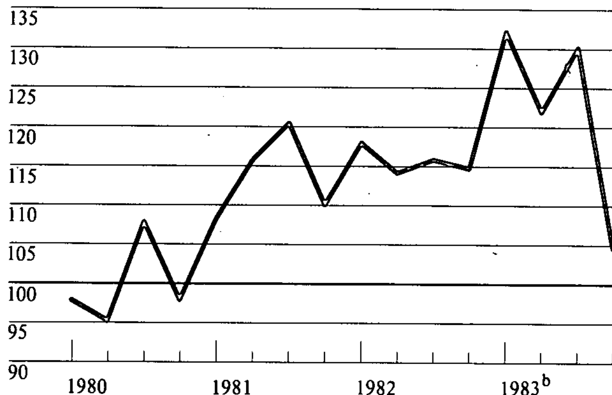
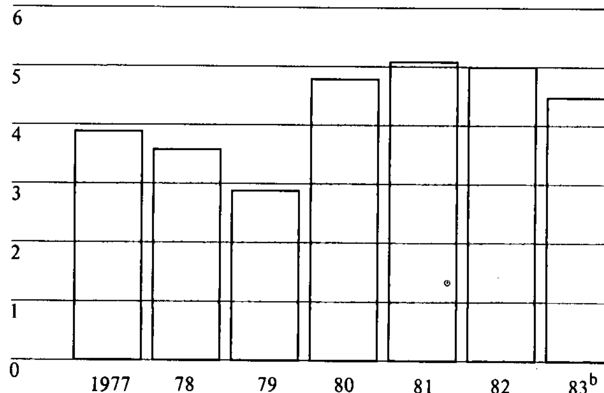
Israel: Wages and Unemployment





[a] Quarterly data.
[b] Estimated.

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Relations With Likud

Begin took office in June 1977 and was committed to moving the economy toward a more free market orientation. He appointed the head of the Liberal Party, a party advocating capitalist ideas, to the Finance portfolio. Many of Begin's campaign promises—compulsory arbitration and nationalization of the pension and health insurance systems—threatened key Histadrut activities. Egyptian President Sadat's visit to Jerusalem in November 1977, however, turned the Begin government's attention to foreign policy. With Begin uninterested in economic issues, the Histadrut easily fended off the government's halfhearted attempts at economic reform.

Faced with accelerating price hikes, former Finance Minister Aridor, who took office in January 1981, concentrated his efforts on cutting inflation. Realizing that the indexation system and real wage gains are major factors in Israel's inflation, he unsuccessfully tried to get the Histadrut to agree to forgo real wage increases. Histadrut officials, however, are under little pressure to protect jobs by moderating wage demands. One of the basic tenets of Israeli policy has always been that significant unemployment is unacceptable. In addition to the normal reluctance to incur the political costs of high unemployment, Israeli politicians have publicly stated their moral obligation to provide jobs for foreign Jews taking up permanent residence in Israel.

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A Short Honeymoon

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Cohen-Orgad took office in October after Aridor was forced to resign when his "dollarization" plan—which we believe he intended as a device to circumvent the indexation system—was leaked.

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Israel's Pervasive Indexation System

Most Israelis are protected from inflation by the indexation system. As a result, the average consumer has fared well in recent years despite triple-digit inflation. Histadrut officials and Israeli politicians over the years have responded to accelerating price hikes by increasing the amount and frequency of adjustments rather than attacking the causes of inflation. As long as Israeli politicians will not tolerate unemployment levels much above 7 percent and Histadrut leaders exploit this to bargain for large real wage gains, Israel is in a vicious cycle that would be politically risky to break.

Wages. *At present, wages are indexed at 80 to 90 percent of the increase in the consumer price index (CPI), depending on the inflation rate, and adjustments are made quarterly. Between 1975 and 1979 the compensation factor was 70 percent, and from October 1979 to July 1983 it was 80 percent. Cost-of-living adjustments were made annually before 1973, twice yearly from then until 1980, and quarterly since 1980. Additional bargaining at the industry and plant levels in the traditionally labor-short economy has more than made up the difference, resulting in large real wage gains.*

Other Income. *Pensions and welfare payments have been fully linked to the CPI for a number of years, and adjustments are made quarterly. This practice stems, in our view, from a widely held belief in Israel's egalitarian society that the elderly and poor should be sheltered from inflation.*

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Financial Assets. *The principal on long-term savings accounts is fully linked to the CPI, and Israelis earn positive real rates of return averaging 3 percent. Government-issued bonds are indexed at either 80 percent or 100 percent and also have a real rate of return of about 3 percent.*

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Mortgages. *The principal on mortgage loans was first indexed in 1980. Until then, mortgage payments were not linked. As a result, lenders demanded such large downpayments that many young couples were excluded from the mortgage market.*

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Taxes. *Tax brackets are adjusted quarterly by 100 percent of the consumer price rise. Thus, Israelis can be put into a higher tax bracket only if their real earnings increase.*

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Cohen-Orgad and Histadrut officials publicly stated their willingness to discuss Israel's economic problems and to devise solutions; at the time, Histadrut officials told US Embassy officers that, while they would defend the cost-of-living adjustment system and real wage gains, they were willing to discuss other issues. At a meeting on 9 November, Histadrut Secretary General Meshel and Cohen-Orgad agreed to set up committees that would also include representatives of the Manufacturers' Association to study ways to promote exports, restrict imports, and help firms with financial problems.

Cohen-Orgad's often-stated public calls for a decline in real wages of 10 to 15 percent this year and large price hikes in recent months have probably eliminated any chance that he could reach agreement with the Histadrut on austerity; even the agreed-upon committees have not been established. The Cabinet on 1 January authorized Cohen-Orgad to negotiate a "package deal" on wages, prices, and taxes with the Histadrut and the Manufacturers' Association, but Histadrut officials quickly rejected the idea. They believe that differences between the government and the Histadrut are too great and that the government is trying to put the burden of economic retrenchment on wage earners, pensioners, and those on fixed incomes, according to reporting from the US Embassy. Histadrut Deputy Secretary General Kessar told a US Embassy officer that Cohen-Orgad's statements are generating rank-and-file pressure for militant action and that the worsening economic situation could increase strike actions.

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Histadrut officials have decided to take the same approach to accelerating inflation that they have in the past—demanding larger and more frequent wage adjustments. A Histadrut official told a US Embassy officer that the current wave of labor unrest might be dampened by monthly (rather than quarterly) cost-of-living adjustments and two (instead of one) salary payments per month. We believe these will be key Histadrut demands when the current framework agreement expires on 1 April. He also indicated that the Histadrut would seek government retraction of reductions in overtime and travel allowances recently agreed to by the Cabinet. [ ] 25X1

Cohen-Orgad has already lost the first round in negotiations with the Histadrut over payment of an advanced cost-of-living adjustment, demonstrating a lack of bargaining skill that the Histadrut will undoubtedly try to exploit in the future. The Histadrut received the full amount of the advance they had demanded after making only minor concessions to Cohen-Orgad and the Manufacturers' Association. The US Embassy reported that the employers and government acquiesced in the face of threats of labor unrest that might harm exports. The US Embassy reports that Histadrut leaders are privately saying that the government has already lost control over economic policy and that a new government is necessary [ ] 25X1

Given its ties to the opposition Labor Party, there is little incentive for the Histadrut to reach an accommodation with Cohen-Orgad. According to recent press reports, Labor Party officials believe it is only a matter of time before the faltering economy brings down the Shamir government. Histadrut officials are probably calculating that they can get a better deal from Labor. In any event, they believe they could not justify acceptance of Cohen-Orgad's proposals to their members, and, in our judgment, Histadrut officials have nothing to lose by taking a tough stand. [ ] 25X1

Implications for the United States

Cohen-Orgad cannot hope to carry out his austerity policies without Histadrut acquiescence. Because this is most unlikely, we believe Israel's balance-of-payments situation will continue to deteriorate. Unless commercial bankers are willing to increase lending, Israeli officials will again look to the United States to bail them out. [ ] 25X1

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Egypt's Worrisome Food Gap

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Agriculture, a cornerstone of the Egyptian economy, is suffering from inadequate investment and government policies that overlook many of the sector's pressing needs. Increases in agricultural production have failed to keep up with population growth since the mid-1960s, let alone meet increased food demand fostered by gains in per capita incomes. As a result, Egypt imports over 50 percent of its food at an estimated cost of about $3 billion in 1982. These imports utilize about 30 percent of Egypt's foreign exchange earnings and are increasingly worrisome with the reemergence of foreign payments difficulties. Because continued high domestic demand and limited arable land provide little hope that Egypt's food gap will narrow, we believe that food imports will remain large and that Cairo will press donors for increased food aid.

Agriculture's Declining Fortunes

The extent of government resources allocated for agriculture has fluctuated dramatically over the past several decades. In the mid-1950s, agriculture's share of total investment was 9 percent. This rose to over 25 percent in the mid-1960s because of the investment program associated with the construction of the Aswan High Dam. After completion of the dam in 1970, the government shifted its attention to industrial development; by 1975, investment in agriculture had fallen to about 7 percent of GDP.

The focus of government investment also limited agricultural growth. Few amounts were allocated for extension services, research, cooperatives, or inputs such as high-yield seeds and fertilizer that would aid small farms. Instead, emphasis was placed on large-scale projects such as the High Dam and land reclamation, which accounted for almost 75 percent of total agricultural investment during the 1960s. Although these efforts helped to add about 360,000 hectares of arable land—at an estimated cost of about $1,100 per hectare—the new land was generally of poor quality, and follow-up investment to enhance productivity was slow to materialize. Moreover, although the High Dam increased water availability and made double- and triple-cropping possible, new problems such as poor drainage and untimely irrigation were fostered by inept and disinterested local government agents.

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Neglect of small-scale agriculture and the inefficient utilization of newly reclaimed areas had a gradual but important negative impact. According to academic and World Bank studies, agricultural output grew at annual rates of 3.5 to 4 percent during 1955-65, fell to about 2.2 percent between 1965 and 1971, and has averaged less than 2 percent in recent years. Nevertheless, the agriculture sector continues to account for 20 percent of GDP and provides employment for 36 percent of Egypt's labor force of 13 million.

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Food demand has been pushed up by rapid population growth and rising per capita incomes. Egypt's population has increased about 3 percent annually, and official figures show that real incomes have grown by an average of 4 percent annually since 1970. Income growth was spurred by oil revenues, Suez Canal earnings, and remittances from the nearly 1.7 million Egyptians working abroad. The increase in real incomes has been enhanced by government price controls. As a result, the average Egyptian now consumes about 2,800 calories per day—equal to nearly 115 percent of recommended daily requirements—a level on par with many developed countries. Government subsidies on other items—such as petroleum, electricity, and goods produced by public-sector companies—have added to food demand by freeing income that would have been spent on other items.

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As food consumption rose, Egypt's agricultural trade balance deteriorated. The turning point came

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in 1973 when net agricultural trade, including cotton, recorded a deficit of almost $100 million. This gap reached $1.1 billion in 1978 and doubled to $2.3 billion in 1981. The deficits were largely caused by grain imports, but imports of meat, dairy products, and sugar were substantial as well.

Food Imports and Subsidies Spark Concern

The widening gap between domestic food production and demand has become increasingly worrisome to Cairo with the reemergence of foreign payments problems. Although food has accounted for well over 30 percent of total imports since the mid-1970s, these purchases were reasonably manageable between 1978 and 1981 because of the financial windfalls that accrued from Suez Canal and oil earnings as well as increased inflows of worker remittances. Beginning in 1981, however, growing current account deficits have made financing the $3 billion food import bill a major problem.

The Egyptian Government not only subsidizes staples such as bread and flour, but it also endeavors to provide ample supplies at low prices. These practices have serious implications for the government's precarious budget situation and have sparked considerable concern among high government officials. Food subsidies cost Cairo $1.6 billion, almost 10 percent of total government expenditures in FY 1982/83. Although Cairo has come under considerable pressure to reform the subsidy system—for both budgetary reasons and as a prerequisite for an IMF standby agreement—political considerations have so far limited reform to only token moves.

Outlook

Stagnant or falling world market prices for primary food commodities reportedly kept Egypt's public food import bill in the $3 billion range again in 1983. The Egyptian Government has attempted to clamp down on imports of luxury food imports, but, with oil earnings recording only marginal increases and Suez Canal earnings limited because of the drop in world oil trade, expenditures for food imports continue to command about 30 percent of foreign earnings. Concessional food aid of over $400 million in FY 1982/83, mainly from the United States and the European Community, has eased the situation somewhat, but financing Egypt's food imports continues to be a matter of deep concern to Cairo.

Institutional Setting

Government controls are pervasive covering water distribution; acreage allocations for various crops; pricing and supply of primary inputs; and pricing and marketing of major crops, including cotton, wheat, maize, and rice. About 85 percent of farmers use human labor to produce for their own consumption and local markets. The other 15 percent use communally owned machinery to produce crops for off-farm sale. Over 95 percent of land titles are for lots of about 2 hectares, but leasing is common, shrinking average farm size to about 1.4 hectares.

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Barring a drastic decline in real incomes, we believe food demand will continue to grow. At the same time, we see only limited prospects for increasing domestic production. The government goal of becoming self-sufficient in cereal production by 1990—including wheat, corn, and rice—is clearly unreachable. Aside from the limitations imposed by Egypt's scarcity of arable land, other factors will continue to keep demand high for imported food:

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- The government is reluctant to make more than minor changes in the politically sensitive subsidy system; even if some food subsidies were significantly lowered, academics argue that only a marginal falloff in demand would occur.
- Low procurement prices discourage production of wheat and other staples.
- There is little expectation of a significant drop in the population growth rate by the end of the

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- There is little expectation of a significant drop in the population growth rate by the end of the decade or even this century.

- Academic and World Bank sources estimate that urban sprawl is claiming 1 percent of prime agricultural land along the Nile per year.

Thus, should international commodity prices rise again, Egypt's food bill will renew its upward track. In this event, Cairo would no doubt continue to press major donors, mainly the United States and the European Community, for increased food aid.

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West Germany: Soviet Trade Relations on Track

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Although Bonn has been concerned that frictions with Moscow over INF deployment and other security issues would spill over into the trade arena, West German–Soviet commercial relations appear to remain on a stable footing. Trade continued to expand during the first three quarters of 1983, even though lower Soviet energy export prices cut Soviet revenues. Economic factors, however, such as the winding down of West German sales for the Siberian pipeline and domestic Soviet economic problems, probably will slow trade expansion over the next few years. Lower oil prices and the softening of West German natural gas demand will reduce Soviet hard currency earnings. Consequently, Moscow's inclination to commit itself to new large-scale purchases from West German firms will depend in large part on the availability of West German credits.

Despite Soviet calls for strengthening bilateral economic ties, Moscow was vague in identifying areas for future cooperation during the recent trade meetings. Bonn, nevertheless, will seek to improve its economic relationship with the Soviets because it recognizes the positive—albeit marginal—impact bilateral trade has on the domestic economy and believes good economic relations with Moscow will help stabilize political relations with Eastern Europe.

Recent Developments

West German–Soviet trade (exports plus imports) continued to expand in 1983 and could top $9 billion for the year. For the first nine months, exports to the Soviet Union jumped by almost 26 percent over the same period in 1982, largely driven by a 50-percent increase in machinery sales. By comparison, West German exports to the EC remained flat, and sales to OPEC fell by almost 16 percent.

Plant, equipment, large-diameter pipe, and other steel products account for 60 percent of West German sales to the USSR. In addition to supplying half of the large-diameter pipe and more than one-third of the gas turbines for compressor stations on the Siberian natural gas export pipeline, West German firms are manufacturing rotor components for Soviet-built turbines and drilling equipment for a Soviet natural gas field near Astrakhan on the Caspian Sea. Other active projects include modernizing and partially reconstructing a Soviet papermill, constructing the Sayansk aluminum smelter plant, and supplying grainhandling equipment to update and expand existing facilities at several Soviet seaports. Through September, iron and steel exports just equaled sales for the same period in 1982—suggesting that deliveries of steel pipe for natural gas pipeline construction are tapering off.

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The value of imports from the Soviet Union was down by 3 percent during the January-September period. Although West German imports of Soviet crude oil and products increased by 17 percent in volume, falling prices have held down Soviet revenues. In addition, the West Germans cut their imports of natural gas by over 4 percent in volume terms. As a result, West Germany's trade balance with the Soviets—which has been in deficit for two years—could show a surplus in 1983.

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Trade Talks Indicate Business As Usual

Bonn had been concerned that its support of INF deployment in Western Europe would disrupt economic relations with the USSR. Throughout the summer, Moscow warned that political events could damage commercial relations

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At the recent Mixed Economic Commission meetings, however, the Soviet delegation reportedly did not emphasize the link between deployment and trade, but rather stressed the USSR's desire for continued stable economic relations. During the discussions, Moscow called for greater long-term cooperation with West German businesses, especially in energy conservation, consumer goods, and agriculture. Surprisingly, Moscow did not press for increased West German purchases of gas, but wants West Germany to increase its purchases of Soviet-manufactured goods. West German Economics Minister Lambsdorff apparently was concerned, however, by the paucity of proposals for joint large-scale projects. According to Embassy reporting, Lambsdorff believes that a large coal-conversion project in the Kansk-Achinsk region in Siberia, one of the few major development projects discussed, remains well in the future. 25X1

Probably as an added measure of reassurance, Moscow resolved two longstanding complaints at the Mixed Economic Commission meetings. The Soviets approved the opening of automatic telephone circuits between West Germany and the Soviet Union for West German businesses, and they agreed to issue multiple-entry visas for accredited West German businessmen and their families living in Moscow. 25X1

West Germany: Trade with the USSR, 1982

	Million US $	Share of Total West German Trade (*percent*)
Exports	**3,869**	**2.2**
Agriculture	327	3.6
Raw materials	40	1.3
Fuels	21	0.3
Chemicals	387	1.8
Manufactures	1,547	3.1
Iron and steel	1,058	10.8
Machinery and transport equipment	1,487	1.8
Metalworking machinery	298	9.4
Other	60	1.4
Imports	**4,691**	**3.0**
Agriculture	30	0.2
Raw materials	233	2.2
Fuels	3,695	10.1
Crude oil	793	4.3
Petroleum products	1,282	5.7
Natural gas	1,456	22.0
Chemicals	168	1.4
Manufactures	240	1.0
Machinery and transport equipment	29	0.1
Other	296	5.9

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Bonn's Economic Perspective

Although the USSR absorbs slightly more than 2 percent of West German exports, Bonn continues to place a high value on its economic relations with the Soviet Union. West Germany's shipments to the USSR account for over one-third of its exports to the East Bloc and exceed its shipments to either Japan or South America. The Soviet Union now is West Germany's ninth-largest trading partner. 25X1

Bonn realizes that sales to the USSR have a limited impact on overall West German economic activity. According to West German estimates, only about 100,000 workers are directly employed in producing goods for export to the Soviet Union. Nevertheless, the high unemployment rate in West Germany makes any source of employment politically important. 25X1

Any cutback in Soviet purchases would significantly affect those West German firms with substantial ties to the Soviets. West Germany's large steel and

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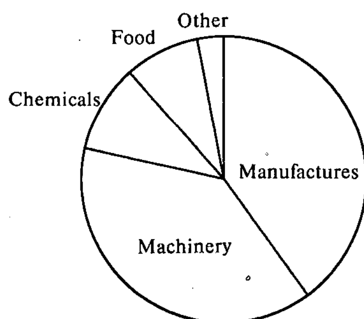
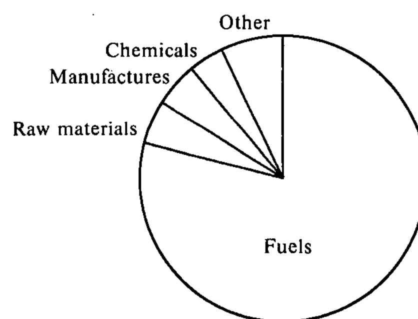
West German/USSR Trade, 1982

West German Exports to the USSR



West German Imports From the USSR



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machine tool industries depend heavily on exports; Soviet purchases account for about 10 percent of the industries' exports.

The USSR has been an especially welcome buffer against hard times for West German steel firms. West German steel production fell by almost 13 percent last year because of the worldwide steel slump, growing protectionism, LDC and East Bloc debt problems, and competition from imports that have captured about 40 percent of the domestic market. Last year, Soviet purchases from West German suppliers of large-diameter pipe and related equipment accounted for about 8 percent of total finished steel production. Moreover, unemployment in the iron and steel industry is currently at 20 percent, more than double the overall rate.

At the current level of energy imports, Bonn does not consider dependence on Soviet energy a significant risk. About 10 percent of West Germany's energy imports come from the Soviet Union, covering only about 4 percent of primary energy needs. Oil from the USSR—crude and products—accounts for slightly more than 7 percent of total West German oil consumption. Soviet gas now comprises about 22 percent of total gas purchases, a share that could grow to 30 percent in the 1990s. Bonn claims, however, that overall energy dependence on the USSR will stabilize at about 5 percent because oil imports from the USSR are expected to decline. Further, Bonn and the gas industry also maintain that the Soviets are reliable suppliers, and that, in any event, they could cope with a cutoff of Soviet gas at least temporarily by increasing domestic production and expanding imports from other West European suppliers.

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West German Political Motives

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Trade with the USSR serves West German political objectives in Eastern Europe. Bonn continues to believe that closer commercial ties with Moscow

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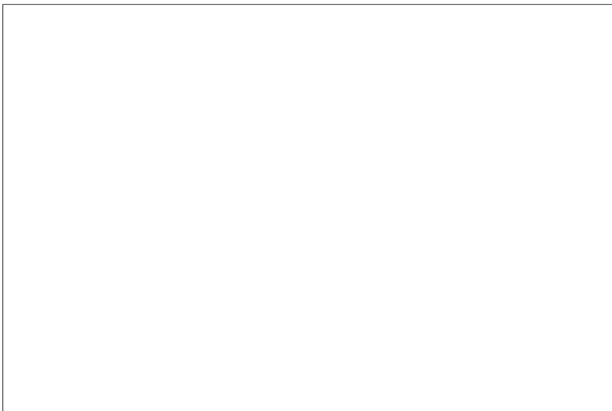
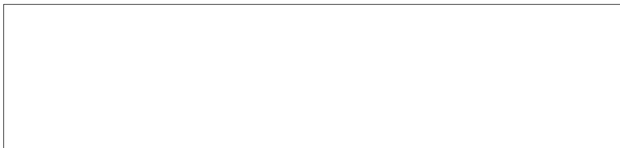
will contribute to stability in East-West relations and, in particular, help keep alive prospects for more extensive contacts with East Germany. Bonn believes the Soviet Union holds veto power over the development of closer West German–East German ties—the crux of *Ostpolitik*.



Prospects for Expanding West German–Soviet Trade

Although Bonn has been worried that political conflicts with Moscow might damage growing economic relations, energy market conditions are far more likely to slow trade expansion in the near term. Soviet exports to the West—hence its hard currency earnings—depend heavily on world energy markets. The USSR managed to expand the volume of its crude oil sales to West Germany last year, but falling oil prices reduced hard currency earnings. Natural gas demand in Western Europe has been soft, further cutting Soviet export earnings. Moreover, this situation is not expected to change soon. Based on projected gas demand, the West German gas entity Ruhrgas does not anticipate an increase in Soviet gas purchases before 1990 beyond the minimum amounts already contracted for. Although Soviet exports to West Germany will increase as gas starts flowing under the Siberian pipeline contract—we currently estimate by as much as $250-375 million in 1985—most of these earnings will be offset over the next decade by pipeline loan payments. Further, the Soviets have had little success in exporting manufactures.



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The absence of specifics on joint large-scale projects at the bilateral talks probably reflects Moscow's reaction to the slack market for its raw materials, a possible trade deficit with the West Germans, and concern about the availability of favorable credits. It further suggests that Soviet import plans could remain conservative until energy demand in Western Europe picks up. With no new major projects in the offing and slowing pipeline business, West German suppliers probably can expect a leveling off or even a decline in new Soviet orders.

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The Soviet Timber Industry

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Although the Soviet Union has the largest forest cover in the world and remains the leading producer of lumber and the second-largest harvester of logs after the United States, performance in the forest products industry has faltered since the mid-1970s. Timber production—the source of raw material for the forest products industry—has fallen abruptly; by 1982 timber output was 8 percent below the level of 1970. Lumber shortages constrained Soviet construction, shortfalls in paper and cardboard output limited supplies of packing materials, and hard currency earnings from timber declined by one-third in 1981 to $1.0 billion.

USSR: Hard Currency Forest Products Exports *Million US$*

1970	1975	1976	1977	1978	1979	1980	1981
389	739	889	1,084	991	1,370	1,500	1,016

Source: Official Soviet foreign trade statistics, Vneshnaya torgovlya.

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Export markets could improve dramatically by the end of the 1980s. Moscow—with roughly one-fifth of global timberland— will have an opportunity to increase its share in West European markets as a result of forced reductions in exports by Sweden and Finland. Scandinavian forests have been overcut and will not be able to sustain current export volume for long. Other opportunities for increases in exports may come from Japan and China. Soviet fortunes could improve further by the turn of the century if the rapid rate of deforestation in world tropical forests continues. Although its vast supply of coniferous wood is not a perfect substitute for tropical reserves, the USSR could expand its trade and possibly enjoy price increases. The key to greater production, however, will be overcoming existing production bottlenecks.

Domestic Shortcomings

The decline in the timber industry stems primarily from transportation snarls. Since 1975 the decline in timber hauled by rail has been far greater than the decline in timber output. The reason for this plunge was a drop in priority. Timber is not considered a major nor a strategic rail customer—its share of total freight tonnage is only about 4 percent. With rail lines saturated and railcars in short supply, Soviet railroad officials chose to divert rolling stock earmarked for timber shipment to other uses. Moscow even imposed bans and embargoes on timber traffic during this period as thousands of railcars were shunted to the movement of grain and other critical commodities. As a result, severe backups occurred in logging operations. Logs piled up at downstream concentration points and at railroad depots. According to Soviet calculations, the amount of timber that accumulated at these transit facilities ranged from two to five times the amount the yards were designed to accommodate.

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Transportation bottlenecks plagued logging as it was expanded to more remote regions. The distance from processing centers increased as logging camps shifted to new woodlands in Siberia, the Urals, and northern parts of the European USSR.

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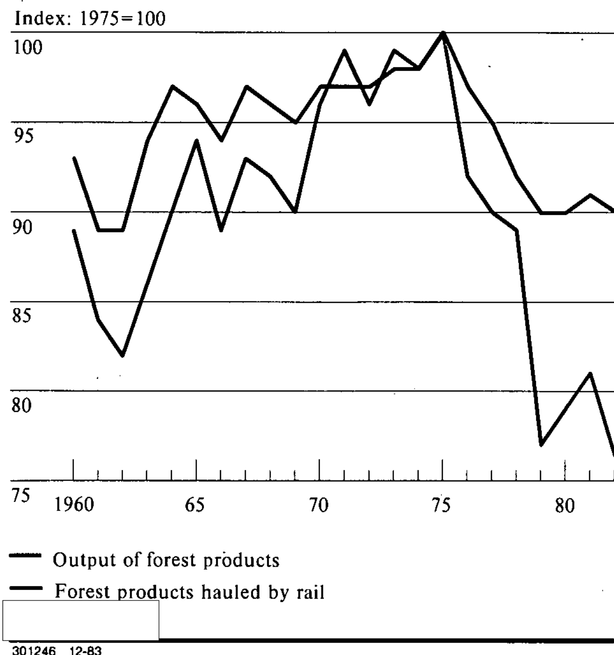
USSR: Output of Forest Products and Forest Products Hauled by Rail



Transportation problems had a ripple effect throughout the industry. Sawmills operated at little more than 80 percent of capacity during the 1976-80 period because of timber shortages. Pulp and paper inventories fell to 40 percent of the norm, with many factories relying on day-to-day wood deliveries. Even when raw materials were delivered, pulp and paper factories operated intermittently because there were too few railcars to transport finished goods. Moreover, [ ] the quality of pulp deteriorated, resulting in paper that tore easily and increased equipment downtime. [ ]

Besides the lack of raw wood, other inputs were in short supply. Fuel shortages hampered logging efforts. Electricity brownouts and fluctuations damaged machinery and limited production in the pulp and paper sector. [ ]

Insufficient Capital and Labor

Both capital and labor inputs allocated to the forest products industry grew more slowly during the 10th Five-Year Plan (1976-80) than in previous plans. Moscow shifted investment funds to agriculture and energy and substantially cut back the share allocated to the forest products industry. From 1971 to 1975, the industry's share of total investment was 4.6 percent; by 1982 it was only 3.8 percent. As a result, the condition of fixed capital—most 35 to 40 years old and at a technological level comparable with that of the United States in the 1930s and 1940s—has deteriorated considerably. [ ] 25X1

A key source of equipment replacement—imports—dried up because of scarce hard currency and the Western sanctions precipitated by the invasion of Afghanistan. Although forest products machinery was not specifically put under embargo, the general strain in East-West relations in recent years has caused several timber machinery barter negotiations with Japan to be canceled or postponed. [ ] 25X1 25X1

The Soviet forest products industry made matters worse through poor investment choices. The Soviets chose a two-pronged investment strategy—construction of large-scale forest complexes at Bratsk and Ust-Ilimsk' in eastern Siberia, and renovation of older facilities in the northwestern and Ural regions. Both yielded disappointing results. The Siberian complexes ran into large cost overruns, precipitated by poor coordination, the harsh climate, delays in the delivery of construction materials, and problems in retaining workers. Renovation of existing facilities in the developed European region disrupted production, and many projects were abandoned in midstream when funds ran out. [ ] 25X1 25X1 25X1 25X1

Employment in the lumber industry has been shrinking steadily since the mid-1960s, with lumberjacks showing the greatest decline. This manpower shortage in logging—so critical because of 25X1

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USSR: Average Annual Growth of Forest Products Output

Percent

	1961-65	1966-70	1971-75	1976-80	1981	1982
Forest products industry	**2.6**	**2.9**	**2.6**	**−0.3**	**2.3**	**0**
Logging	0.8	1.2	0.8	−2.2	0.1	−1.3
Sawmilling and woodworking	1.4	1.2	0.1	−3.1	0	−0.7
Pulp and paper	7.7	7.2	5.0	0.5	2.6	0.1

Source: CIA's index of Soviet industrial production. These indices are calculated to account for the distortions in Soviet data that result from double-counting and disguised inflation.

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the resulting slowdown in the raw material flow—has persisted. Poor housing and lack of public services make it difficult to recruit and retain workers. Despite substantial wage increases, labor turnover has remained high. To supplement the work force in logging and milling, the Soviets have employed prisoners, foreign workers, and university students.

Outlook

Soviet plans call for the production of forest products to increase by 17 to 19 percent during the 1981-85 period. We believe, however, that actual gains will fall short of this target. Railroad bottlenecks may ease somewhat, but we do not foresee the dramatic increase in the availability of rolling stock necessary to raise output to the level of the early 1970s. Moreover, the lack of major capital outlays will leave equipment and machinery in poor shape.

Future Export Opportunities

Forest products are the USSR's fifth-largest hard currency earner, following fuel, gold, arms, and machinery. Japan is the major purchaser of unprocessed logs and wood chips, and the United Kingdom remains the primary buyer of lumber. We estimate that hard currency earnings from timber and timber products will average between $1.1 billion and $1.5 billion per year in the mid-1980s. Underlying this growth estimate is our belief that the supply of timber for export will increase as some production bottlenecks are reduced and as domestic consumption is held in check to provide for exports. We expect a modest increase in demand, particularly in Japan where construction investment has turned upward.

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Export opportunities could improve dramatically late in the 1980s. Industry analysts expect strong upward price pressures as the housing industry increases demand for forest products. Moreover, Moscow will have an opportunity to increase its

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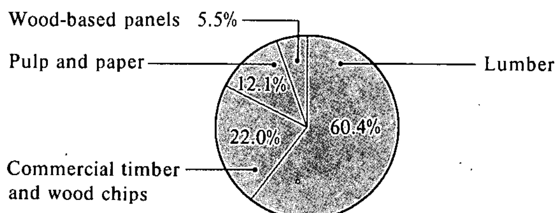
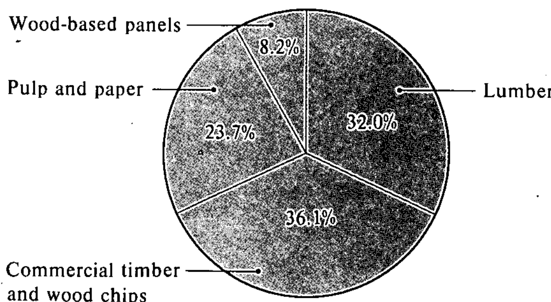
USSR: Composition of Forest Products Exports[a]

1960
Total: 15 million cubic meters



1980
Total: 37 million cubic meters



[a]All products have been converted to cubic meter equivalents.

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share of West European markets later this decade because of forced reductions in exports by Sweden and Finland—major Soviet competitors. Scandinavian forests have been overcut and will not be able to sustain current export volumes.

Substantial increases in export volume could be derived from trade with China and Japan. Beijing is deficient in timber resources and is searching for sources of wood; agreements with Soviet and US foresters have already been reached. We believe the Soviets will attempt to develop Siberian forests adjacent to the Chinese border and will actively compete with US companies for sales to the Chinese. Tokyo's large existing timber-processing capacity and reliance on imports suggest that Japanese businessmen will be looking for increased timber imports as economic conditions improve. Likely future deals already under consideration include the construction of pulp and paper plants on Sakhalin and logging and sawmilling facilities in the Angara-Yenisey river basin.

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Soviet export opportunities could increase further in the 1990s if the rapid rate of deforestation in world tropical forests continues. The USSR's vast supply of coniferous timber, although not a perfect substitute for tropical reserves, could enable Moscow to expand its market share. The Soviets, however, will have to overcome production bottlenecks and market timber aggressively if they are to exploit these opportunities.

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Next 2 Page(s) In Document Denied

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