Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Directorate of Intelligence

~~Secret~~

25X1

file copy
do not remove

International Economic & Energy Weekly

25X1

15 June 1984

~~Secret~~

DI IEEW 84-024
15 June 1984

Copy 685

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

25X1
Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Page Denied

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Secret

25X1

International Economic & Energy Weekly

25X1

15 June 1984

25X1

iii Synopsis

1 Perspective—Limited Oil Market Reaction to Persian Gulf Attacks

25X1

3 Briefs
Energy
International Finance
Global and Regional Developments
National Developments

15 Japan: Nakasone Turning to Economic Issues

25X1
25X1

19 Israel: Persistent Economic Inefficiency

25X1
25X1

23 Saudi Arabia: Sectoral Implications of the Oil Slump

25X1
25X1

25X1

25X6

25X1

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

25X1
25X1
25X1

Secret
15 June 1984

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

25X1

International Economic & Energy Weekly

25X1

Synopsis

1 **Perspective—*Limited Oil Market Reaction to Persian Gulf Attacks***

25X1

The world oil market has responded rather calmly so far to attacks on oil shipping in the Persian Gulf. In our view, the market will continue to react calmly if attacks against shipping remain at the level of recent weeks.

25X1

15 **Japan: Nakasone Turning to Economic Issues**

25X1

As the November Liberal Democratic Party (LDP) presidential election approaches, Prime Minister Nakasone will increasingly be forced to deal with economic issues—his weakest suit.

25X1

19 **Israel: Persistent Economic Inefficiency**

25X1

For almost a decade, Israeli politicians have failed to address Israel's persistent economic problems. We believe that the next government after the 23 July elections will not seriously address them unless it wins an absolute majority or faces a serious foreign exchange shortage.

25X1

23 **Saudi Arabia: Sectoral Implications of the Oil Slump**

25X1

Despite the sharp drop in oil revenue over the past two years, Saudi Arabia is resisting across-the-board spending cuts that might undermine its major objectives of boosting living standards and broadening its economic base. Riyadh has focused investment cuts on the foreign-dominated construction industry and is taking steps to support Saudi firms in financial straits.

25X1

25X1

25X6

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

25X1

International Economic & Energy Weekly

25X1

15 June 1984

Perspective

Limited Oil Market Reaction to Persian Gulf Attacks

25X1

The world oil market has responded rather calmly so far to attacks on oil shipping in the Persian Gulf. With the attack on a Kuwaiti tanker on 10 June, the number of confirmed attacks since late March reached 12 and has caused an increase in insurance and charter rates for shipping in the northern portion of the Gulf. Yet, oil exports from the Persian Gulf were about 8.1 million b/d in May, only 600,000 b/d less than during April, according to our analysis. With the exception of the fall in Iranian exports of 300,000 b/d to 1.5 million b/d in May, the drop probably reflected a seasonal decline in oil demand rather than an unwillingness of tankers to enter the Gulf. Iranian exports, which fell to about 800,000 b/d during the 17-24 May period as a result of uncertainties over insurance premiums, rebounded later in the month to 1.5 million b/d following Iranian price discounts of up to $2 per barrel.

25X1

Spot oil prices have increased slightly on several occasions following confirmation of reported attacks, only to fall back to earlier levels. We believe the lack of market response to date reflects:

- Failure of the attacks to inflict sizable damage or cause a noticeable disruption in oil flows.
- Ample surplus capacity of 3 million b/d outside the Persian Gulf.
- A growing cushion of commercial and government-owned stocks, including Saudi floating storage, in key consuming areas.
- Market belief that major Western powers, especially the United States, will be quick to respond militarily to a disruption and also release oil from stockpiles to prevent price escalation.

25X1

In our view, the market will continue to react calmly if attacks against shipping remain at the level of recent weeks. A substantial escalation in the number and frequency of attacks against tankers or oil facilities, however, could change industry perceptions of the Gulf situation. Key indicators that would signal market concern include:

- Sustained spot price increases for Nigerian or North Sea crudes of 50 cents per barrel or more.
- Noticeable increases in production (200,000 b/d or more) from non-Gulf producers including Nigeria, Mexico, Libya, and Venezuela.
- A noticeable increase in spot or government-to-government oil transactions for key importers such as Japan, France, or Italy.

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

- Attempts by companies or governments to boost oil inventories, which would cause an increase in overall OPEC crude production to a level in excess of 19 million b/d as compared with estimated May production of 17.4 million b/d.

25X1

We believe a major escalation of hostilities such as daily strikes against oil tankers or Iranian attacks against the oil facilities of Iraq's Gulf supporters would produce an immediate jump in spot oil prices. We believe it would be only temporary given the present stock situation and surplus capacity outside the Gulf. Should Iran succeed in severely damaging Gulf export capabilities or sustain a partial closure of the Strait of Hormuz, we believe market reaction would produce a more substantial ($10 to $15 per barrel) oil price hike.

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Briefs

Energy

Australian Coal Exports Up

Australian coal exports—Canberra's largest export earner—are headed for another record year. Coal shipments are up nearly 25 percent in the first quarter compared with year-earlier levels. Sales to all regions rose, with Western Europe showing the sharpest growth. Coking and steam coal shipments to Western Europe were up 42 and 50 percent, respectively. The increases resulted largely from price discounts. The average export price of coking coal to Europe in February, for example, was nearly 25 percent below year-earlier levels. If present trends continue, Australian coal exports could reach 74 million metric tons this year and possibly surpass coal sales by the United States—historically the world's largest coal exporter.

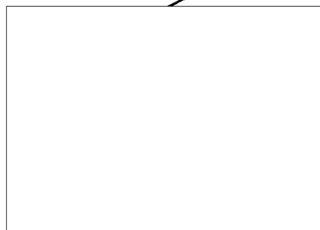
25X1
25X1

Australia: Coal Exports *Thousand metric tons*

	January-March 1983	January-March 1984	Percent Change, 1984 Over 1983
Total	**15,070**	**18,491**	**23**
Coking coal	10,404	12,049	16
Far East	9,149	9,903	8
Japan	7,685	8,178	6
Western Europe	1,130	1,600	42
Other	125	546	337
Steam coal	4,666	6,442	38
Far East	2,869	4,013	40
Japan	1,863	2,449	31
Western Europe	1,344	2,018	50
Other	453	411	−9

25X1

Canadian Heavy Oil Upgrader Gets Government Assistance



After nearly two years of negotiations, Husky Oil, the federal government, and the provincial governments of Alberta and Saskatchewan have agreed on a financial incentives package for the $2.5 billion Lloydminster heavy oil project. Under the agreement, Ottawa will provide a $40 million grant and up to $615 million in loan guarantees while Alberta and Saskatchewan will provide $305 million each in loan guarantees. When completed in 1989, the project will produce 42,000 b/d of synthetic crude from heavy oil deposits, reducing the country's dependence on foreign oil.

25X1
25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Ottawa is eager for synthetic crude to play a larger role in meeting the country's energy needs, and over the past year the federal and provincial governments have offered similar incentives to get other capital-intensive heavy oil and tar sands projects started. The Lloydminster facility, however, is the largest undertaking to be proposed since the $12 billion Alsands synthetic oil project folded in 1982. Indeed, the large capital costs involved had prevented Husky or other companies from going ahead without government aid. With the financial package in hand, Husky officials hope to attract other companies into the venture. Texaco Canada earlier expressed interest in the project and has indicated it will make a decision on its participation this summer.

25X1

Doubts About Iraqi Pipeline Spur Through Saudi Arabia

Saudi Arabia's recent decision to increase the flow of oil through its pipeline to the Red Sea reduces a potential alternate route for Iraqi oil exports. According to press reports, Riyadh is now moving 1.5 million b/d through the pipeline, more than double the previous rate of 600,000 b/d and close to the pipeline's 1.85-million-b/d capacity. In addition to security reasons, the Red Sea route has become more attractive because of higher insurance rates for Gulf shipping.

25X1
25X1

The availability of at least 500,000 b/d in the Saudi pipeline is critical to plans to build a spur from Iraq's southern oilfields to the Saudi pipeline. A pipeline through Jordan is the only other option available to the Saudi route, but the Iraqis are concerned with the risk of running a pipeline close to Israel.

25X1
25X1

Costa Rica Facing Power Shortage

Hydroelectric plants in northwestern Costa Rica may have to be shut down, reducing power supplies in Costa Rica, Nicaragua, and Honduras. According to the US Embassy, US and Panamanian engineers recently examined two power plants—which supply 50 percent of Costa Rica's electricity—and reported that one hydraulic turbine has been damaged because of improper debris filtration. To repair the damage completely, both plants would have to

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

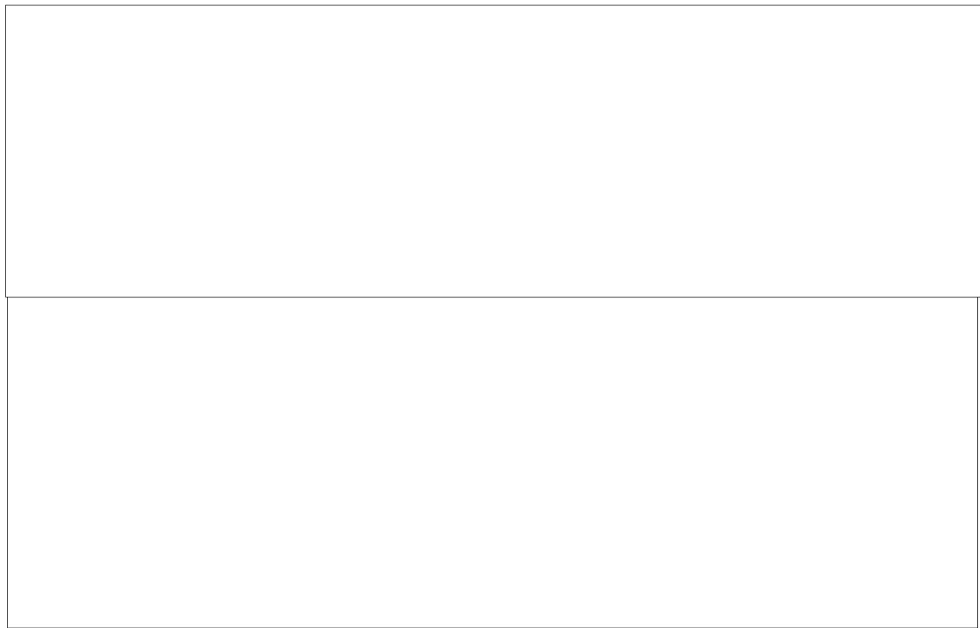
Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

shut down for four months, costing Costa Rica an estimated $1 million a day in lost production. Although a final decision has not been made, interim cleaning measures call for reducing the water flow to the generators to remove debris. According to Costa Rican Electric Institute officials, anticipated shortages will result in rationing during peak hours, and sales have already been supended for at least 15 days to Honduras and Nicaragua. 25X1

International Finance

Mexico's Ambitious Debt Initiative

25X1



25X1

25X1

25X1

While some influencial bankers support more favorable terms for countries like Mexico that have made major economic adjustments, a quick accommodation is unlikely. Many other bankers—in particular those from US regional and West European banks—are fundamentally opposed to generous concessions on interest or to reconsideration of financial packages set during the past two years. Bankers favoring concessions believe that flexibility will encourage other case-by-case settlements and undercut momentum toward collective actions by debtors. They see across-the-board debt solutions that could come without bilateral concessions as undermining international financial discipline and retarding progress on economic adjustments. 25X1

Mexican officials believe they are in a strong position, and will press hard on all points. Mexican financial officials want to offset criticism from within their government and from opposition politicians—who continue to call for debt moratorium or repudiation—that de la Madrid has been too soft with foreign bankers. Past endorsements of tough economic adjustments by senior money center bankers and Western monetary authorities have further emboldened Mexico. 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Mexico's poor economic growth prospects will not be substantially improved by debt rescheduling. Without continued fundamental economic policy changes and some increase in savings, we do not believe that even favorable debt rescheduling terms will be sufficient to boost investor confidence or encourage international banks to reestablish normal trade credits.

25X1

Dim Outlook for Nigeria-IMF Agreement

General Buhari's government apparently intends to avoid reaching a final agreement with the IMF for as long as possible while looking for other sources of financing. Senior Nigerian financial officials will meet in Washington with top IMF officials early next week. Devaluation still remains the major obstacle, and Lagos continues to argue that a large devaluation would raise prices to unacceptable levels.

25X1
25X1

Lagos probably hopes that the recent reduction in the money supply resulting from a currency conversion and a new austerity budget will convince the Fund to reach an agreement.

25X1

Economic decision making within the Buhari government continues to be haphazard and uncoordinated. The US Embassy reports that there is growing domestic pressure on the government not to negotiate a Fund agreement. Many Nigerians increasingly view a hike in oil production and exports as a preferable alternative to the painful adjustments required under an IMF-supported loan program.

25X1

Philippine Economic Austerity Package

The economic austerity measures announced last week by President Marcos appear aimed at forcing a speedy conclusion to negotiations with the IMF and moving forward with rescheduling debts to foreign banks and governments. Marcos also is seeking to establish unpopular economic policies before the opposition is seated in the new assembly and begins to debate his management of the economy. The measures included floating the exchange rate, which resulted in a 22-percent devaluation, a 10-percent import surcharge, a 30-percent tax on exporters' windfall profits, and a 5-percent budget cut. The Philippines has failed to meet IMF monetary and fiscal preconditions during almost a year of negotiations. In a budget-busting preelection spending binge, the government again overshot the IMF's targets.

25X1
25X1

IMF agreement on a standby loan is still unlikely before late summer; the IMF will require at least six weeks to assess the new measures.

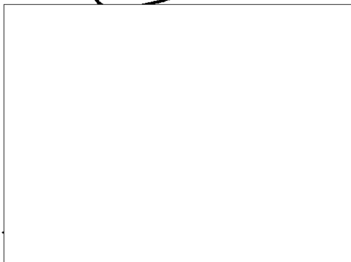
25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Global and Regional Developments

Honda To Build Auto Assembly Plant in Canada



The Honda Motor Company last week announced plans to invest $79 million in an automobile assembly plant in Ontario. Honda thus will be the first Japanese automaker to produce cars in Canada, although Toyota is building an aluminum wheel manufacturing plant in British Columbia. Initial production of 19,000 cars is scheduled for 1987, with full production of 40,000 reached in 1989. The cars will be assembled from kits imported from Japan and sold in the Canadian market. Future exports to the United States have not been ruled out. Industry Minister Lumley estimates the Canadian content of the automobiles initially will be about 23 percent, with Honda likely to purchase items such as glass and batteries domestically. Honda also has agreed to assist Canadian parts firms in developing the technology and capabilites to increase domestic content in the automobiles.

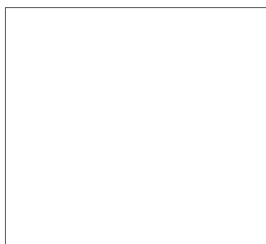
25X1

25X1

Ottawa has been pushing Japanese automakers to establish production facilities in Canada and is enthusiastic about the deal. Nevertheless, the limited production, low Canadian content, and few jobs created—the highly automated plant will employ only 350 workers—indicate Honda's investment was undertaken primarily to appease Ottawa and prompt relaxation of Canadian quotas on Japanese automobiles. Canadian parts producers are not optimistic that Honda will maximize its use of their products. Both the parts industry and the UAW have been urging Ottawa to require 60-percent Canadian content in all automobiles either made or imported in Canada and expressed disappointment at the low level of Canadian content in the new automobiles.

25X1

Airbus Industrie Approaches Japanese Firms



Western Europe's Airbus Industrie is moving to develop a wider range of aircraft and is talking to Japan about joining the consortium on future designs. According to a recent Japanese press report, Airbus informally asked three Japanese manufacturers if they would develop the main wing for two all new designs—the TA-9 and TA-11. Airbus officials said they plan to market the aircraft in 1990 following introduction of the 150-seat A-320 design. The TA-9 is a twin-engine 370 passenger version of the A-300 and the TA-11 is a 4-engine, 225 passenger, transoceanic aircraft. These designs, coupled with the launch of the A-320, indicate that Airbus is accelerating plans to expand their product line in an effort to be competitive across the board with US manufacturers. Despite the press reports, we believe Japan is unlikely to get responsibility for the wing section. Britain, the builder of wings for current airbus designs, would be unlikely to pass this business to Japan. More likely, Airbus—knowing Japanese needs to improve abilities in this area—made the offer as an inducement to gain Japanese interest in participating in other aspects of the new aircraft.

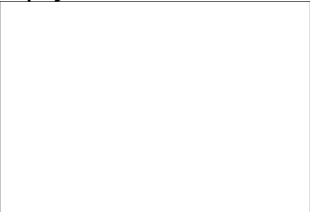
25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Several Countries May Relax Recombinant DNA Regulations

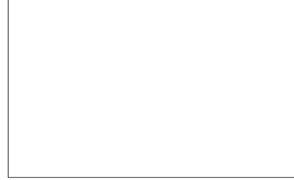


A trend appears under way in several countries to ease recombinant DNA regulations and guidelines. Government groups in Japan, the Netherlands, and Sweden are recommending more relaxed conditions related to recombinant DNA research because of a belief that the risks are no greater than those posed by traditional micro-organism research. They also are calling for less stringent regulations for the mass production of recombinant DNA-derived products. Relaxed regulations would provide an incentive for corporations from other countries, including those from the United States, to move their basic research and product testing and evaluation to these countries. Any such moves would allow increased opportunities for technology transfer to occur and could narrow the current US lead in the commercial application of biotechnology.

25X1

25X1

Chinese and Soviet Purchasing of Manganese Ore



China is purchasing high-grade manganese ore for the first time. Gabon reportedly will provide 140,000 metric tons and Australia will ship 80,000 tons, both at the current world price of $1.43 per ton. The imports probably will be mixed with domestic ore to produce high-quality ferromanganese. China has abundant reserves of low-quality manganese, but expansion of its domestic steel industry could require more imports of high-quality ore.

25X1

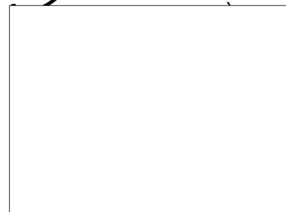
25X1

25X1

News of the Chinese purchases follows recent reports of large manganese contracts between the Soviet Union and Australia, Gabon, and Brazil. The Soviets, the world's largest manganese producer, are reportedly experiencing ore grade problems. Increasing demand for manganese by the Communist countries provides one of the few bright spots in a market where excess capacity, declining manganese usage per unit of steel, and a pessimistic long term outlook for steel production suggest a rather slow recovery. The average mine operating rate worldwide is only 60 percent and prices are 19 percent below their 1981 highs. As a result, several ore producers—Brazil, India, and Mexico—are starting or increasing ferromanganese production in the hope of capturing the benefits of higher value added.

25X1

Soviets Out of the Rice Market



The USSR, one of the world's largest rice importers in 1979-82, has sharply curtailed purchases because of growing stocks and good harvests. According to our estimates, the Soviet Union is likely to take only 450,000 metric tons this year compared to a record 1.3 million tons of rice imported in 1981. Soviet rice stocks are estimated to be equivalent to more than one year's consumption, and a record harvest is expected this year, according to the US Agricultural Attache in Moscow. The Soviets are likely to import only customary amounts on barter from North Korea and India. Both the United States and Thailand have made rice sales overtures to Soviet trade officials this year but have been rebuffed.

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Low Soviet rice imports are bad news for exporters of high-quality rice, who hoped that large Soviet purchases would bolster the sagging market. The market for cheaper, low-quality rice is also depressed because many LDC importers cannot afford rice imports. As a result, world prices have plunged 40 percent from a 1981 peak, and the US Department of Agriculture expects world rice exports this year will fall to 11.8 million tons, the lowest level since 1978. 25X1

Sugar Talks Begin Anew

Talks began this week in Geneva on a new International Sugar Agreement to replace the one which expires in December. There was little progress during two earlier negotiating sessions because of disagreements over the size and allocation of quotas, the role of stockpiles, the target price stabilization band—currently 13 to 23 cents per pound—and Cuba's exemption from export quotas for sugar sales to other Communist countries. The general pessimism of the participants is reflected in the stance of the chairman of the negotiations, Jorge Zorreguieta of Argentina, who reportedly has on hand an administrative agreement that would maintain the International Sugar Organization but without any specific economic provisions. Without such measures, prices could be driven considerably below the current 7.5 cents per pound should countries with large sugar stocks—such as Brazil and India—dump surplus sugar. According to press reports, Brazil is threatening such action and others probably would follow suit. Moreover, industry experts are predicting another bumper sugar crop in 1985 and, regardless of any agreement on buffer stocks and quotas, prices will be difficult to sustain. 25X1

25X1

25X1

National Developments

Developed Countries

Possible Lull in West German Recovery

West German real GNP in first quarter 1984 was up 3.6 percent from the year-earlier period because of very strong exports and investment. Some leading indicators, however, already are pointing toward a lull in the recovery. New orders fell sharply in March and April over the previous two months, and the April survey of the business climate worsened—probably reflecting the impending metalworkers' strike. The strike, which began 14 May, almost certainly portends even gloomier data for May and June. We believe real GNP will slow markedly in the second quarter but should then recover as in previous years of major strikes and continue at a 2- to 3-percent annual rate for the remainder of the year. 25X1

25X1

West German Industrial Employment Continues To Decline

Although West German industry still accounts for 43 percent of employment—the highest share in the Big Seven countries—the number of industrial jobs continues to decline. Since 1971, the number of industrial jobs in West Germany has declined by 2.4 million while employment in services has risen by 1.7 million. Last year industrial employment fell 3.5 percent. Creation of

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

service-sector jobs—0.5 percent last year—was not able to offset the industrial job losses. As a result, overall employment fell 1.7 percent in 1983 and the unemployment rate hit a postwar high of 9.1 percent.

25X1

West Germany's First High-Tech "Spinoff"

25X1

A Siemens development team working on integrated circuits has founded an independent company to exploit its ideas. The new firm was established with full cooperation from Siemens—which retains 25-percent participation rights—and received financing from a Siemens-backed venture capital company. Such spinoffs are common in the United States, but rare in most other countries. For West Germany, which lags behind Japan and the United States in several high-tech areas and in financing new ventures, the Siemens spinoff could be an important first step in efforts to catch up.

25X1

Italian Parliament Passes Controversial Legislation

25X1

The Italian Parliament last week passed a weakened version of a controversial law limiting cost-of-living wage adjustments. The law is a key element of the Craxi government's effort to control inflation—currently running at 12 percent. The legislation, which divided labor unions and met stiff opposition from the Communist Party, sets a ceiling on wage adjustments for six months, limits increases of some administered prices to 10 percent, and provides minor tax relief—mostly to lower income workers. The law is weaker than the government's original proposal and the Communist opposition already has announced it will seek a popular referendum to repeal the six-month restriction on wage increases. We believe the failure to pass a stronger measure will put further pressure on wholesale prices that recently accelerated, in part, because of the rise in the lira price of raw material imports. We doubt Rome will achieve its goal of holding consumer price increases to 10 percent this year.

25X1

MITI Seeks Boost in FY 1985 R&D Budget

25X1

According to press reports, Japan's Ministry of International Trade and Industry (MITI) is seeking a sharp increase in FY 1985 government funding for high-tech R&D by attempting to free R&D spending from constraints imposed by the Ministry of Finance. Such funding has grown slowly since 1981. MITI is concerned that budget increases for R&D are necessary to maintain the pace of technological innovation as well as MITI's influence with the industry.

25X1

Turkish Prime Minister Ozal's Policies Under Attack

Prime Minister Ozal is under increasing attack both for rising inflation and for his anti-inflation policies, according to the US Embassy. Since March, Ozal has implemented a series of steep price increases on goods and services provided by the public sector. While long overdue, the increases have helped to boost inflation to a 50-percent annual rate and have drawn fire from a number of quarters. In addition, businessmen—normally staunch Ozal supporters—are criticizing his anti-inflation policies because high interest rates and a shortage of credit have created financial difficulties for many firms.

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Despite the criticisms, Ozal has reaffirmed his intention to continue his tight money, free market policies and continues to call for sacrifices. While the tough measures are politically risky, he probably believes it is better to get them over with quickly while he still has the public's support following his party's decisive victory in local elections in March.

25X1

Less Developed Countries

Mexican Wage Settlement

The small wage hike announced last week will help President de la Madrid stick to his tough austerity program. The US Embassy reports minimum wages will go up only 20 percent. To help ensure labor's assent, the government agreed to freeze some utility prices for the remainder of the year and to monitor price controls more rigorously. The next round of wage negotiations is scheduled for December.

25X1

25X1

The government's ability to limit wage increases is likely to strengthen Mexico's position with international bankers in debt rescheduling talks. The new wage settlement will reduce inflationary stresses and pressures on the peso. The settlement—less than half of what union leaders originally had asked for—underscores labor's close ties with the government. Although labor faces its third consecutive year of falling real wages, its willingness to continue making sacrifices is critical to de la Madrid's success in implementing austerity under Mexico's IMF-supported loan program.

25X1

New Nicaraguan Economic Policies

Recent economic measures to contain the government budget deficit will extend state control and heighten popular discontent:

- The regime has announced stiff price increases on subsidized goods beginning next month to eliminate most food subsidies.
- The US Embassy reports the government will create a retail sales network for eight food products—six will become state monopolies—and will launch a campaign to generate public support, claiming that the new distribution system will ease shortages.
- The government has announced a crackdown on "hoarders and speculators." The Sandinistas say neighborhood Defense Committees will play an increasing role in monitoring retail trade.
- The regime has proposed a "consumer protection law" that would allow the government to set prices or nationalize commerce on essential items.
- The government has begun implementing uniform national wage scales.

25X1

25X1

The steep price hikes will be unpopular, especially among workers whose wages have been frozen since 1982. Standardization of salaries will create additional distortions in the economy and further weaken the role of the independent unions. Moreover, we believe the new state monopoly on distribution will have little impact on shortages, but the regime may use the "war on speculators" to increase nationalizations.

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Drought Hits Kenya

The US Embassy reports that drought will reduce the main grain harvest this fall and threatens a food crisis early next year. The government already is planning to request food aid. The Kenyan Government estimates that corn production will total no more than 15 million bags this year, far below the normal range of 20 to 26 million bags. The wheat crop has been similarly affected. The dry weather also will reduce the output of agricultural export products, although high world prices will soften somewhat the impact on foreign earnings. Tea and coffee comprised almost one-half of exports last year, and output of both is expected to be lower.

25X1

25X1

Somalia Changes Economic Team

President Siad's replacement of virtually his entire economic team during the recent cabinet reshuffle results in large part from the protracted internal debate over economic liberalization and relations with the IMF. Finance Minister Addou, chief negotiator of the Fund program Siad rejected in February, was made Minister of the Presidency. We believe the cabinet changes will further delay serious negotiations with the IMF. There is a good chance, however, that the new economic team—mindful of the lessons of the past several months—will maintain better communication with the President and other cabinet members. This ultimately could facilitate reaching an accord with the Fund. New Minister of Finance Osman, according to US Embassy reporting, generally has been in favor of the reforms recommended by the IMF, and former Finance Minister Addou may be able to use his new position to facilitate government approval of a Fund agreement.

25X1

25X1

Communist

Chinese Playing the US Grain Market

China reordered 340,000 tons of US wheat late last month after earlier canceling orders for that amount. The cancellation had contributed to a drop in prices and China then quietly repurchased the grain. This maneuver, the largest in several years, indicates the Chinese have returned to active participation in the US market. Purchases will have to be large in coming weeks for Beijing to meet its quota for 1984 under the Long-Term Grain Agreement. To date, the Chinese have taken delivery of only one-fourth of its 6-million-ton quota.

25X1

25X1

25X1

China Buying US Synthetic Fibers Again

Beijing recently reentered US fiber markets. China, the largest US polyester customer in 1982, dropped out of the US market in 1983 in retaliation for restrictions on Chinese textile exports and had been filling its needs from Japan and other Asian suppliers. US producers believe the reentry into the US market probably reflects Chinese concern that oil transportation disruptions in the Persian Gulf could drive up petrochemical prices.

25X1

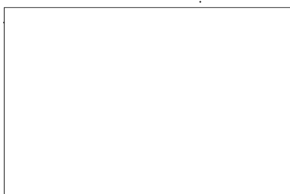
25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

USSR Ends Legal Minicomputer Imports



A Soviet decision to discontinue legal imports of minicomputers from the West is unlikely to lead to any reduction in efforts to acquire advanced Western minicomputers through illegal channels. The State Committee for Supply has informed Soviet institutions that they no longer will be permitted to purchase Western minicomputers, according to sources of the US Embassy in Moscow. The new Soviet policy will not have any appreciable impact on minicomputer imports from the West, however, which declined dramatically after the US imposed strict controls following the Soviet invasion of Afghanistan. Soviet purchases fell from more than $50 million in 1979 to about $5 million in 1982.

25X1

25X1

Soviet-made minicomputers are significantly inferior to their Western counterparts, and Soviet customers tended to resist using them as long as Western equipment was available. Nevertheless, for higher priority military research and development applications where more capability, versatility, and reliability are crucial, the Soviets can be expected to try to acquire export-controlled US minicomputers illegally.

25X1

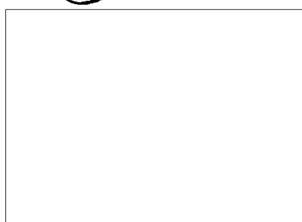
Soviet Construction Decree

A recent joint decree of the Central Committee and the Council of Ministers harshly criticizes the Soviet construction industry and lists measures to improve its performance. The decree is in line with a steady drumfire of criticism directed at this sector, accompanied by several top-level personnel changes over the past year. Published on 27 May, the decree cites such chronic abuses as scattering investment resources over too many projects and the accumulation of a huge backlog of unfinished projects. The decree calls for greater centralization in the planning of overall construction, a larger banking system role in controlling this activity, a review of investment plans, and more emphasis on territorial—as opposed to ministerial—management of construction. Its language, however, is vague, contradictory, and fails to come to grips with the inadequate incentive system responsible for many of the shortcomings of the sector. For example, the decree does not change the current performance criteria in the industry—the gross value of construction put in place. Until evaluation and financing of construction organizations is keyed to project completion, rather than the gross value of output, other changes will have little impact.

25X1

25X1

Soviet Educators To Get Pay Raise



A decree issued in late May will raise wages and bonuses for teachers and other education workers by 30 to 35 percent over the next few years. Teachers in grades one through four and boarding school workers will receive pay boosts on 1 September. Increases for the rest of the education work force will be phased in over several years, starting in the northern and eastern regions of the USSR. The pay hikes are one of several steps under last April's educational reforms to attract more and better people into teaching, particularly for primary grades, at the secondary vocational level, and in rural areas. Teachers are among the lowest paid workers in the USSR and received their last pay raise in 1975. Low pay and lack of prestige have kept the number of applicants to teachers' colleges low; since 1970 the number of teachers in grades one to 10 has declined.

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Vietnam Opens Ship Repair Facility

Vietnam's first large commercial shipyard, the Pha Rung complex near Haiphong, was commissioned this spring—three years behind schedule. It probably will not be fully operational until 1985. According to the Vietnamese press, the $33 million project, financed and constructed by Finland, will be capable of repairing 35 12,000-ton ships a year. Although the repair facility is intended to serve Hanoi's expanding commercial fleet, it can accommodate any ship in the Vietnamese naval inventory.

25X1

25X1

Soviet Aid for Lao Pipeline

Moscow agreed last month to build the Laotian portion of a 500-kilometer pipeline linking Vientiane to the Vietnamese port of Vinh. Construction of the new pipeline, capable of carrying 2.2 million barrels of petroleum products annually, probably will begin next year. We believe this project, along with reconstruction of a major road between Laos and Vietnam, is intended to reduce Lao dependence on Thailand for strategic commodities. Vientiane currently imports most of its petroleum products—about 330,000 barrels a year—through Thailand. In 1979 Thailand closed its border with Laos for several weeks, creating a severe fuel shortage in Laos.

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Japan: Nakasone Turning to Economic Issues

25X1

As the November Liberal Democratic Party (LDP) presidential election approaches, Prime Minister Nakasone will increasingly be forced to deal with economic issues 25X6 Overall, the economic news in Japan—especially the recovery—looks good. But the Diet session, which will extend into the summer, must tackle such items as health care costs, which can cause difficulties for the LDP. Nakasone has little flexibility for dealing with these problems because of the persistent central government deficit.

Some Good Economic News

Prime Minister Nakasone can look forward to generally good economic news this year. Mainly on the strength of domestic demand, GNP growth is picking up and should top the 4-percent mark. The official growth target for the fiscal year, which began 1 April, was set at 4.1 percent, and we agree with most forecasters that the Japanese will reach this goal.[1] Indeed, most major private forecasters are more optimistic than the government.

Our own estimate, based in part on econometric model results, shows private demand—especially private investment—on the rise, while government spending continues to increase more slowly than GNP:

- Housing investment will be up in 1984 after several years of decline.
- Plant and equipment investment has also begun to pick up as the recovery has pushed production levels closer to capacity and profitability has improved.

The weakest area of the domestic economy is consumer demand, which accounts for nearly half of GNP. Continued modest gains in real wages and salaries will keep the rate of growth of private consumption expenditures slow over the next several years. 25X1

Foreign Demand Losing Its Kick

In contrast to last year, when the external sector accounted for nearly half of GNP growth, international trade will give only a small boost to growth in 1984. The Economic Planning Agency (EPA) forecasts that foreign demand will make up only 0.5 percentage point of 1984's 4.1-percent projected growth, with domestic demand accounting for the rest.

We agree with the EPA assessment:

- There is little prospect that exports to LDCs will pick up rapidly. Many of the countries that have been Japan's growth markets in Latin America and the Middle East are in economic trouble and, in many cases, need to conserve foreign exchange for debt repayment.
- The delayed impact of yen appreciation with respect to the European currencies suggests exports to industrial countries are also likely to show less strength. At the same time, the stronger yen and continued economic growth will eventually boost imports, reducing net foreign demand even more.

Nagging Current Account Surpluses

Although the growth of net exports in real terms will be low, the gap between exports and imports in nominal dollar terms continues to rise. We expect

[1] All annual figures in this article refer to the Japanese fiscal year.

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

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Alternative Scenarios

Several key assumptions about the yen's value and external events underlie our trade forecast. Sudden changes in the cost of oil or the value of the yen could sharply alter this year's trade outlook.

Yen Appreciation
We assume the yen will appreciate to 215 yen per dollar by year's end. Major Japanese forecasters, in their trade projections published earlier this year, were calling for an exchange rate in the 220 to 230 yen per dollar range. The EPA used the then-current rate of 234 yen per dollar.

The yen could appreciate against the dollar more rapidly. In the short run, more rapid appreciation probably would increase Japan's surplus, because trade volume would not adjust immediately. If the yen appreciated to 190 yen per dollar, we estimate the current account surplus would reach $33 billion; if the yen remains at its current level of about 225 yen per dollar, the current account surplus would be $24 billion, according to our model.

Oil Prices
Japan is vulnerable to drastic oil price changes because its economy depends on imported oil for over 60 percent of its total energy needs. Crude oil imports in calendar year 1983 amounted to $40 billion. The two major oil price runups turned large trade surpluses into deficits. We estimate that a $5 per barrel increase in oil prices this year would reduce the current account surplus by $12 billion.

World Import Volume and Prices
We expect total world import volume to grow by about 6.5 percent in real terms. A 1-percentage-point change in the growth rate of world trade would alter the current account surplus by $3-4 billion. A 5-percent average increase in raw material and food import prices above our baseline increase of 2 percent would raise Japan's import bill by $1.3 billion.

Protectionism Abroad
Protectionist measures by Japan's major trading partners could also reduce the surpluses. Restrictions are already in place on a large proportion of Japanese exports, however, and in many cases exporters have been able to raise unit prices on restricted goods, maintaining the total dollar volume of sales.

the current account surplus to reach $25-30 billion in 1984 compared with $24 billion last year. The Economic Planning Agency has officially forecast a surplus the size of 1983's, but the press has speculated that the EPA may boost its forecast to $30 billion. Most other major forecasters expect it to be in the $20-30 billion range. A few, including the prestigious Japan Economic Research Center and the Mitsubishi Research Institute, expect it to top $35 billion. These overall estimates include an increase of at least $5 billion in the trade surplus with the United States from last year's $20 billion.

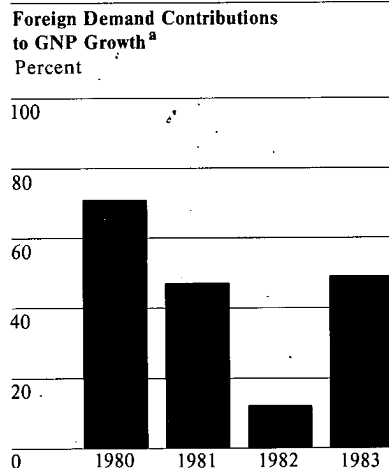
For 1984, stronger dollar export prices will account for much of the increase in the current account surplus. Export volume is expected to increase only 2 percent, but higher dollar prices for Japan's export goods will push the value of exports up by over 10 percent. Import volume, buoyed by the domestic recovery, should be up by about 8 percent. Assuming world oil prices and costs for other important raw materials remain relatively stable, however, the dollar value of imports will about match the 10-percent rise in the value of exports.

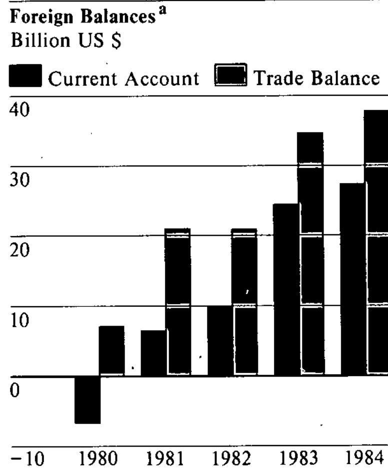
25X1
25X1
25X1
25X1
25X1
25X1
25X1
25X1

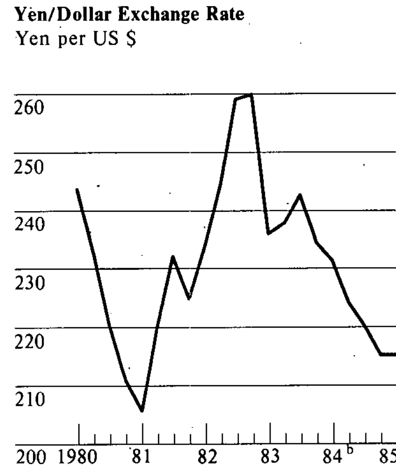
Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Japan: Trade Indicators







[a] Japanese fiscal years.
[b] Projected.

25X1

302984 6-84

Economic Battles Loom

Despite the relatively good news on economic growth, the Diet session this summer will focus on some tough economic issues that must be balanced against what is seen by most Japanese as an excessive central government deficit. Fiscal policy is constrained by the persistent deficit, which amounts to about 25 percent of central government expenditures.

Even with growth up, Nakasone is being criticized for not doing enough to push the economy. Within his own party, Director General Komoto of the Economic Planning Agency—a potential rival for the presidency of the LDP in elections this fall—has called for more expansionary policies, including a further tax cut aimed at business. According to a press report, his goal is 5- to 6-percent growth. In addition, the Ministry of International Trade and Industry (MITI) favors a higher growth target.

The opposition parties—especially the Socialists and Komeito—have criticized Nakasone for not aiming for more rapid growth, and they were particularly dissatisfied with the FY 1984 budget. This year's budget provides little stimulus and calls for the slowest growth in spending in 30 years. Expenditures, at 50.6 trillion yen, are only 0.5 percent over the 1983 level, a decline of 2 percent in real terms.

25X1

25X1

It now appears that the Diet debate this summer will revolve around deficit-cutting measures and funding of specific programs. The sharpest arguments probably will be over a bill to reform the national health program by instituting participant fees in the health insurance system.

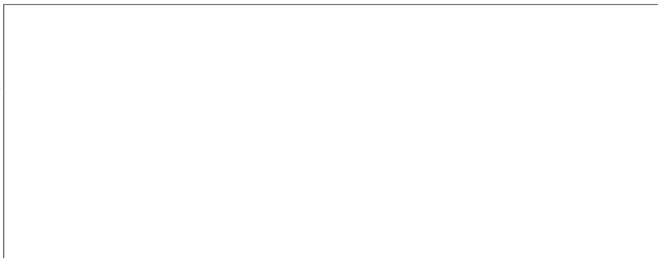
25X1

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4



25X1

25X1

If growth should slow later this year, Nakasone would be faced with additional problems. Because of unhappiness over the deficit, Nakasone would find it nearly impossible to stimulate the economy using fiscal policy. To increase GNP by 1 percent, for example, would require pump-priming expenditures of around $6 billion—a far larger amount than the increase in the entire government budget for 1984.

25X1

A downturn in growth later this year could well raise the question of Japan's long-term growth potential and the need for fundamental change—issues that can only provoke contentious debate. Even with strong export performance, Japanese growth rates have been falling since the mid-1970s. From a level of about 10 percent per year in the 1960s and early 1970s, they have declined over the past decade—mainly because of the two oil shocks and changes in the structure of Japan's economy—to about 3 percent. Tokyo's fiscal policy options for boosting growth will remain constrained by the central government's persistent budget deficit. Indeed, deficit-financing bonds, which were issued in the mid-1970s as a short-term expedient, are beginning to mature and will make government financing even more difficult.

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Israel: Persistent Economic Inefficiency

25X1

For almost a decade, Israeli politicians have failed to address Israel's persistent economic problems—high inflation, low investment, large real wage gains, sluggish productivity, and large current account deficits. During this same period the Israeli public has become much more consumer oriented and has come to expect an ever-increasing standard of living. Each Israeli government has been loath to confront these expectations, in part because of generous US aid, and the primary focus of Israeli economic policy has been to maximize consumer welfare in the short run. We believe that the next government after the 23 July elections will not seriously address the country's economic problems unless it wins an absolute majority or faces a serious foreign exchange shortage.

Fundamental Problems

A number of laws, institutional practices, and traditions inhibit the efficient functioning of the Israeli economy. Many stem from the egalitarian ethic of the country's founders. Israel's economic problems include:

- A powerful labor union organization, the Histadrut, that consistently wins large real wage gains.
- An indexation system that protects most Israelis from rapid inflation but reduces the government's incentives to attack the price spiral.
- Interrelated wage agreements aimed at ensuring that no group of workers obtains an "unfair" salary advantage over others.
- Unwillingness to tolerate significant unemployment.
- Lack of control over the money supply because Israeli law requires the Bank of Israel to print whatever amount of shekels is required to finance the government's budget deficit.
- Inability of government to cut expenditures or even to enforce spending ceilings.

25X1

Because most financial instruments are linked to increases in the consumer price index, we believe many potential entrepreneurs put their funds into financial holdings that guarantee positive real rates of return rather than into plant and equipment investment that has a much less certain payoff. According to Israeli statistics, plant and equipment investment has grown 1 percent annually over the last decade; its share of GNP has declined from 21 percent to 17 percent since 1973.

25X1

The poor investment performance has been a major factor contributing to sluggish productivity, which has grown only 1.2 percent annually since 1972. Other factors include:

25X1

- Hesitancy of Israeli employers to lay off workers for fear of being caught short when demand strengthens.
- High marginal tax rates that reduce worker incentives.
- An increasing amount of worktime spent juggling personal financial portfolios to beat rapid inflation.

25X1

Lagging productivity and a strong appetite for imported consumer goods have undercut efforts to improve the foreign payments. The civilian goods and services deficit has doubled from $2.1 billion in 1980 to an estimated $4.2 billion last year. For example, press reports indicate that Israelis have been buying video cassette recorders in such large volumes that Israel now has more of them per capita than any other country in the world. Real wage gains, combined with sluggish productivity, increase the costs of Israeli exports, reducing their competitiveness abroad.

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

**Shamir and Cohen-Orgad—
Solid Rhetoric, Poor Performance**

Prime Minister Shamir was forced to deal with economic issues immediately upon taking office last October. The Tel Aviv Stock Exchange had crashed because Israelis were selling their stocks, particularly bank stocks, to purchase US dollars. In a speech to the Knesset when his Cabinet was approved, Shamir said that the government would reduce public and private consumption, cut subsidies, and raise labor productivity. He warned Israelis that the standard of living would not improve until production increased. [ ]

The Finance Minister, Yoram Aridor, was forced to resign two days later amid the furor created when his plan to make the US dollar legal tender in Israel was reported in the Israeli press. Cohen-Orgad replaced him a week later. Cohen-Orgad had publicly supported many of the measures required to deal with Israel's economic problems and called for a reduction in real wages of at least 10 percent, large budget cuts, and increases in fees for a wide range of public services. He declared that improving the foreign payments was his first priority. [ ]

Using our model of the Israeli economy, we project that the civilian goods and services deficit would have declined this year to $2.8 billion, compared with $4.2 billion in 1983 if Cohen-Orgad's policies had been fully implemented. This projected improvement would cost a decline in real GNP of 2.6 percent and an increase in the unemployment rate to 5.7 percent compared with 4.5 percent in 1983. [ ]

In the more than six months since taking office, however, Shamir and Cohen-Orgad have failed to put their plan into effect. This failure resulted from a lack of support from within the Cabinet and from Histadrut officials. For example, the US Embassy reports that on 25 January Cohen-Orgad was forced to make concessions to TAMI—a small party in the coalition with a low-income constituency—on increased social welfare spending to keep TAMI's support on a no-confidence vote. [ ]

Even the one major policy change Cohen-Orgad has carried out will be ineffective, in our view. Foreign currency controls were instituted in early November and have since been tightened. Israelis traveling abroad can purchase no more than $2,000 worth of foreign currency; holdings of foreign securities, bank accounts abroad, and gold are prohibited; and a limit of $2,000 on charges made abroad has been imposed on credit card holders. We believe that these moves will have at best only a marginal impact on the foreign payments because Israelis have long been adept at getting around such controls. [ ]

25X1

25X1

The decision to hold elections on 23 July has ended any chance that Cohen-Orgad might implement an austerity policy. Indeed, US Embassy sources in the Finance Ministry report that Cohen-Orgad is under pressure from his cabinet colleagues to engage in "election economics." We believe Cohen-Orgad will try to avoid blatant manipulation of the economy prior to the elections, but he probably will succumb to pressure to hold the line on government-controlled prices and to ignore overspending by cabinet ministers. [ ]

25X1

25X1

**After the Election—
The Same Old Problems**

Whatever government takes office, it will face the same economic dilemmas that plague the current one. If current economic trends were to continue, we project that private consumption would grow at an annual average rate of 6.6 percent in 1985-87, helping to produce GNP growth averaging nearly 4 percent. Even though recovery in Western Europe and the United States would boost exports by an annual rate of 7 percent, continued strong domestic demand would increase imports, resulting in a civilian goods and services deficit of $5.3 billion in 1987 compared with $4.2 billion last year. The foreign financial gap—the sum of the civilian goods and services deficit, self-financed military payments, and debt repayment—would reach $7.9

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Finance Ministry Resignations

The resignations this week of two top Finance Ministry officials, including the director general, were prompted by Finance Minister Cohen-Orgad's preelection economic concessions, according to press reports. The Cabinet recently increased the monthly pay of 20,000 civil servants by $50, and raises as high as 18 percent are under discussion for regular army personnel. The opposition Labor Party will use the resignations to bolster its assertion that the Likud is unable to manage the economy.

billion in 1987 compared with $5.4 billion last year. In the absence of additional US aid, this scenario indicates foreign commercial banks would have to increase their exposure more than we believe is likely, or Israel would have to draw down foreign exchange reserves to unacceptably low levels.

We have projected several alternate scenarios based on programs a new government might use to confront Israel's economic problems. An effective program to increase labor productivity, for example, would stimulate the economy. Real GNP would increase at an average annual rate of 6.2 percent. Although higher domestic demand would boost imports, much of the additional output would be available for exports, and the financial gap would change little from our projections of current trends.

If the new government tried to boost investment—through low-interest loans, rapid depreciation allowances, or lower income tax rates, for example—the domestic economic benefits would be substantial but at the cost of even larger foreign deficits. Assuming real investment increases 10 percent annually in 1985-87, we project that GNP would grow by an average annual rate of 6.1 percent, 2 percentage points higher than current trends would indicate. By 1987 the unemployment rate would decline to 2.4 percent. The foreign financial gap, however, would increase to $9.0 billion in 1987, $1.1 billion more than would be the case if present trends continue.

In either of these scenarios, the financial gap would nearly deplete foreign exchange reserves as early as 1986, necessitating austerity measures. If the new government pursued an austerity program soon after the elections, and if real private consumption and government civilian and domestic military consumption declined 2 percent annually in 1985-87 and real exports increased by 10 percent annually, the financial gap in 1987 would still be $4.3 billion compared with $7.9 billion if current trends continue. Among the costs of such an austerity program would be a drop in real GNP growth to an average of less than 1 percent annually and an unemployment rate of 6.1 percent in 1987.

25X1

25X1

Outlook

If either Labor or Likud wins a majority in the Knesset—which we believe is unlikely—an austerity policy could be put in place relatively soon. A big Likud victory would give Cohen-Orgad the political strength to carry out the policies he has been advocating. A large Labor Party victory could open the way for budget cuts and a wage pact with the Histadrut, with which Labor has close ties.

25X1

25X1

A serious austerity program is unlikely if neither the Labor Party nor the Likud bloc wins a majority and there is another coalition government. A coalition government forced to rely on the continuing support of TAMI or the religious parties to stay in power, for example, will find it almost impossible to pare social or religious programs. Nothing short of a drastic shrinking of foreign exchange reserves, in our view, could force the hand of a coalition government.

25X1

25X1

Implications for the United States

To stave off a foreign exchange crunch, we believe the next Israeli government will take the same approach as past governments—turn to the United States for more aid. Israeli officials will take the position that any additional aid should be grants

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Israel: Alternative Economic Scenarios

	Real GNP Growth (*percent change*)				Unemployment Rate (*percent*)				Financial Gap (*billion US $*)			
	1984	1985	1986	1987	1984	1985	1986	1987	1984	1985	1986	1987
Current trends	1.9	2.8	3.6	4.9	5.2	5.0	4.6	4.0	6.4	6.7	7.3	7.9
Higher investment	1.9	4.6	5.8	8.0	5.2	4.8	3.8	2.4	6.4	7.3	8.3	9.0
Higher labor productivity	1.9	4.0	5.9	8.7	5.2	5.0	4.6	4.0	6.4	6.8	7.3	7.8
Austerity	1.9	0.3	0.8	1.4	5.2	5.3	5.6	6.1	6.4	5.7	5.0	4.3

25X1

rather than loans, citing the US administration's recommendation for aid to Israel in FY 1985—which is entirely grant—as a precedent. The Israeli Government may also ask for a rescheduling of debt owed to the US Government. This debt is almost half of the $22.5 billion outstanding at the end of 1983. Principal repayment on Foreign Military Sales loans will begin to increase in 1986 when the 10-year grace periods start to lapse.

25X1

Israeli officials believe that their "special" relationship with Washington precludes their having to turn to the IMF. Israel does not want to agree to austerity under an IMF-supported loan program. Moreover, some Israeli officials appear to believe that Saudi Arabia has disproportionate influence within the IMF and are loath to deal with an institution that they regard as having too much Saudi influence.

25X1

The Israeli Government may try to persuade Jews living abroad, particularly those in the United States, to increase their contributions to Israel. American Jews, however, have not, in the past, significantly increased their giving in response to economic crises. According to Israeli statistics, donations soared in 1974 after the 1973 October War but fell back to traditional levels in 1975 and 1976 when Israel was in a severe foreign exchange crunch. This, plus the minimal response to Israel's appeals after its invasion of Lebanon, suggests that foreign Jews increase their contributions only when they perceive the survival of the state is at stake.

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Saudi Arabia: Sectoral Implications of the Oil Slump

25X1

Despite the sharp drop in oil revenue over the past two years, Saudi Arabia is resisting across-the-board spending cuts that might undermine its major objectives of boosting living standards for all Saudis and broadening its economic base.[1] Riyadh has focused investment cuts on the foreign-dominated construction industry and is taking steps to support Saudi firms in financial straits because of the current economic slowdown. In order to better export the country's petroleum resources, the petrochemical and oil export refinery projects at Yanbu and Jubail remain on schedule. The slump in oil revenues, however, has forced the government to give greater weight to price in awarding contracts, an approach that puts US companies at a disadvantage compared with European and Asian competitors.

Construction

According to the US Embassy, the government brake on project spending has ended the boom in construction, the largest sector other than oil. Particularly hard hit have been housing, commercial offices, and transport. An Aramco index measuring overall expenditures on construction indicates that outlays declined 18 percent during the fiscal year that ended in April. Other indicators, such as raw materials imports, also are down.

To slow construction activity, the government is using with greater frequency a law requiring open bidding on contracts. The Saudis have relied on this technique to scale down some of the more grandiose projects. The Kingdom also has cut in half the ceiling for advance payments to contractors and has delayed progress payments to firms by as much as four months, according to various press reports.

25X1

As a result, construction companies increasingly are looking to commercial bank loans and suppliers' credits to meet ongoing expenses. press reports claim that local banks give out loans based on a government ranking of project priorities.

25X1
25X1

The impact of the cuts is being felt by both foreign and domestic contractors—particularly smaller Saudi firms. Some suppliers, unable to sell idle equipment inventories and other materials, also are feeling the crunch, according to the Embassy. Most major contractors are relying on their backlogs and cash from advance payments to weather the current slowdown. Some are shifting from construction into operations and maintenance work.

25X1
25X1
25X1

The rising number of financially troubled Saudi firms has prompted Riyadh to take steps to alleviate the situation. One protectionist measure requires foreign companies to subcontract at least 30 percent of new government jobs to domestic firms. Revised bidding procedures also give local companies a better opportunity to win contracts. Moreover, the Foreign Capital Investment Committee (FCIC) decision last November to place a moratorium on new joint venture companies reflects the

25X1
25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Saudi Arabia: Real GDP Growth, by Sector, 1981-83 *Percent*

	Saudi Fiscal Years		
	1981	1982	1983
Total GDP	**8.0**	**1.7**	**−10.8**
Petroleum	3.6	−9.4	−37.2
Construction	10.3	10.1	−6.2
Government services	7.8	1.3	−12.2
Other	12.9	12.2	11.3

regime's view that the construction industry has a surfeit of foreign companies. The FCIC is accepting foreign bids only for high-priority projects such as schools, hospitals, and electric power, according to the press.

The continued slump in construction activity will result in substantial layoffs of foreign workers. As many as 500,000 expatriates, 20 percent of foreign workers, could be out of work this year, according to the US Embassy. Most of those affected will be non-Arab unskilled personnel. Many will try to find temporary employment in other areas of the Saudi economy rather than return home. The layoffs are unlikely to cause serious problems for the government, in our judgment, because the expatriates know the Saudis can easily jail or deport malcontents.

The Saudis so far have avoided serious political repercussions in the adjustment to reduced oil revenues. Although local entrepreneurs frequently complain about the business climate, according to the press, and blame the recession partly on the government, their discontent has not approached an intensity that would threaten the regime. Most firms begrudgingly accept current stringencies, but remain confident construction prospects will improve in the future. Many Saudi officials—especially Western-educated ones—even regard the slowdown as an opportunity to control runaway development programs.

Oil Production

The soft oil market and the need to pare expenditures have had a major impact on the oil industry, which accounts for about 50 percent of GDP. Aramco, the Saudi-owned producing company, already has reduced its maximum sustainable oil productive capacity from 10.5 million b/d in 1981 to 8.0 million b/d. These reductions will not impair Riyadh's ability to respond to a tighter oil market; we estimate the Saudis could restore productive capacity to a maximum sustainable level of 10 million b/d in a year.

25X1

25X1

25X1

Neither do we believe that the drop in productive capacity will create shortages of natural gas needed for the Kingdom's domestic industries. Natural gas requirements this year for electric utilities, desalination plants, and existing petrochemical complexes will average about 45 million cubic meters per day. This volume can be met by the gas produced with oil output at current levels, 4.7 million b/d in May. Even if oil production fell to as low as 2.5 million b/d, most facilities could switch to alternative liquid fuels,

25X1

25X1

25X1

Petrochemicals

The government has kept up expenditures for the industrialization program. Construction of eight petrochemical projects and two refineries at the new industrial cities of Jubail and Yanbu is largely on schedule, and one methanol facility and a nitrogenous fertilizer plant already are in operation.

25X1

25X1

The Saudi Government has three petrochemical plants scheduled to begin operations next year:
- The Saudi Petrochemical Company (Sadaf), a $2.9 billion joint project with a local affiliate of Shell Oil.

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

- The Al-Jubail Petrochemical Company, a $1.1 billion plant jointly owned with a subsidiary of Exxon.
- The National Methanol Company, a $380 million facility shared with two US companies, Celanese and Texas Eastern.

These plants will have a capacity of 2.7 million metric tons per year of petrochemical products. Most output is to be taken by the foreign partners. A Japanese company already has signed a long-term contract with Sadaf for about 75,000 tons per year of products, according to press reports.

The Saudi Government, through its oil marketing company Petromin, is moving ahead with Mobil and Shell to bring two oil refineries for export on stream by the end of this year. The facilities will enable Saudi Arabia to boost exports of refined products from 75,000 b/d currently to 575,000 b/d. The Saudis have indicated they will follow Kuwait's strategy of buying retail outlets and refineries in Europe to assure secure downstream markets. Earlier this year, Riyadh presented prospective buyers with a proposed pricing schedule for products loosely aligned with current market prices,

Other Sectors

Riyadh continues to emphasize the development of nonoil light industry. The Saudi Industrial Development Fund (SIDF), a government agency that extends soft loans to the private sector, has been steering investment away from construction into more technically advanced and diverse areas, especially import substitution projects, according to the press. As an incentive, the SIDF provides industrial investors interest-free loans for as much as 50 percent of initial capital requirements. The government also grants local firms a 10-year tax holiday and duty-free imports of raw materials and other inputs.

Agricultural production has not lost momentum despite some funding cutbacks and delays in government price support programs.

the Saudis expect the 1984 wheat harvest to jump from about 691,000 tons in 1983 to as much as 1.5 million tons this year, enough to make the Kingdom self-sufficient, according to Saudi officials. The Saudis probably used the claim of a bumper crop as a pretext to reduce wheat subsidies paid to farmers by as much as one-third to $760 per ton. The subsidy still is extravagant; the world market price for wheat is about $180 per ton. If the bumper harvest does materialize, paying wheat farmers will exhaust budget allocations for all agricultural programs.

Implications for the United States

Saudi Arabia's development plans have important implications for the close Saudi-US relationship. The Saudis will be entering a depressed petrochemical market and will have to offer competitive prices. This could cause price wars and stir protection sentiments in some importing countries. Saudi Arabia already has warned the United States publicly that it will retaliate should Washington impose protectionist measures against Saudi petrochemical imports.

US commercial opportunities in Saudi Arabia are likely to rebound slowly. The impact of a more competitive bidding environment, in our opinion, will fall on construction. We anticipate that the cost-conscious Saudis are likely to focus on price and financial arrangements. A more price-oriented approach could give a strong advantage to European and Asian firms that have lower labor costs and government-supported concessional financing. At the same time, a more restrained development program should have little direct impact on most of the US firms already in Saudi Arabia; the Embassy reports that most are not primarily involved in construction.

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

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Major Soviet 1,420mm Gas Pipelines, 1981-85

702589 (546685) 6-84

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Status of the Soviet 1,420-mm Gas Pipeline Program

25X1

Pipelaying is completed on the Siberia–to–Western Europe natural gas export pipeline and on four of the five domestic gas pipelines planned for 1981-85. Three of the domestic gas pipelines probably are operating at or near design capacity.The natural gas export pipeline is operating at less than full capacity and limited throughput will continue until compressor stations are completed. The USSR has delayed replacement orders from Western firms for the control panels damaged in the January fire at the head compressor station of the export pipeline. Instead, Moscow reportedly is considering the option of using Soviet equipment. During 1984-85, we believe the USSR will have adequate supplies of pipe and gas turbines to complete the scheduled construction program.

Pipelaying Operations

we believe the USSR has recently completed pipelaying operations on the Urengoy-Center I (Yelets) gas pipeline—the fourth of five domestic gas pipelines planned for 1981-85. Pipelaying on the fifth (Urengoy-Center II) has begun and is scheduled to be completed next year. Since 1980, the USSR has laid about 17,000 km of 1,420-mm gas pipeline.

The Soviet press has reported recently that construction of a major gas pipeline from the Yamburg gas deposit (north of the Urengoy gasfield) is scheduled to begin in 1985. The gasfield at Yamburg is very large, with reported reserves of 3-4 trillion cubic meters. We estimate that reserves at Yamburg are adequate to allow production of 150 billion cubic meters annually; this would require the construction of another two or three gas pipelines.

Compressor Station Construction

We believe that nearly all of the compressor stations planned for the Urengoy-Gryazovets, Urengoy-Petrovsk, and Urengoy-Novopskov gas pipelines are operational. Most of the compressor stations on these pipelines are equipped with Soviet GTK-10 gas turbines. These bulky 10-MW units weigh nearly as much as a US-designed 25-MW unit and are far less fuel efficient.

25X1

some of the 40 line compressor stations on the gas export pipeline are operational.

25X1 25X1 25X1 25X1

The Soviet press has reported that 16-MW aeroderivative gas turbines are being installed on the export pipeline. We have no evidence to back this claim.

25X1 25X1 25X1 25X1

the January 1984 fire was contained within the control-center building and did not damage the turbine/compressor sets.

25X1 25X1 25X1

The USSR has delayed ordering replacements for the damaged Mark II Speedtronic control panels, and we have reports that the Soviets are considering the use of their own equipment. Initially the Soviets could rely on gasfield pressure to sustain pipeline throughput to the first line station, located about 100 kilometers from the start of the pipeline.

25X1 25X1 25X1 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Aeroderivative Gas Turbines

The GPA-Ts-16 is a mechanical-drive industrial turbine derived from aircraft engines taken from the TU-154 and IL-62 passenger airplanes. The aircraft engine is converted to an industrial gas turbine by the Kazan' Turbomotor Production Association assigned to Kazan' Aircraft Engine Plant 16 of the Ministry of the Aviation Industry. According to Soviet media reports, 55 GPA-Ts-16 gas turbines were scheduled for assembly during 1983—compared with five units in 1982.

Availability of Gas Turbines

In addition to the 120 US-designed Frame V gas turbines originally ordered for the gas export pipeline, the Soviets have purchased another 21 Frame V gas turbines from the Italian power-equipment firm Nuovo Pignone.

We estimate that the USSR probably will complete installation by early 1985 of at least 18 Soviet GTN-25 gas turbines at six compressor stations on the gas export pipeline. To accommodate increased output of the GTN-25 gas turbine, we believe the Soviets have had to delay production of some turbines intended for the electric power industry and the chemical industry.

We believe that the GTN-25 is less efficient and less reliable than the US-designed Frame V gas turbine.

This will tend to minimize the effects of operating problems with the GTN-25.

25X1

25X1

25X1

Pipe Supplies

Soviet pipe supplies are ample. This year, as in the recent past, the USSR will import about 2.6 million metric tons of large-diameter pipe (LDP), primarily from Japan, West Germany, Italy, and France. The USSR has negotiated prices 30 percent below the average price paid during 1979-83, cutting import expenditures to $1 billion in 1984.

25X1

The low prices reflect hard Soviet bargaining with foreign LDP suppliers.

25X1

25X1

25X1

25X1

25X1

Moscow threatened to reduce sharply purchases from the major West German pipe supplier unless the firm accepts Soviet price demands.

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

25X6
Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Page Denied

Next 5 Page(s) In Document Denied

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707040001-4