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International Economic & Energy Weekly [redacted]

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22 June 1984

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22 June 1984

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International Economic & Energy Weekly [redacted] 25X1

22 June 1984

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Synopsis

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Briefs

Energy

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Indonesian President Names New Head of Pertamina

President Soeharto last week ousted Pertamina President Judo Sumbono and named General Abdul Rachman Ramly, head of the state tin mining corporation, to succeed him. Sumbono's ouster followed months of increasing criticism both by senior Indonesian officials and foreign oil company representatives for his mismanagement, financial misdeeds, and refusal to cooperate either with the Pertamina Board of Commissioners or with the foreign oil companies. We believe foreign oil companies will welcome Ramly's appointment as an indication that the Indonesian Government is responsive to their

[redacted]

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complaints and wants their continuing investment. Ramly has a good reputation for management as head of the state tin mining corporation. Unlike Sumbono, who had limited contact with foreigners before his appointment to head Pertamina, Ramly has served as a diplomat in the United States. 25X1

South African Natural Gas

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Pretoria is considering the exploitation of a natural gas field off the southern coast that could meet 6 to 8 percent of South Africa's fuel needs. Exploitation of the Mossel Bay gasfield has been delayed for a number of years, but press reports now indicate that Pretoria is studying a $1.6 billion proposal to develop the gasfield and then convert the gas into methanol and then into gasoline and diesel fuel. The field holds an estimated 30 billion cubic meters of gas. Government spokesmen have been unwilling to verify the reports, but have acknowledged that the South African cabinet could be asked to decide on the project in the next few months. Development would further reduce Pretoria's vulnerability to a fuel embargo and cut its fuel import bill. 25X1

Norway Lowers Estimate of Troll Gas Reserves

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The Norwegian Petroleum Directorate now estimates recoverable natural gas reserves from the Troll field at about 1,290 billion cubic meters, 20 percent lower than earlier estimates. The downward revision is unlikely to significantly alter Norway's ability to supply gas to European purchasers in the next two decades. The reevaluation of reserves is based on data from exploratory wells, compared with earlier estimates that were based solely on seismic work. The adjustment affects estimated recoverable reserves in the eastern portion of the field, which has yet to be declared commercial, and is not expected to begin producing until after the year 2000. Recoverable reserves in block 31/2—the western portion of the field—remain unchanged at 460 bcm. Statoil, the Norwegian state oil company, is expected to begin negotiations for the sale of gas from this portion of the field next year. 25X1

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International Finance

Argentine Reaction to US Move on Loan Guarantee

[redacted]

Buenos Aires has reacted with restraint to the US decision not to extend a $300 million loan guarantee. The Argentines appear inclined to contain criticism of the United States as they continue talks with the IMF and try to work out a package with commercial lenders for payment of outstanding loan interest due on 30 June. [redacted] The US Embassy and press reports suggest that Buenos Aires wants to limit damage to bilateral relations, but Argentine officials have reaffirmed their intention not to accept any contractionary economic policies. [redacted]

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The US Embassy reports that President Alfonsin, in the wake of the accord signed earlier this month with political opponents, is becoming increasingly unwilling to resist labor's demands for additional wage hikes. Strike activity has increased, and labor leaders have formulated a "battle plan" to extract concessions in coming weeks. As a result, wage policy is, at least in the private sector, beyond government control. Alfonsin will probably use labor restiveness to bolster his arguments against accepting IMF-mandated austerity measures. Unless he moves soon to regain control of wage policy and challenge labor, however, Alfonsin will face increasing political difficulties in reaching an accord with creditors. [redacted]

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[redacted]

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IMF Suspends Guatemala's Standby Agreement

[redacted]

The IMF suspended Guatemala's standby agreement after Chief of State Mejia refused to raise the unpopular value-added tax (VAT). The IMF believes this was necessary to reduce the current account deficit and the budget deficit, which threatens to reach 5.5 percent of GDP. Without a VAT increase to curb import demand, the government will face a growing need to take the unpopular step of devaluing the currency. Because the remedies are so unpopular, Mejia is likely to temporize by announcing a few minor increases in other taxes, while allowing arrears on debt service and other foreign payments mount. Consequently, the trade deficit and creditworthiness of Central America's largest economy will continue to worsen until the government takes tougher measures. [redacted]

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Global and Regional Developments

Canada Sets New Quotas on Japanese Auto Imports

Ottawa and Tokyo agreed last week on revised import quotas on Japanese automobiles that will limit them to a maximum of 18.1 percent of the Canadian new car market. The agreement, covering the year ending 31 March 1985, pegs the level of Japanese car imports to a percentage of the Canadian market for the first time since quotas were introduced in 1981. The new quota is based on projected total Canadian automobile sales of 917,000 in 1984, which will permit the importation of 166,000 Japanese cars. If actual sales in 1984 are significantly above the government projection, however, Ottawa will allow additional Japanese imports—up to 4,400 more—into Canada during the last three months of the agreement. Despite expected healthy growth in the domestic automobile market—Canadian auto sales to date, together with industry projections, indicate domestic sales could exceed 1.1 million cars this year—International Trade Minister Regan warned that quotas are likely to continue unless Japanese automakers make "very dramatic investments" in Canada. Regan noted, for example, that Honda's decision to establish a production facility in Ontario played a pivotal role in Ottawa's decision to increase this year's quota. 25X1

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Japanese Share of the Canadian Automobile Market *Thousand units*

	1977	1978	1979	1980	1981	1982	1983	1984 [a]	
								High	Low
Total sales	991	988	1,003	932	904	714	843	943	917
Japanese imports	135	113	79	138	208	178	177	170	166
Japanese share of Canadian market *(percent)*	13.6	11.4	8.0	14.8	23.0	25.0	20.9	18.1	18.1

[a] Government projections.

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EC Proposes Telecommunications Initiative

[redacted]

The EC Commission proposed a new initiative in early June calling for an "action program" to create a Communitywide market for telecommunications equipment. The proposal is the third and final part of the Community's high-technology program already consisting of ESPRIT—an R&D program on information systems—and a small program intended to promote the biotechnology industry. 25X1 The telecommunications initiative, however, is little more than a statement of goals and contains few substantive recommendations. For example, the initiative recommends that the national telephone monopolies in each country increase purchases of equipment produced by other EC members—rather than relying on domestic producers—but it does not propose how to achieve this. Furthermore, the Commission does not intend to submit a proposal for an R&D program in telecommunications until late in 1984. Nevertheless, the initiative probably will be approved by the heads of state during the 25-26 June European Summit in Fontainebleu to demonstrate the Community's commitment to advancing high-technology industries. [redacted] 25X1

OPEC Imports From Major Industrialized Nations Down Sharply

[redacted]

According to US, Japanese, and West German trade statistics, OPEC imports from these major industrial countries continued to decline in the first quarter of 1984. For the OPEC members as a group, imports were down 13 percent. This first-quarter decline follows a 20-percent drop for all of 1983. 25X1 Indonesia, Iraq, Nigeria, and Saudi Arabia accounted for nearly all of the first-quarter fall in sales. Imports of manufactures—off 16.4 percent—showed sharp declines while food imports rose sharply. This decline in sales reflects the financial problems facing some OPEC members as well as cutbacks in development programs introduced last year. [redacted] 25X1

Coffee Market Unsettled

[redacted]

The coffee market since last fall has been buffeted by higher prices, low inventories in consuming countries, adverse weather—which cut output by 14 percent in the Ivory Coast and reduced crop quality in Brazil—and shipping difficulties in Colombia. 25X1 The International Coffee Organization's (ICO) Executive Board will meet next week in Kinshasa, Zaire, to discuss the current market situation. Key agenda items are likely to be undershipments of export quotas by some members, requests for quota increases by other members, and a redistribution of export shortfalls. Prices broke the $1.50 per pound barrier for mild arabica coffee in April—outside the ICO's $1.20 to $1.40 price range—before settling back slightly in recent weeks. Higher prices have triggered four one-million-bag ICA quota increases—the latest on 1 June—and have boosted exporters' quotas in the coffee marketing year, which ends 30 September, by 7 percent. [redacted] 25X1

Producers believe higher prices in the futures market are attributable, in large part, to speculation by some US buyers, who believe a damaging frost could hit Brazil's coffee crop before the frost season ends in mid-August. In recent years, damaging frosts have hit Brazil every two or three years, and the most recent occurrence was in July 1981. [redacted] 25X1

National Developments

Developed Countries

British Defense Ministry Considers Competitive Procurement Policy

British Defense Secretary Heseltine intends to officially unveil a reorganization plan for the Ministry of Defense (MOD) next month that includes a controversial proposal to base procurement policy on competitive bidding. Heseltine, who is known for his management expertise, reportedly believes that competition in the procurements procedure would take it out of the political realm and tighten his control over the process within the Ministry. The reorganization plan also carries out a recent commitment by the government to increase cooperation between the MOD and the Department of Trade and Industry to develop defense equipment and services with greater export potential. Trade Secretary Norman Tebbit, a close Thatcher lieutenant, apparently has contributed substantially to Heseltine's plan.

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According to the US defense attache in London, Heseltine will propose:
- Replacing the current "sole-source" preferred contractor procurements policy with a more competitive open-market approach.
- Increasing reliance on industry for the design and development of defense equipment.
- Emphasizing closer work with US defense firms to stretch R&D funding.
- Splitting contracts between several firms to develop alternative suppliers.

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The main opposition to Heseltine's procurement plan will come from major British defense firms. Many of the companies have already seen an outline of the proposal and are arguing that the change in procurement policy would be unlikely to result in significant cost savings in the 1980s and would not provide adequate safeguards for protecting sensitive technological information. They also contend that it would reduce both their profits and their motivation to achieve excellence, encourage foreigners to purchase small firms in the United Kingdom—thus reducing British control over the domestic defense industry—and eliminate needed financial support for risky R&D ventures. Despite this opposition, we expect Heseltine will be successful in his drive to change MOD procurement procedures. He probably has the support of Prime Minister Thatcher because the initiative is consistent with her goal to revive British industrial competitiveness.

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Developments in West German Metalworkers' Strike

Prospects for a settlement appear only marginally improved as nonbinding arbitration of the six-week-old metalworkers' strike began this week. Former Defense Minister and labor leader Georg Leber heads the eight-man mediation panel. Despite steep costs to both sides, neither labor nor management is budging from its position on the key union demand—that the workweek be gradually reduced from 40 to 35 hours without pay cuts. Chancellor Kohl is increasingly under fire for siding with management. His condemnation of labor's

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demands has bolstered union resolve, and he has ruled out the past practice of using government influence to reach a settlement. [redacted] 25X1

West German hopes for 3-percent real GNP growth this year and a record trade surplus have been dashed by the strike. Many businessmen, including those in sectors not directly affected, are delaying new orders and investment. [redacted] 25X1

West Germany Establishes Biotechnology Commission

[redacted]

The Bundestag voted last month to establish a commission to monitor and evaluate the ethical and moral consequences of biotechnology research. Only the Greens—who favor a much more restrictive approach to this field—voted against the Social Democratic motion. Commission members, representing a cross-section of the public, are to begin work in July. West Germany lags in 25X1 commercial application of biotechnology research, but Bonn has targeted this and other high technologies for increased funding. In addition, Foreign Minister and Free Democratic Party leader Hans Dietrich Genscher has proposed creation of private universities funded by firms to specialize in microelectronics and biotechnology research that would be shared with the firms. [redacted] 25X1

Japanese Researching Dual-Use Engine Ceramics

[redacted]

Japan's Nissan Motors is attempting to develop ceramic gas-turbine engines for both automobiles and cruise missiles. [redacted] 25X1 Nissan is using a rotor made of advanced ceramics in the development of a 100-horsepower gas-turbine engine. Although primarily an automobile firm, 25X1 Nissan already supplies gas-turbine engines for operational short-range, antiship cruise missiles as a subcontractor to Mitsubishi Heavy Industries. Ceramic engine parts can improve engine efficiency and have the potential to boost auto mileage by about 30 percent and cruise missile ranges by as much as 100 percent. [redacted] 25X1

New Zealand Supports Exchange Rate

[redacted]

The New Zealand Reserve Bank has announced it will reenter the forward foreign exchange market to support the New Zealand dollar. The move was prompted by devaluation rumors and a heavy outflow of funds late last week following Prime Minister Muldoon's announcement of early elections on 14 25X1 July. The Reserve Bank withdrew from forward dealings nearly a year ago in an effort to lift trading restrictions on the dollar, but is anxious to avoid a devaluation that could boost inflation, currently 4 percent annually. Nonetheless, we expect market pressures will necessitate a devaluation before yearend. [redacted] 25X1

Less Developed Countries

Philippine Banking Crisis Looms

[redacted]

The Philippine Central Bank recently averted the failure of the nation's 11th-largest commercial bank by organizing a $21 million emergency loan from other banks. Nonetheless, the bank's near collapse has convinced many 25X1

Philippine analysts that a major financial crisis is imminent, according to the US Embassy. The Central Bank provided commercial banks with over $400 million in overdrafts earlier this year—contributing to rapid money supply growth and further delaying negotiations with the IMF for a $650 million standby loan. Recent Central Bank efforts to restrain money supply growth have weakened many banks as interbank lending rates have risen to over 40 percent. Moreover, the quality of loan portfolios is declining because of rising business failures, and banks are increasingly relying on volatile short-term deposits. These developments threaten the viability of many "second tier" banks as well as the large government-owned Philippine National Bank, whose assets exceed $5 billion. [redacted]

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Pakistani Growth Slows

[redacted]

After six consecutive years of almost 6-percent growth, the Pakistan Government estimates that GDP will grow by only 4.5 percent during the fiscal year ending 30 June, the lowest rate of growth since President Zia came to power in 1977. We believe GDP growth actually is even lower than government estimates because some data indicate agricultural production was even less than that reported by the government. Agricultural output, according to government estimates, declined by an estimated 4.6 percent because of a massive shortfall in the cotton crop and disappointing wheat and rice harvests. Industrial output, however, reportedly increased by 7.7 percent. Data on the foreign payments indicate a drawdown in foreign exchange reserves of about $270 million from the June 1983 level of about $2 billion reflecting smaller cotton exports and a 3-percent decline in workers' remittances. This is the first drop in remittances since the major exodus of workers to the Persian Gulf in the early 1970s. [redacted]

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Despite a deterioration in economic performance, we do not believe that the economy by itself will generate serious political problems for Zia as he prepares for elections that probably will be held in the fall. We believe he will be able to convince Pakistanis that bad weather caused most of the agricultural problems. Moreover, the government has held down price increases for basic foodstuffs. Foreign exchange reserves still are equivalent to about three and a half months of imports, a very comfortable margin for Pakistan by past standards. The falloff in remittances, however, casts a shadow on future economic growth. Remittances have been a major source of foreign revenue and have been instrumental in increasing the middle and lower class incomes. [redacted]

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Djibouti's Financial Problems

[redacted]

A decline in French grant aid to Djibouti since 1981 and the government's unwillingness to cut spending sufficiently or raise taxes have caused an increasingly tight financial bind. Lower official aid flows, stagnating tax receipts, larger defense expenditures, and increased loans to public enterprises resulted in an overall budget deficit of $28 million last year, according to IMF statistics, compared to a $12 million surplus in 1981. The trend has worsened this year; the US Embassy reported a $9.6 million budget shortfall in the first

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quarter. The reduction in grant aid, drops in spending by French personnel within the country, and continued high import levels have hit the external accounts as well. By yearend 1983, external debt had increased 150 percent over the 1981 level to reach $44 million, according to the IMF. Moreover, by April of this year, untied foreign reserves had dropped to almost one-half the December 1982 level, and were sufficient to cover only two months of imports. Djibouti is responding by delaying development projects, borrowing from the national social security fund, collecting past due taxes, and appealing to Saudi Arabia for an additional $10 million in economic assistance. Economic difficulties have had little political impact to date, but tensions could arise between the dominant Issas tribe and the rival Afars if the economic problems worsen. [redacted] 25X1

Communist

CEMA Summit Declarations

[redacted]

Official declarations issued at the CEMA summit last week are long on rhetoric and short on substance. A statement on the preservation of peace reendorsed Soviet and Warsaw Pact proposals for a comprehensive test ban, nonmilitarization of space, a ban on chemical weapons, limiting and reducing military budgets, and other arms controls. The United States is portrayed as a threat to the international economic order, but the parties favor continued trade with the West and reaffirm a CEMA commitment to expand economic ties with non-Socialist countries. Although the reaffirmation of interest in East-West trade is weakly stated, it nonetheless appears to be a political victory for the East Europeans, who have resisted Soviet pressure to reduce their economic links with the West. On the issue of Soviet oil prices, one Soviet stated that the five-year average would be replaced by a three-year average starting in 1986; other sources believe the issue has not been resolved. [redacted] 25X1

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Moscow Evaluates Industrial Experiment

[redacted]

Izvestiya recently published the first detailed high-level statement on the progress thus far of the "economic experiment," which gives five industrial ministries more autonomy in using investment and wage funds. [redacted] each of the ministries has improved its performance since the test began in January in meeting delivery contracts, the key indicator of success under the experiment. Results are less encouraging for enterprise planning of investment spending, but the official commented that factories have not had enough time to plan such expenditures. He said the Soviets are preparing to broaden the experiment widely in 1985 and beyond. [redacted] 25X1 25X1 25X1

The leadership had preordained that the experiment would be a success and a model for Soviet industry. The industries involved have been given priority in such areas as the acquisition of resources. Consequently, the results will reveal little about the actual potential for applying these measures throughout the economy as long as resources are in short supply. [redacted] 25X1 25X1

Soviet Drought Abates

Recent rains have broken the severe drought that has devastated the grain crop in and around the Volga Valley, an area that produces about one-fourth of the annual Soviet grain harvest. The rains have temporarily halted further damage to the surviving grain crops, but additional rainfall is needed to replenish subsoil moisture. If ideal weather prevails through the end of the crop season, total Soviet grain production still could reach 200 million metric tons—5 million tons more than last year's estimated output. Meteorological data show that the high-pressure system responsible for the most damaging weather had dissipated by 6 June. According to reporting from 12 Soviet weather stations in the valley, precipitation since the beginning of the month has been 60 percent above normal. Current weather patterns suggest that more rainfall is likely during the next few days.

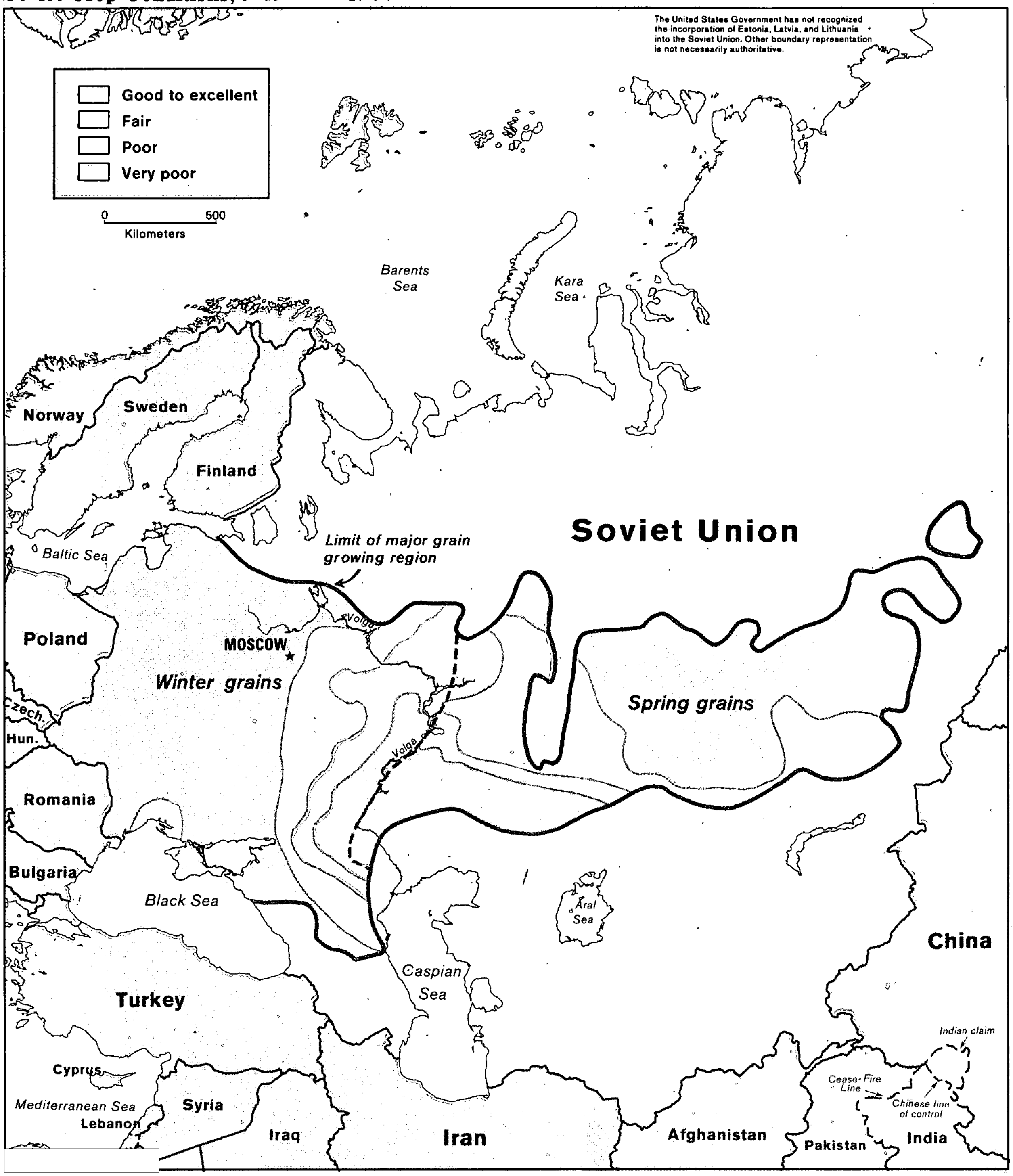
Soviet Grain Purchases

Grain traders say the USSR is negotiating to buy 1.2 million metric tons of this year's US wheat crop and 300,000 to 500,000 tons of US corn. These are the earliest purchases in several years and probably reflect concern about the Soviet crop and a desire to set prices should Western crops deteriorate.

Sharp Increase in Vietnam's Hard Currency Debt Arrears

According to a recent IMF report, Vietnam's foreign debt arrears to non-Communist countries reached $428 million at the end of 1983—a 70-percent increase over the previous year. Private Japanese banks and businesses account for nearly half of the overdue payments and the Iraqi Central Bank for 20 percent. Hanoi's scheduled debt service payments since 1979 have doubled to about $260 million annually, roughly one and a half times hard currency earnings from exports. Since 1981 Hanoi has rescheduled on a bilateral basis

Soviet Crop Conditions, Mid-June 1984



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$250 million in loans from commercial banks and official creditors. Hanoi's requests for a Paris Club rescheduling and for IMF loans, however, have been turned down because Hanoi has been unwilling to undertake economic reforms under an IMF-supported loan program. 25X1

Cuba Fails To Lure Foreign Investors

In the two years since Havana implemented a law permitting direct foreign investment in Cuba, the country has failed to attract any investors. The Cubans have been seeking investment in the tourist industry to help boost foreign exchange earnings and have been courting the Japanese in particular. 25X1
Although tax provisions in the law are favorable and the transfer of dividends in hard currency is permitted, other provisions apparently have discouraged investment:

- Only minority foreign ownership is permitted.
- Firms must be managed or comanaged by Cubans.
- Cuban government–owned firms must receive first priority as suppliers to the foreign firm.
- All labor and materials must be paid for in hard currency at the overvalued official exchange rate.

We doubt that Havana will relax these regulations given Castro's often stated antipathy toward economic liberalization. 25X1

[redacted] 25X1

The Impact of Reduced Oil Revenues [redacted] 25X1

Unlike most Third World nations, Saudi Arabia's oil wealth guarantees that it can afford virtually any weapon system it wants. Most developing countries are limited by financial considerations in purchasing weapons, but Saudi Arabia has the luxury of choosing suppliers according to its political and technical preferences. We anticipate that recent events in the Persian Gulf—including Iran's air attacks on Saudi ships and the Saudi Air Force's downing of an Iranian F-4 in early June— [redacted]

Budget constraints imposed by reduced oil revenues, however, are forcing the Saudis to scale back or reevaluate many military projects. The government has not canceled any major programs currently under way, but it has instituted some cutbacks in spending, more careful monitoring of military expenditures, and program delays in order to stretch out weapons payments. Although these measures reduced military spending last year by about one-third to $17.4 billion, we believe shortages of skilled manpower and other nonfinancial [redacted]

The Military's Mission and Political Role

The primary role of the 57,000-man regular armed forces is defense against external attack. The Saudis see themselves as surrounded by potential enemies and recognize that their extensive borders and small population make them vulnerable to outside aggression. The primary threat at present is Iran, but Saudi Arabia has longstanding border disputes with North Yemen and South Yemen that have periodically produced clashes. In addition, the Saudis greatly fear Israeli military power and, their current financial support for Iraq's war effort notwithstanding, remain apprehensive about Baghdad's potential regional ambitions. The growing Soviet military presence around the Arabian Peninsula and Moscow's military relations with North Yemen and South Yemen also are sources of Saudi concern. To deal with these perceived threats, we estimate that since 1973 the Kingdom spent about $150 billion on its armed forces. Much of the equipment ordered is among the most advanced available, [redacted] 25X1 25X1

The primary role of the 20,000-man National Guard and the secondary role of the regular armed forces is maintaining internal security. The siege of the Grand Mosque in Mecca in 1979, evidence of growing religious fundamentalism among some groups, and fear of Iranian-supported subversion by Saudi Shias has led the Saudi leadership to devote substantial resources in recent years to improving its internal security capabilities. [redacted] 25X1

Although the overall capabilities of Saudi military and internal security forces have improved markedly, their rapid expansion over the past 10 years has produced substantial problems that limit military effectiveness. These include severe manpower shortages, which have led to an increasing dependence on potentially unreliable expatriates. Pakistanis, for example, man an entire Army armored brigade and fill important technical and other support positions within the Air Force and the Navy. As in many developing countries, [redacted] 25X1 25X1 25X1

25X6 [redacted]

Budgeting in the Ministry of Defense and Aviation

Before the decline in Saudi oil revenues, the Ministry of Defense and Aviation "budget" was a collection of each force's programs over which the Ministry exercised only loose control. Service programs with direct political backing from a royal family member and/or the Ministry of Finance often were funded without prior coordination with the Defense Ministry. [redacted]

Defense Ministry officials have recently begun placing greater emphasis on accountability. Within the Ministry, the Foreign Procurement Division has been charged with increased oversight over the three services' budgetary requests. Moreover, the Ministry of Finance now has the power to deny funds to previously approved military programs. This had led to late payments exceeding $1 billion on a wide range of contracts. [redacted]

Budget Impact on the Military

All three regular services, as well as the National Guard, have experienced budget cutbacks and delays in major programs over the past year. Mindful of its wide-ranging defense needs, however, the government has yet to cancel a major military program. Military expenditures increased steadily for nine years before dropping severely during the last fiscal year. We believe that the $17.4 billion spending level announced by the government is somewhat understated and will probably approach $20 billion once all revisions are in. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1 the Saudis see airpower as the most effective means of defending their country and have made improvement of the Air Force their highest military priority. As a result, the 17,000-man Air Force has engaged in a massive modernization program over the past 10 years that has included the purchase of F-15 fighters, French-made Shahine/Crotale surface-to-air missiles (SAMs), and air defense radars. At present, the Saudis deploy one of the most modern air forces in the Middle East. In addition, under the $4 billion US-supervised Peace Shield Program, the Air Force plans to acquire its own 25X1 AWACS aircraft and upgrade ground radar and communications facilities. [redacted] 25X1

Nonetheless, the recent decline in oil revenues has affected Air Force programs—an indication that the Saudis take their current budget difficulties seriously. Western contracters have indicated that funding for Peace Shield now will be spread over three to five years instead of one, although the scope of the program has not been reduced. [redacted] 25X1 25X1

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Fiscal Year [a]	Defense Spending		Total Budget Balance *(billion US $)*
	Value *(billion US $)*	Share of Government Expenditures *(percent)*	
1978	9.3	22.9	−2.2
1979	10.5	23.8	−4.9
1980	14.0	29.5	6.7
1981	20.7	26.2	33.6
1982	24.2	27.7	24.4
1983	27.1	29.6	0.8
1984 [b]	17.4	27.1	−10.0
1985 [c]	23.0	33.0	−13.0

[a] Ending in April.
[b] Preliminary.
[c] Projected.

[redacted] 25X1

[redacted] 25X1

Financial problems have not, however, prevented the Saudis from moving quickly to redress air defense shortcomings in response to events in the Iran-Iraq war. In May 1984, for example, Iranian attacks on Gulf shipping led the Saudis to order 400 US Stinger hand-held SAMs. At the same time, [redacted] 25X1

[redacted] or a similar aircraft as a replacement for their aging Lightning interceptors. Complete replacement of the Lightning fleet with Tornados would probably cost at least $650-700 million, not including spare parts and training. Although no orders appear imminent and [redacted] the Saudis seem serious about procuring new fighters in the near future. [redacted] 25X1

[redacted] 25X1

The government has scaled back one of the largest land forces construction projects, the King Khalid Military City at Hafar al Batin near the Kuwaiti-Iraqi border. When finished, this division-sized, multibillion-dollar installation will be one of the largest and most modern Army facilities in Saudi Arabia. Since 1983 fiscal considerations have led to the elimination of facilities for one brigade and to delays in the construction of the supporting airfield. [redacted] 25X1

The 10-year, $6.4 billion Army aviation program, now in the final planning stages, reportedly is under close scrutiny by the Ministry of Finance. This ambitious program calls for the organization of

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three combat aviation battalions, acquisition of as many as 500 helicopters, and construction of 18 new airfields. [redacted] We believe, however, that this program also will suffer delays and cutbacks, [redacted]

Funding problems and competing priorities may also be delaying a multibillion-dollar purchase of a new main battle tank for the Saudis' two armored brigades. Riyadh is considering the US M-1 and West German Leopard II as replacements for its older French AMX-30s. The government may also be delaying the tank purchase because of manpower considerations and a desire to divert more funds to air defense needs. [redacted]

[redacted]

Initiated in 1972, the US-supervised Saudi Naval Expansion Program (SNEP) has, at a total cost of over $7 billion, provided Riyadh with 13 missile-equipped warships, major bases at Jiddah on the Red Sea and Jubail on the Persian Gulf, plus training for about 2,000 naval personnel. At present, projects under way include construction of several naval training centers and a communications network. Although financial constraints have led to many of the SNEP's current difficulties, new budgetary review processes in the Defense and Finance Ministries probably also account for some of the funding delays. In our judgment, however, the Navy's large French and Pakistani naval training programs and the service's severe manpower shortages may also diminish arguments for continuing to lavish funds on the US projects. [redacted]

[redacted] under way since 1980, includes purchase of four guided-missile frigates, two support ships, 24 helicopters equipped with antiship missiles, and an extensive personnel training program. [redacted]

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[redacted] Largely immune to fiscal restraints in the past, because of the clout of its political patrons, the National Guard has had to delay by two years the completion of the second phase of its ambitious modernization program. This calls for the equipping of two brigades with tanks and armored personnel carriers. [redacted]

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Internal Security Forces

Despite recent budget problems, the Saudis have spent about $1 billion since 1979 to modernize their internal security capabilities. Items purchased include helicopters, riot control equipment, computers, and electronic surveillance devices. Given the regime's sensitivity to domestic opposition and the continuing threat of Iranian-backed subversion, we anticipate that the Saudis will not allow reduced oil revenues to prevent them from proceeding with further improvement of their internal security forces. [redacted]

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Outlook

We expect that the world oil market probably will remain soft through 1986. As a result, some Saudi military programs will suffer cutbacks and delays as the government adjusts its budget to the reduced oil revenues. Financial constraints already seem to have encouraged more disciplined budgetary practices at the Ministries of Finance and Defense. Riyadh's lower oil income will, we believe, provide a useful pretext for the Saudis to pick and choose more carefully what military systems they plan to buy, delay purchase of less urgent items such as a new main battle tank, and eliminate costly but nonessential options associated with many ongoing programs. Funding for operations and maintenance could suffer as well. [redacted] 25X1

Lower oil revenues probably will affect Saudi negotiating strategy with its principal arms suppliers. We anticipate that the Saudis will take a much tougher bargaining position than they have in the past, pressing potential suppliers for more favorable contracts. Moreover, this year Saudi Arabia passed a law requiring major defense contracts to provide for the investment of 35 percent of the contract's value in local, jointly owned industrial projects. In addition, tighter budgets could also serve as a convenient excuse for the Saudis to continue with policies designed to diversify their arms sources so as to preclude overreliance on a single supplier. [redacted] 25X1

Because of its immense oil reserves and considerable financial clout, Saudi Arabia will nonetheless remain in the enviable position of being able to afford almost any major weapon system. We anticipate that the kingdom will continue to accord military spending—especially for those items related to air defense—a high priority in the budget.

[redacted] 25X1 25X1

Somewhat tighter defense budgets in the future could elicit unfavorable reactions from certain military officers, unused to financial limitations on their pet projects or disturbed over possible reductions in their living standards. [redacted] 25X1 and the likelihood of continuing tensions in the Gulf area, however, we doubt that the government would cut the overall budget [redacted] 25X6

[redacted] 25X1

Saudi Arabia: Interest Groups and the Oil Slump [redacted]

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Saudi Arabia has worked hard to insulate its citizenry from the impact of spending cuts caused by two years of reduced oil revenues. Riyadh's ability to protect subsidies and other welfare programs, however, will be tested if Saudi Arabia's revenue position shows no marked improvement during the next several years. Popular expectations of a steady rise in living standards, particularly in urban areas, have grown during more than a decade of soaring oil income and have locked the regime into a sizable financial commitment [redacted]

The Technocrats

Government austerity measures have not significantly affected most elements of Saudi Arabia's urban population. These include well-educated bureaucrats who oversee the daily operations of important government ministries, professionals who fill the ranks of the civil service, and the military officer corps. Several high nonroyal officials, including the Minister of Finance, Aba al-Khayl, and the Minister of Petroleum and Minerals, Yamani, are inner circle advisers and are very well compensated. Riyadh provides ample salaries to all senior officials as well as other generous perks that help mitigate any potential dissatisfaction with the regime. [redacted]

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Most government officials, however, do not have such influence, and resent the almost total control of the government by the royal family. [redacted]

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Many are frustrated over Fahd's failure to implement long-promised political reforms that would give them a voice in the decision-making process. [redacted]

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Religious Groups

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Riyadh is paying close attention to its relations with the country's two leading religious groups, the Sunnis and the Shias. On balance, we believe the current economic slowdown may help the government to placate the growing number of Sunni fundamentalists who believe that the rapid pace of Westernization in Saudi Arabia runs counter to Islamic tenets. Since Fahd assumed the throne almost two years ago, fundamentalism has been on the rise among the lower and middle classes, particularly university students. This increase probably reflects the movement of the uneducated lower classes into the cities. [redacted]

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A more immediate concern for Riyadh is the Shia community concentrated in the Eastern Province. The Shias play a prominent role in Saudi Arabia's

Saudi Arabia: Quality of Life Indicators *Index: 1979 = 100*

	1979	1980	1981	1982	1983 [a]
Number of vehicles registered	100.0	120.1	143.2	175.2	210.0
Number of telephones in operation	100.0	139.1	222.1	287.7	410.0
Consumer imports [b]	100.0	120.7	137.2	149.5	165.0
Consumer price index	100.0	103.3	106.6	106.6	110.0

[a] Estimated.
[b] Includes electrical appliances, leisure goods, and wearing apparel. Does not include foodstuffs or automobiles.

[redacted] 25X1

oil industry, making up about 30 percent of the total Aramco payroll and 80 percent of all Saudis working for the company. [redacted] 25X1 The government has not forgotten that long-standing Shia bitterness over their second-class status boiled over into open violence in late 1979. [redacted]

Hefty increases in development spending since the riots have helped improve relations between Riyadh and the Shias, according to the US Embassy. With only about 16 percent of the country's population, the Eastern Province accounts for about 30 percent of all current construction activity, according to the Consulate in Dhahran. Not all of this money filters down to local Shias; for example, the multibillion-dollar industrial complex at Jubail is being built mostly by foreign workers. [redacted]

The Bedouin

The government has not allowed the spending slowdown to have a significant impact on the lifestyle of Saudi Arabia's influential bedouin population. The bedouins are the most loyal supporters of the royal family, and they dominate the National Guard, the country's most powerful internal security force. We believe the bedouin are the least likely to abandon loyalty to the royal family because of their deep-seated respect for a political system based on tribal traditions. They receive large government subsidies in return for their loyalties. [redacted] 25X1

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Although a steady migration from a rural subsistence existence to the material offerings of an urban life—particularly health services—has reduced the number of nomadic bedouins, we believe the total bedouin population is well over 1 million. Many bedouin tribesmen work in cities for only short durations before returning to their rural homes. [redacted] 25X1

Students

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Many knowledgeable observers believe that one of the most serious threats to political stability is the increasing number of unemployed Saudi youth. Of particular concern are the approximately 50,000 students studying abroad who expect to share in the modernization process. Students exposed to Western social values probably are unwilling to conform completely to a restrictive religious society. King Fahd approved over 24,000 new jobs immediately before the current budget was announced last April, but similar moves in the future are less likely because of a hiring freeze now in effect. [redacted]

Riyadh is pursuing a number of approaches to preclude student dissatisfaction that could become a focal point for antigovernment activity by other groups critical of royal behavior. [redacted]

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[redacted] In addition, the regime stresses local education in part to improve its ability to monitor students. Another lever is the government's willingness to cover the cost of tuition and other amenities, such as food allowances at local universities. [redacted]

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The Royal Family

The material demands of the royal family, whose number totals between 3,000 and 5,000, are increasing the drain on Riyadh's finances and are a potentially contentious political issue. The placement of royal family members in key positions in the government, business, and the military shelters many princes from the effects of the economic slowdown. The princes not only continue to collect their royal allowances, but also receive lucrative commissions from project contracts and other business dealings. We estimate that as much as $250 million may be set aside just for allowances. [redacted]

[redacted]

The general slowdown in the economy has affected the local real estate market, another important source of royal family income. Demand for rental property is down, particularly in high-cost inner city areas, while the slump in construction activity is limiting opportunities for quick profits in land speculation. [redacted]

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Outlook

The Saudi Government has successfully avoided the need to adjust expenditures with politically unpopular austerity measures. Riyadh's ability to continue this approach would be strained by a prolonged slump in oil revenues. Fahd will be under close public scrutiny to see that he does not mishandle the allocation of government funds in favor of any single interest group. A large drop in the flow of funds to the Shia community, for example, risks rekindling old resentments, which could be exploited by Tehran to recruit local dissidents for terrorist activities. Fahd's balancing act will not be any easier by his likely refusal to make more than token reductions in the extravagant spending habits of the royal family. [redacted]

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[redacted]

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Western Europe: Decisions Affecting Gas Security [redacted] 25X1

The United Kingdom is in the final stage of a political debate over whether to purchase large quantities of natural gas from Norway's Sleipner field. Some British officials oppose these imports because of the foreign payments implications. They favor instead increased domestic production and a small volume of imports from the Netherlands. The outcome of London's gas negotiations with Norway and the Netherlands could have major implications for the security of West European gas supplies in the 1990s. Failure to proceed quickly with the development of the Sleipner field could delay the subsequent development of Norway's Troll field—a future source of gas that is needed to prevent further inroads by the Soviet Union into the West European gas market in the 1990s. Although the Dutch option would add flexibility to the West European gas market by integrating the pipeline network between the continent and the United Kingdom, it could also eventually provide Moscow with a means to penetrate the UK market. [redacted] 25X1

Market Setting

The prospects of rising gas demand and declining indigenous production in Western Europe indicate that both continental Europe and the United Kingdom—two distinct markets because of the absence of any interconnecting pipeline—will become increasingly reliant on natural gas imports during the remainder of the century. Current forecasts project that natural gas demand on the Continent will increase from 167 billion cubic meters (bcm) in 1983 to approximately 200 bcm in the mid-1990s, with only about 85 percent of projected requirements covered by indigenous production and existing supply contracts. Prospective suppliers for the remainder of the century now include the Netherlands, Norway, the USSR, and Algeria, and competition for incremental market share will be stiff. [redacted] 25X1

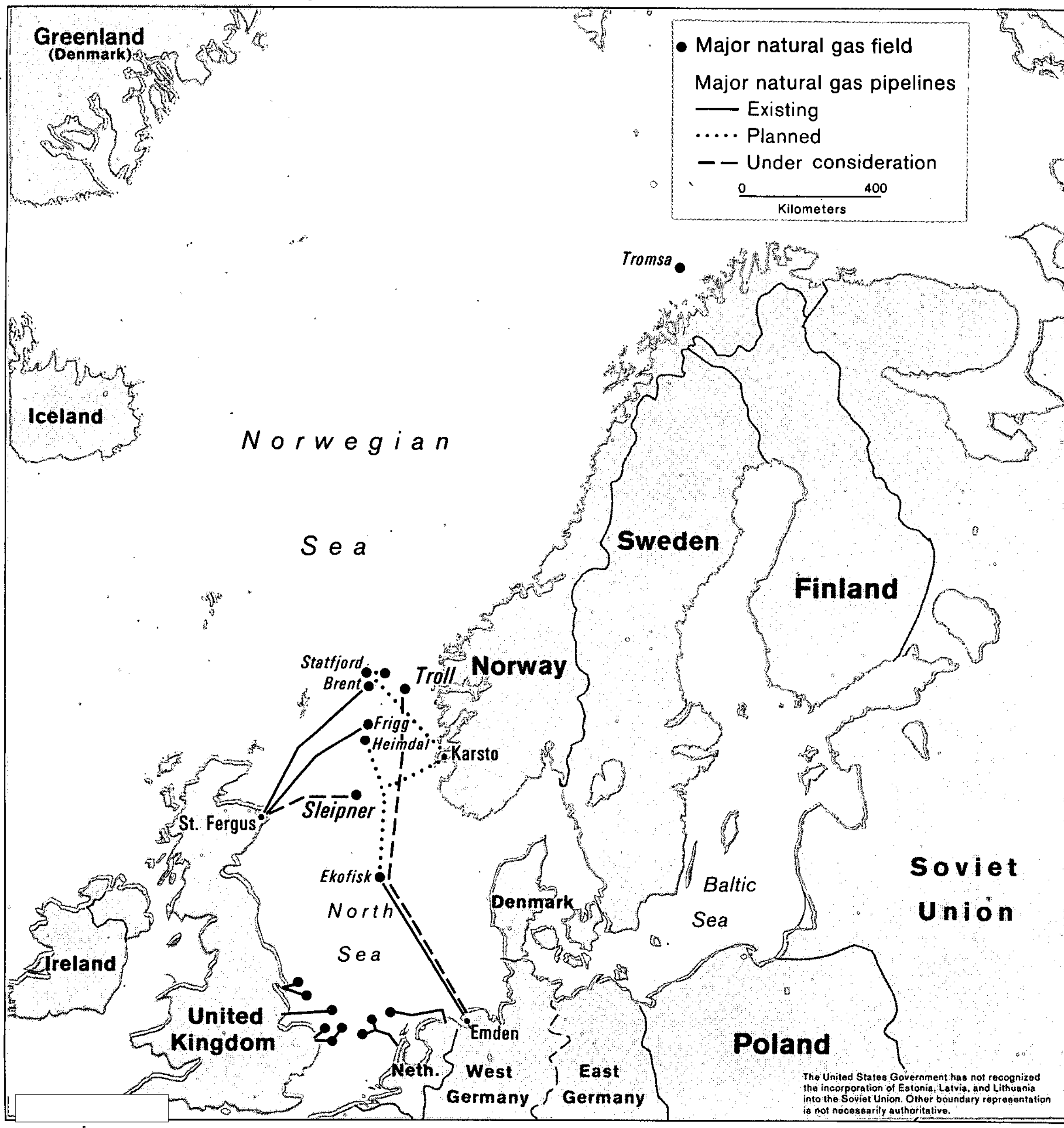
Marketing efforts by Norway and the Netherlands—secure OECD suppliers—are under way both on the Continent and in the United Kingdom. The United Kingdom is a major European gas producer and now meets about three-fourths of its requirements from indigenous production; the British Gas Corporation (BGC) imports the remainder from Norway. Declining production from Britain's southern basin gasfields and termination of Norwegian deliveries from the Frigg field in the early 1990s point to a potential gas supply gap in the United Kingdom of around 30 bcm in 1995, according to the BGC. Unlike most other European buyers facing similar prospects, the BGC is moving now to fill these projected needs. [redacted] 25X1

Meeting British Needs

After 18 months of negotiations, the Norwegian state oil company (Statoil) and the BGC reached an understanding in February for the purchase of about 12 to 14 bcm of natural gas from Norway's Sleipner field. Sleipner gas supplies are expected to be developed by the early 1990s and would roughly offset the loss in supplies from the Norwegian Frigg gasfield. The gas deal is subject to both British and Norwegian parliamentary approval. [redacted] 25X1

Some British officials, however, have voiced reservations about the agreement. In particular, Nigel Lawson, Chancellor of the British Exchequer and former Energy Secretary, has played a key role in

North Sea: Natural Gas Systems



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opposing the deal because of the potential financial implications. According to some British economists, the $28 billion gas deal would increase British imports by $2 billion a year in the mid-1990s. In addition, if these volumes are not produced domestically, the cost to the Treasury from lost tax revenues could total more than $4.2 billion. For these reasons, Chancellor Lawson has advocated increased reliance on domestic gas production and imports from the Netherlands as an alternative to the purchase of Sleipner gas. In February, the UK Department of Energy instructed the BGC to explore the possibility of purchasing natural gas from Gasunie, the Dutch state gas utility.

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Although the Dutch have not previously sold gas to the United Kingdom, the Netherlands now has additional gas available for export, and Gasunie has offered to supply the British with about 5 bcm per year—less than half the volume that would be available from Sleipner—possibly beginning as early as 1990. Although the initial offer was at a price about 20 percent higher than the Sleipner price, Gasunie recently made a more competitive offer and indicated its willingness to negotiate. With only lukewarm interest expressed recently by Continental buyers in additional Dutch gas volumes, The Hague would like to penetrate a new gas market in the United Kingdom. We believe any Dutch sales to London would reduce future availability of Dutch gas to Continental buyers in the 1990s. At the same time, the outcome of London's gas negotiations with Norway and the Netherlands will have major implications for the security of gas supplies in Western Europe during the next decade. [redacted]

Dutch Push Gas Exports

The Netherlands—Western Europe's largest gas supplier—is looking to negotiate new gas export contracts for the 1990s. In its new 25-year gas-marketing plan, Gasunie indicates it wants to preserve existing foreign markets by extending present export contracts by 10 years. Dutch gas marketing efforts are prompted by the expiration of current export contracts around 1990, the expected stabilization of domestic sales, and an increase in gas reserves. By reclassifying some uncertain reserves as proven, Gasunie recently boosted proved gas reserves by 24 percent to 1.9 trillion cubic meters. [redacted] 25X1

The Politics of Negotiation

The Sleipner gas deal is a major and complex political issue in the United Kingdom. In addition to Lawson, who has close connections with Prime Minister Thatcher, several oil companies and oil industry consultants also oppose the deal. On the other hand, Sir Dennis Rooke, chairman of the BGC, strongly supports it. Although Rooke has a good reputation in the gas industry, his relations with the current government are poor, according to US Embassy sources. The combative Rooke has even considered signing the contract without government approval in the hope he can get away with it. Rooke and Lawson clashed in 1982 when Lawson, as Energy Secretary, promoted legislation that brought private industry into the energy sector and ended the BGC monopoly on gas sales. [redacted] [redacted] the biggest reason for believing that Sleipner will not be accepted by the government is that doing so now could strengthen the BGC and Rooke at a time when high officials in the British Treasury and Department of Energy want to "privatize" the corporation. There is speculation that these officials and other Cabinet members want to keep Rooke uncertain until they reach decisions on privatization and then cut a deal—perhaps in a year's time—with many issues on the table besides Sleipner. [redacted] 25X1 25X1

The Sleipner Option

A British decision to proceed with the Sleipner agreement would provide a secure and certain source for meeting roughly one-fourth of British gas demand in the 1990s. Even with Sleipner gas imports of 12 to 14 bcm annually, the United Kingdom would require increased domestic production, according to the BGC. Indeed, BGC is currently engaged in its largest ever exploration program—spending $140 million annually on domestic gas exploration. With a statutory requirement to ensure supplies for 16 million customers, the BGC views the Sleipner deal as a prudent course. Moreover, the agreed price is favorable to BGC, and the corporation probably wants to finalize the agreement soon, given the current buyers' market for natural gas in Western Europe. [redacted] 25X1 25X1

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Viewing the Dutch Option

Some UK officials [redacted] have proposed increasing domestic production and importing Dutch gas to meet future demand needs. According to this strategy, the lower volume of Dutch gas imports would have a less adverse effect on the foreign payments, and increased domestic production could benefit British industry. Some companies have recently unveiled significant new gas development plans in the British sector of the North Sea and have stated that there is no need for Norwegian imports:

- Conoco intends to develop four new North Sea gasfields with recoverable reserves of 70 bcm at a cost of over $1 billion and claims that southern basin gas reserves are sufficient to meet British requirements to the year 2000.
- British Petroleum (BP) recently stated that enough British gas reserves are recoverable at a price comparable to the Sleipner price to meet domestic needs until after the year 2000 and has announced it will develop four gasfields in the southern sector of the North Sea capable of producing about 4 bcm annually.
- One energy consulting firm asserts that eight or nine new gasfields will be given the go-ahead in the North Sea in the next few years alone. [redacted] 25X1

Without Sleipner, however, the British gas industry will have to find and develop more than the equivalent of about three-fourths of its current output to satisfy demand requirements when Frigg gas supplies run out. To meet such an ambitious target, British offshore gas would have to be developed much faster over the next 10 years than it was during the boom years of the 1970s. Given the uncertainties surrounding demand, indigenous supply, and foreign payments implications, [redacted] London may eventually approve the Sleipner contract with lower volumes and possibly take some Dutch gas as well. Under this scenario, London may also change its current policy of forbidding export of UK North Sea gas, according to Embassy reporting. Dutch supplies could be used to meet British needs in the 1980s, while Norwegian supplies would come on line in the 1990s in combination with maximum domestic production. [redacted] 25X1 25X1

Outlook and Implications

In our judgment, the security of gas supplies in Western Europe over the next decade will be significantly influenced by the British decision on the Sleipner contract. A decision by London to approve the Sleipner purchase would improve prospects for marketing the Norwegian Troll field. Oslo has stated that progress on Troll will be delayed pending resolution of Sleipner sales. Troll is the only large, secure OECD gas supply available and capable of meeting Continental requirements in the 1990s. Because of a 10-year leadtime for Troll development, we believe a decision to proceed with the project in the next year or so is essential to prevent significant additional Soviet gas sales to the West Europeans in the 1990s. [redacted] 25X1

Alternatively, a decision by London to rely on increased indigenous production and some smaller volume of Dutch gas imports could pose risks to the United Kingdom, if—as we believe is possible—domestic output falls short of expectations. The United Kingdom would then be forced to seek additional imports, either from Norway or potentially the Soviet Union. The Soviet option would be available to London once the pipeline link to the Continent from the United Kingdom was built to import Dutch gas. The pipeline, however, could enhance other aspects of European gas security by integrating the distribution network. [redacted] 25X1

On balance, we believe London will eventually approve the purchase of Sleipner gas. British Department of Energy officials, however, may instruct BGC to reduce the volume agreed to in the original deal by 20 percent because they believe domestic production can be increased significantly. [redacted] 25X1 25X1 25X1 [redacted] The French and West Germans are negotiating with the Soviets for lower prices, and the Soviets have been successful in selling additional gas to Italy. As a result, attempts by the British to unilaterally alter contract terms probably would force a review of Sleipner marketing plans and portend delays for Troll. [redacted]

Beyond Sleipner

The willingness of West European gas suppliers to adjust to the realities of a weak energy market by lowering prices could have a positive impact on West European gas security. Norway and the Netherlands—which account for 70 percent of proved European gas reserves—recently have shown considerable price flexibility in making available additional gas supplies. The Norwegian price offer to the United Kingdom on Sleipner gas was well below its 1980 deal to sell Statfjord gas to the Continent, and even lower than the Norwegians seemed determined to get six months ago. Such price flexibility is probably a prerequisite to the development of Troll's huge reserves. Although the Dutch initially misread the market and priced future supplies too high, The Hague submitted a more competitive offer to the United Kingdom, indicating a willingness to negotiate further. On the Continent, the Dutch have offered to provide additional gas supplies to Italy at the present price. Two months ago, the Dutch were demanding a higher price as a premium for being a secure gas supplier, [redacted]

Given the price flexibility of suppliers, the prospect of enhancing gas security now rests primarily with consumers. In gas contract renegotiations scheduled to occur this year with the Dutch, consumers probably will have the opportunity to take additional volumes of Dutch gas beyond contract expiration dates. Indeed, The Hague has indicated a willingness to offer buyers a 10-year extension of current contracts, which run into the 1990s, according to industry sources. Additional Dutch gas supplies have the potential to partially meet future demand growth and minimize Soviet sales until the Troll field can be developed in the mid-to-late 1990s. 25X1

[redacted] 25X1

Price flexibility on the part of Norway and the Netherlands, however, may not be enough to attract consumers. Although the Dutch offered additional gas supplies at competitive prices, Rome recently opted for Soviet gas and lucrative countertrade agreements. As a result of signing for Siberian gas, Rome hopes to make sales of $600-800 million to Moscow by 1990, beginning with the signing of a $150 million contract for the construction of an experimental coal slurry pipeline in the Soviet Union, according to US Embassy reporting. Thus, even if the Sleipner agreement is approved and the outlook for Troll development brightens, the prospect of receiving lucrative Soviet contracts in return for gas purchases could lure some West European consumers to purchase additional Siberian gas in the 1990s. [redacted] 25X1 25X1

[redacted] 25X1

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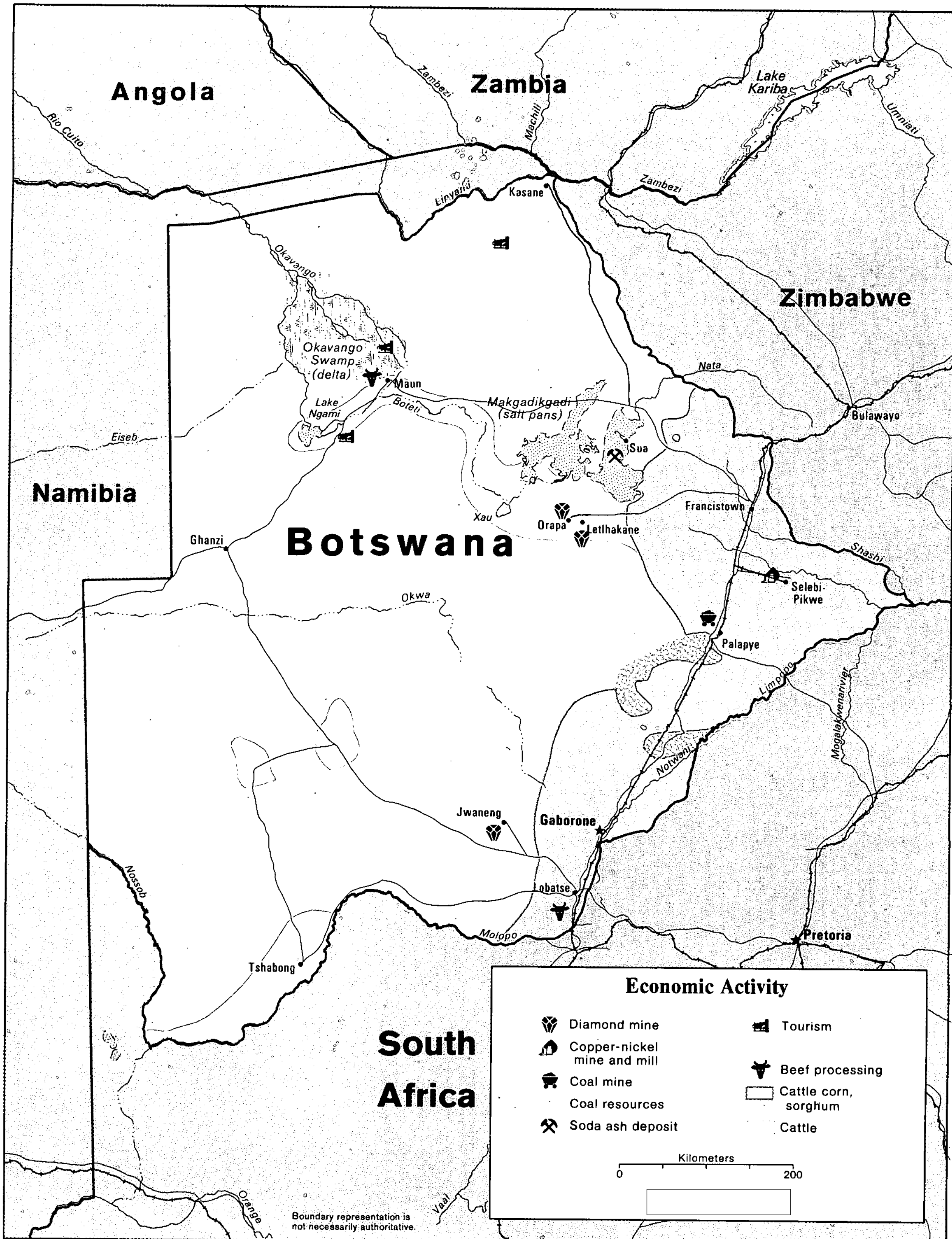

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Botswana: Economic Success Story

Botswana's impressive economic development record—one of the best in the Third World—is being tested by a series of setbacks. Heavily dependent on the United Kingdom and other foreign donors at independence in 1966, Botswana has built an export-based economy and today finances all of its operating budget and much of its development spending from its own resources. Per capita national income has risen from $75 at independence to more than $900—although the distribution is highly unequal. The economy has good growth prospects, but it remains vulnerable to swings in the diamond market and to disruptions in its close economic ties to South Africa.

Growth and Vulnerability

The 1970s were years of rapid, export-led economic growth and of surpluses in the budget and current accounts. The mining of diamonds, nickel, and copper, begun in the early 1970s, along with improvements in the commercial cattle industry and the start of beef exports to the European Community, boosted real national income by an average of nearly 15 percent annually during the decade. Increases in customs receipts and diamond royalties led a 33-percent average annual rise in government revenues during the decade. Conservative fiscal management allowed Gaborone to enjoy budget surpluses that were applied to development spending. Foreign investment in mining spurred growth in the construction industry and accounted for the bulk of large inflows of private capital that, together with export growth of about 30 percent annually, resulted in foreign payments surpluses.

Since 1979, however, Botswana's narrowly based, export-led economy has been jolted by a series of reverses. These difficulties have included an epidemic of hoof and mouth disease that curtailed beef exports, sharp swings in the international diamond market that whipsawed Botswana's key export, and a prolonged slump in the world minerals market that threatens the solvency of Botswana's major employer, a nickel and copper mine. In 1982 Botswana experienced the onset of a severe drought—as yet unabated—that has withered subsistence crops, devastated grazing lands, and caused substantial reductions in the national cattle herd. These, together with other weaknesses, ensure that periods of severe economic stress will continue to challenge Gaborone's economic management.

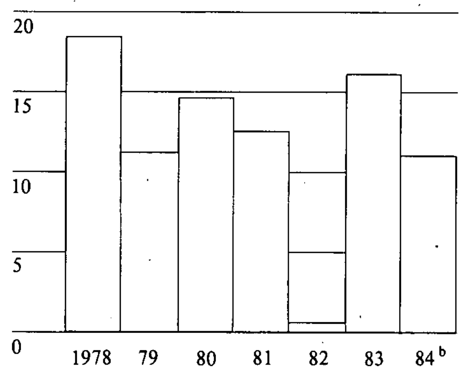
The Mineral Sector. Diamond mining has been the springboard for Botswana's economic growth. As a result of a mine that opened in 1982, diamond production has more than doubled and mining has become Botswana's largest productive sector, accounting for about one-fourth of GDP. Botswana now ranks just behind South Africa and the USSR in diamond production.

Diamond sales constitute two-thirds of exports but have been subject to volatile world demand. During the speculative diamond boom of 1979-80, for example, the value of diamond exports nearly tripled. In 1981, however, slumping world demand—especially for the high-quality gemstones that account for over one-third of the diamonds produced in Botswana—caused sales to fall by 40 percent, resulting in the first current account deficit in a decade.

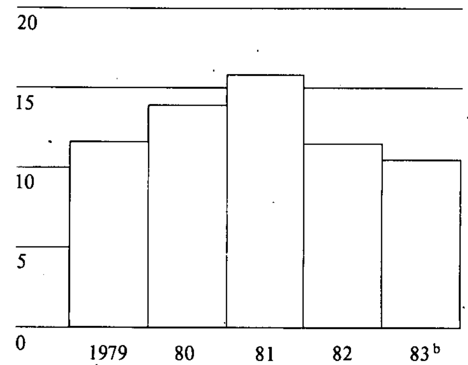
Botswana's diamond mines are operated by a subsidiary of De Beers, the South African diamond giant, and are marketed by a De Beers–controlled cartel—the Central Selling Organization (CSO)—

Botswana: Economic Indicators

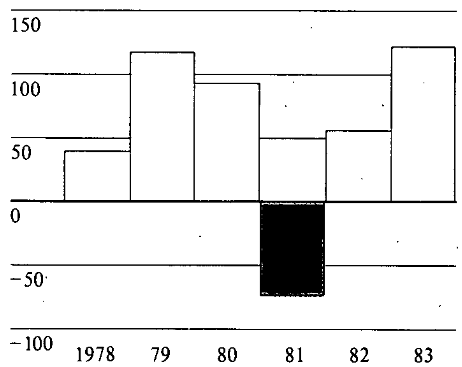
Real GDP Growth, 1978-84 [a]
Percent



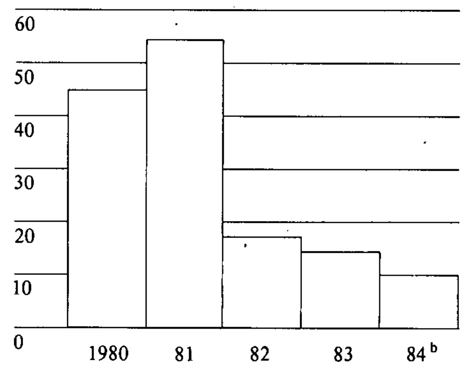
Inflation Rate, 1979-83
Percent



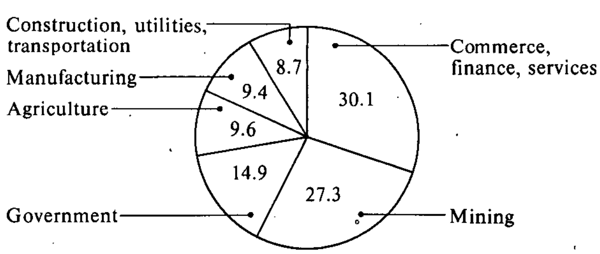
Balance of Payments, 1978-83
Million US $



Production of Principal Food Crops, 1980-84 [d]
Thousand tons



GDP by Sector, 1982/83 [b]
Percent



[a] Year ending 30 June. Based on consumer price deflator. In comparison, the use of a consumer price deflator to reflect the real purchasing power of Botswana's export-oriented output results in a decline in real GDP for both 1981 and 1982, when the Botswana pula experienced substantial devaluation.

[b] Estimated.

[c] Consumer price index.

[d] Year ending 30 June.

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in London. Contractual arrangements with De Beers guarantee that a percentage quota of Botswana's annual output—based on Botswana's share of the total volume supplied to the CSO worldwide—will be purchased. [redacted]

The collapse of the diamond market in 1981, however, compelled Gaborone to add to its diamond stockpile, now valued at more than $500 million, equivalent to about half of Botswana's national income. Despite record export sales last year, about one-third of output was stockpiled. [redacted]

Botswana's only other significant mineral production is nickel-copper matte and a small amount of coal for domestic use. The nickel mine is owned jointly by the government, Anglo-American Corporation of South Africa, and a US firm that is the only significant US investor in Botswana. The complex is considered one of the most technically efficient in the world. [redacted]

Although the US partner buys all of the output for refining in the United States and reexport to Europe, low world prices have caused repeated losses and rising debt, according to press reports. The mine's political importance as a source of employment, however, has made its continued operation a government priority. Gaborone has successfully pressured its private partners in the venture to participate in a series of financial bailouts to keep the mine open. [redacted]

Prospects for new mineral development are mixed. Once-promising prospects for an expansion of coal output for export are now dimming in the face of a world coal glut. On the other hand, development of soda ash deposits in northeastern Botswana is set to begin soon; South Africa is slated to be the major market, but political tensions between Gaborone and Pretoria could derail the project. [redacted]

Agriculture. The severe drought—now in its third year—has aggravated Botswana's chronic food deficiencies. Even under normal conditions Botswana cannot feed itself. Output before the drought averaged only about one-third of domestic consumption, 25X1 and has fallen to about 10 percent of consumption in each of the last two years. Imports of food—mostly from South Africa, which treats Botswana as part of its domestic market for grain—have increased substantially, as has dependence on international food relief. We estimate that Botswana will require well over 100,000 tons of foodgrain imports in 1984. 25X1 As many as half of the roughly 1 million population now depend on government food distribution, according to press and US Embassy reports. [redacted] 25X1

The cattle industry, the country's second-largest foreign exchange earner, has also been afflicted by the drought. The industry has long been a major factor in economic growth and is still the main economic activity for about 70 percent of the 25X1 populace. With 2.8 million head of cattle, the country has the highest cattle-to-people ratio in the world. Commercial ranching has become more popular in recent years, and the nearly 400 large ranchers now own 500,000 head, according to the World Bank. [redacted] 25X1

Beef processing is Botswana's main manufacturing activity and the principal employer in the manufacturing sector. Beef exports—primarily to South Africa and to the United Kingdom and other 25X1 members of the EC—were just recovering from the economically devastating bouts of hoof and mouth disease when the drought hit. Although a high slaughter rate has prevented some near-term economic losses, the national herd may have fallen by as much as 800,000 head since 1981. Moreover, the UN Food and Agriculture Organization estimates that an additional 800,000 or more head could die

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Economic Ties With South Africa

Botswana's economy is linked closely to that of South Africa. Most of its foreign trade depends on South African roads and railways. We estimate that 40,000 migrant laborers from Botswana work in South Africa, nearly half legally in South Africa's mines and most of the others unofficially in agriculture. These jobs help relieve Botswana's unemployment, boost incomes, and provide foreign exchange.

Botswana is dependent on South African corporate investment. One promising project requiring Pretoria's cooperation involves the development of large soda ash deposits for export to South Africa. British Petroleum has begun the initial phases of an investment of over $300 million, but Pretoria, which is a potential partner in the construction of associated transport systems, has attempted to link its involvement to Botswana's willingness to sign a formal security accord. Gaborone's determination to proceed with the project and Pretoria's interest in obtaining a low-cost source of soda ash for its glass, aluminum, and paper industries suggest the two countries will find a compromise.

Botswana's membership, along with Lesotho and Swaziland, in the South African–sponsored Southern African Customs Union (SACU) has provided Pretoria with another important source of leverage. South Africa collects duties on the imports destined for these landlocked countries and then transfers the revenues based on reported SACU imports. Pretoria, however, also provides a hidden form of aid by allowing the members to overstate their imports, a practice probably intended originally as a reward for formal cooperation in the union with South Africa. According to the US Embassy in Pretoria, however, South African officials have recently hinted that such supplements will be reduced in September unless current members accept South Africa's four so-called independent tribal homelands as new and equal members of SACU. Although we believe Botswana would strongly resist such a demand, SACU receipts account for over 30 percent of its government revenues, and Gaborone would feel the pinch if Pretoria decided to reduce these payments.

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Like other states in the region, Botswana has sought, unsuccessfully, to loosen its economic ties to South Africa. Botswana is a founding member of the Southern African Development Coordination Conference (SADCC), a nine-nation regional group formed in 1980 partly to promote regional development but also to alleviate economic dependence on South Africa. The SADCC secretariat is located in Gaborone. (Other SADCC members are Angola, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia, and Zimbabwe.) Despite support from Western donors, however, the SADCC has made little progress. Its efforts have been hampered, in part, by South African–backed insurgents in Angola and Mozambique who have disrupted transport routes and precluded the building of new transportation links that are vital to developing alternatives to South Africa.

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from the drought before the rainy season starts in October.

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Recent Performance and Outlook

Despite recent difficulties, the Botswana economy is demonstrating resilience. Diamond sales were up sharply early last year, spurred largely by higher production but also by some improvement in the world market. Diamonds last year earned a record $416 million in foreign exchange, double the 1982 level, and accounted for two-thirds of total exports, according to press reports. Beef sales to the EC, which absorbs half of Botswana's beef exports, also are strong; these sales last year nearly filled the quota Botswana is allowed under the Lome Convention.[1] [redacted] 25X1

As a result, foreign exchange reserves rose dramatically—they now cover more than six months of imports—and foreign payments achieved a record surplus last year, according to press reports. Botswana's external debt remains low, with debt servicing absorbing less than 6 percent of export earnings. [redacted] 25X1

The domestic economy stabilized during the last year, despite the continuing drought. Inflation eased to 10 percent in 1983 from its peak of 16 percent in 1981. The government continues to maintain strict control over the budget and projects a surplus for the current fiscal year that started on 1 April. [redacted] 25X1

Botswana faces a critical need to generate nonagricultural jobs for its rapidly growing labor force. The unemployment rate probably exceeded 12 percent last year, hitting young people hardest and creating potentially fertile ground for political unrest. Out of an annual increase in the labor force of 12,000 to 13,000, 7,000 to 8,000 became employed, according to press reports. Although jobs in the modern sector grew by 10 percent annually during the 1970s, less than 30 percent of total employment in Botswana is in the modern sector. The rest is in subsistence agriculture and traditional herding sectors, which are not expected to have rapid growth.

[redacted] 25X1

[1] Under the Lome Convention, exports from the former colonies of EC members are accorded duty-free access to the European market. The United Kindgom's entry to the EC gave Botswana such access but subject to nontariff barriers that include a negotiable quota on volume and price restrictions designed to prevent dumping on the European market. [redacted] 25X1

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