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International Economic & Energy Weekly

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17 August 1984

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17 August 1984

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Comments and queries regarding this publication are welcome. They may be directed to [redacted] *Directorate of Intelligence,* [redacted] [redacted] 25X1 25X1

Secret
17 August 1984

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707130001-4

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International Economic & Energy Weekly [redacted]

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Synopsis

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21 **USSR: The Economy at Midyear 1984** [redacted] 25X1

The Soviet economy continued a moderate recovery in the first six months of 1984. Taking into account the declining prospects for agricultural production, we estimate that GNP growth probably will be in the 2-to-3-percent range for the year. [redacted] 25X1

27 **Argentina: Financial Imperatives Versus Struggling Democracy** [redacted] 25X1

President Raul Alfonsin believes creditors should ease the repayment burden to support Argentina's fragile democracy, but his attempts to strike deals with creditor banks so far have failed. Even with an IMF program, Argentina probably will face recurring financial crunches throughout the 1980s. [redacted] 25X1

33 **Zaire: The "Bitter Pill" of Economic Reform** [redacted] 25X1

Zaire has been making a strong effort this year to stick to its latest economic stabilization program. To achieve economic stability, it will have to maintain strict economic adjustment policies for several years. [redacted] 25X1

37 **Smaller Gulf States: Cutting Back on Foreign Aid** [redacted] 25X1

Kuwait, Qatar, and the United Arab Emirates have tried to use foreign assistance—as much as $6.1 billion or 10 percent of GDP in 1981—to bolster their security. The current oil glut, however, caused them to slash aid disbursements about 70 percent last year, and the flow will remain depressed at least through 1985. [redacted]

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43 **Western Europe: Growing Demands for a Shorter Workweek**

Settlement of the West German metalworkers strike by shortening the standard workweek from 40 to 38.5 hours with no cut in pay has opened the door for similar labor demands throughout Western Europe. We believe the shift to shorter workweeks will continue but will have little impact on Western Europe's double-digit unemployment because it does not address the underlying causes of the problem.

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Briefs

Energy

OPEC Production Slips

OPEC production in July averaged 17.7 million b/d, down 1.5 million b/d from the June level. Saudi Arabia—acting as OPEC's swing producer—cut output to relieve recent downward pressure on prices. Saudi production dropped about 1 million b/d, despite Riyadh's recent oil-for-planes barter deal with Boeing. Nigeria's production slipped 200,000 b/d below its OPEC-mandated quota because of marketing and storage problems, while Iranian oil production rose slightly above its OPEC ceiling in July. Most other OPEC members continued to violate their quotas and so far this year OPEC has not held production to its ceiling of 17.5 million b/d. Continued cheating will put additional downward pressure on prices and will threaten the cartel's already tenuous accord unless oil demand experiences an unexpectedly strong rebound in the coming weeks.

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OPEC: Crude Oil Production [a] *Million b/d*

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	1984			
	Quota	First Half	June	July
Total	**17.5**	**18.2**	**19.2**	**17.7**
Algeria	0.725	0.7	0.7	0.7
Ecuador	0.2	0.2	0.2	0.2
Gabon	0.15	0.2	0.2	0.2
Indonesia	1.3	1.5	1.5	1.4
Iran	2.4	2.3	2.4	2.5
Iraq	1.2	1.1	1.2	1.2
Kuwait	1.05	1.0	1.0	0.9
Libya	1.1	1.2	1.3	1.1
Neutral Zone	[b]	0.5	0.5	0.4
Nigeria	1.3	1.4	1.3	1.1
Qatar	0.3	0.4	0.5	0.4
Saudi Arabia	5.0 [c]	4.9	5.5	4.5
UAE	1.1	1.3	1.3	1.7
Venezuela	1.675	1.7	1.7	1.7

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

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British Act To Maintain Oil Prices

In an unprecedented move, London recently requested that several private oil companies cooperate with the British National Oil Corporation (BNOC) to support oil prices. BNOC—the state corporation that normally sets UK crude prices—has so far refused to lower its official prices despite several contract terminations that resulted in trading losses of as much as $600,000 per day in July. London's decision to intercede—because of British concern that a price reduction would trigger an uncontrolled slide in world prices—was taken after the British learned of a sharp decrease in Saudi production, which they expected would cause the oil market to firm. Public announcements by British Petroleum and Royal Dutch Shell that field maintenance would reduce UK oil production by as much as 500,000 b/d during August apparently were designed to help support prices. Although maintenance operations normally reduce British oil production at this time of year, the maintenance schedules are not usually released to the press.

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Spot Oil Market Firms

The fall in OPEC oil production and the actions taken by the British Government to support its official oil prices have caused spot crude oil prices to firm in recent weeks. Spot prices for Saudi Arab Light crude increased about 70 cents per barrel in August to $27.70, although they are still well below the official price of $29 per barrel. Since the end of July, the price of UK Brent crude has jumped about $1.50, to $28.50, while Nigerian Bonny Light is up about 60 cents to $28.20—compared to official prices of $30 per barrel. The increase in spot oil prices caused one US company late last week to rescind its $2 per barrel July price cuts. Spot prices for most crudes remain about $1.50 below official levels, however, and we expect OPEC will have to restrain its oil production to near the organization's ceiling for at least several more weeks to prevent new declines in spot oil prices.

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OECD Nuclear Power Output Increases

[redacted]

According to the trade press, nuclear electricity generation in the OECD countries was up nearly 20 percent in second quarter 1984 compared to the same period a year ago--reaching 4.3 million barrels per day oil equivalent (bdoe). Nuclear power generation in Western Europe jumped nearly 40 percent, led by large increases in France and West Germany, which are now producing 800,000 and 400,000 bdoe, respectively. The majority of the increase in nuclear power generation resulted from the introduction of new generating capacity, although improved plant-operating factors also were important. Twenty nuclear reactors have started commercial operation in the past 12 months: six in the United States; three in the United Kingdom; two each in Canada, France, Japan, Spain, and West Germany; and one in Sweden. We expect nuclear electricity generation to continue to surge in the year ahead. Twenty-five additional nuclear reactors are scheduled to come on line by the end of this year, and the spread of economic recovery throughout the OECD is stimulating electricity demand. [redacted]

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OECD: Gross Nuclear Electricity Generation

Terawatt-hours
(except where noted)

	Second Quarter 1983	Second Quarter 1984	Percent Change
OECD	**190.1**	**227.0**	**19.4**
United States	73.1	78.4	7.3
Japan	26.7	28.3	6.0
Canada	12.5	11.6	−7.2
Western Europe	77.8	108.7	39.7
Belgium	6.6	6.9	4.5
Finland	3.6	4.1	13.9
France	29.4	42.4	44.2
Italy	1.6	1.0	−37.5
Netherlands	0.9	0.9	0
Spain	1.8	5.4	200.0
Sweden	8.0	10.5	31.2
Switzerland	3.2	3.4	6.2
United Kingdom	11.6	13.3	14.7
West Germany	11.1	20.8	87.4

[redacted]

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[redacted] 25X1

Sakhalin Gas Development Plan Announced

[redacted]

According to the Embassy in Tokyo, the Sakhalin Oil Development Corporation, jointly owned by a Japanese consortium and the Soviet Union, announced a technical plan for development of the Chayvo gasfield off Sakhalin Island. The plan calls for four offshore platforms producing roughly 5 billion cubic meters of gas per year for 20 years. The gas would be piped 230 kilometers to Dekastri, where it would be liquefied for shipment to Japan. [redacted] 25X1 25X1

Japanese Export-Import Bank financing—necessary for completion of the $3 billion Chayvo project—is contingent on purchase commitments from the Japanese power companies that would buy the gas. The companies, however, are reluctant to make any promises, having contracted for supplies into the 1990s, while gas demand is projected to remain flat. These and other delays probably will further postpone Sakhalin development, which already has been in limbo since the early 1970s. [redacted] 25X1

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International Finance

[redacted]

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Soviet Bank Seeks New Branch in Netherlands

[redacted]

[redacted] the Soviet-owned Moscow Narodny Bank in London expects to receive permission soon from the Dutch Government to incorporate in Amsterdam. The opening of a branch in Amsterdam would mark the first successful expansion since 1974 of the Soviets' overseas banking network. Soviet banking officials have stated the new branch would be involved in organizing broad-based Eurocurrency loan syndications for the Soviet Foreign Trade Bank. Moscow probably also hopes that a branch near Rotterdam—the major entry port for Soviet oil into Western Europe—will facilitate oil sales. [redacted] 25X1

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Global and Regional Developments

West German Concern About Trade Restrictions

[redacted]

West German Economics Minister Martin Bangemann said last week that Bonn probably would enact overriding legislation if the United States imposes tough new extraterritorial trade restrictions. The law would be similar to the British Protection of Trading Interests Act, which London used in 1982 to circumvent a US ban on exports for the Soviet gas pipeline. Former Economics Minister Lambsdorff directed his staff this spring to draft a bill that would block application of US trade laws to US subsidiaries and importers of US technology in West Germany. [redacted] 25X1

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Bonn long has considered US policy on trade in strategic items overly strict. This latest expression of concern almost certainly was prompted by pending renewal of the US Export Administration Act and by the recent leak of an internal West German Government study that concluded that US export restrictions on high-technology trade are increasing and affecting not only the USSR, but also Japan and Western Europe. West German officials deny, however, that Bonn, as recommended in the study, is canvassing other countries about a possible joint approach to Washington. [redacted] 25X1

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Reaction to US Textile Import Moves

[redacted]

Textile and apparel exporters have mounted a major diplomatic and media campaign attacking a US Government proposal announced this month that would tighten rules of origin for all clothing imports. They also have taken aim at petitions recently filed by US textile firms that claim unfair export subsidization by 13 exporters—Argentina, Colombia, Indonesia, Malaysia, Mexico, Panama, Peru, Philippines, Portugal, Singapore, Sri Lanka, Thailand, and Turkey. Exporters have asserted that: 25X1

- The US measures would violate the Multifiber Arrangement and the GATT.
- The US law, which denies an import injury test in countervailing duty investigations to countries that have not signed the GATT subsidies code, is unfair and illegal. (None of the 13 exporters named in the suit is a signatory.)
- Financially troubled LDCs need to expand earnings to cope with their international debt problems.

Textile and Apparel Exports, 1982

Percent

	Share of Manufactured Exports	Share Exported to US
Argentina	4	23
Colombia	32	23
Indonesia	20	41
Malaysia	11	23
Mexico	15 [a]	74 [a]
Panama	44	23
Peru	53	21
Philippines	47 [a]	50 [a]
Portugal	40	2
Singapore	8	22
Sri Lanka	68	60
Thailand	43	18
Turkey	47	1

[a] Estimated.

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A meeting in late July of textile exporting LDCs in Karachi denounced the possible US actions and asked members to appeal to public opinion in industrial countries. Last week the group requested a GATT textile committee meeting in September to examine the measures. Although the 13 countries listed in the subsidy complaints accounted for only 11.25 percent of US textile and apparel imports in 1982, some small producers or new entrants into the market, such as Sri Lanka or the Philippines, are highly dependent on the US market. 25X1

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Economic Impact of the Red Sea Mining

Saudi Arabia, Italy, Egypt, and Iran are likely to suffer most if more mines are laid in the Red Sea because of their large volumes of trade through the Suez Canal. Statistics of the Suez Canal Authority show that Saudi Arabia is by far the biggest user of the route. Last year, 48 million tons of its exports and imports moved through the Canal. The Saudis have a major stake in ship movements through the Canal, as well as the cargo tonnages. With 946 transits last year, their fleet was the third most active in Canal traffic among shipowning nations. Only the fleets of Greece with 2,436 transits and the USSR with 2,060 were more active.

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Italy had the second-largest stake in Suez trade last year, and ranked 10th among shipowning users of the Canal. The volume of Egypt's trade via the waterway was third largest in tonnage of cargo, but its own ships made only 104 transits. Iran's volume of cargo through the Canal was almost as high as Egypt's. Iranian ships, however, made even fewer transits--only 98.

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Status Report on the Esprit Project

[redacted]

Initial R&D projects and participants have been selected for the Esprit Project, the European Community's effort to improve its competitive position in the information and computer industries. The Esprit program will focus on five areas of research and development: microelectronics; software technologies; advanced information processing; advanced office systems; and computer-aided manufacturing. Earlier this year, the EC allocated $1.3 billion for the first five years of the project. Late in July, the EC chose 90 research projects involving 300 West European companies, research labs, and universities to receive the first $350 million of funding. Much of the research is similar to Japan's efforts under its Fifth-Generation Computer Project. [redacted]

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When the Esprit Project was established, participation was open to any company that was performing R&D in information or computer technologies in the EC. The EC, however, may be applying selection criteria unevenly. In at least one case, [redacted] the EC attempted to exclude major participation by IBM. Although IBM is now involved in some Esprit projects, IBM and other large US firms have only been awarded minor roles. [redacted]

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National Developments

Developed Countries

IMF Threatens To Suspend Credit to Ankara

[redacted]

According to press reports, the IMF is threatening to suspend the $57 million tranche of the current standby agreement that is due to be drawn this month, because of Ankara's failure to meet agreed monetary targets. The limits for net domestic assets of the Central Bank and credits to the public sector have been exceeded by about 11 percent as of early last month, while the money supply soared almost 20 percent between May and July. The Fund will almost certainly insist on a tightening of monetary policy to combat Turkey's 55-percent inflation rate. Despite increasing domestic pressure to ease policy, Prime Minister Ozal is likely to try to meet IMF demands to slow monetary growth. The Central Bank has recently boosted interest rates by 1 to 4 percentage points, interest rates for six-month time deposits have been raised from 48 percent to 52 percent, and the Treasury has begun issuing high-interest bonds to reduce excess liquidity. Failure to comply with the IMF's conditions would hurt Turkey's ability to attract loans to meet sharply rising debt-service needs in 1985, when rescheduled debt payments fall due. [redacted]

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Spanish Economic Projections

[redacted]

Madrid recently projected optimistically that real growth will average 3 percent annually during 1984-86. Even so, the government projects that unemployment would fall only from 20.3 percent at the end of this year to 19.6 percent in 1986. The Gonzalez administration predicts that, at best, 279,000 jobs would be created by the end of its mandate in 1986 if trade unions accept a 1-percent real wage cut next year and a further 0.5-percent decrease in 1986.

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The government also is counting on lower salary demands to help bring inflation down to 6 percent over the next two years and boost real investment 8.8 percent annually. Madrid probably intends to use these forecasts to attempt to extract concessions from trade unions—negotiations on a social pact between government, business, and labor began last week. Even if the government succeeds, as we expect it will, wage moderation alone will do little to promote economic recovery. The Gonzalez administration still faces several difficult and politically unpopular tasks: putting industry on a sounder footing, reforming the social security system, and cutting the budget deficit. [redacted]

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Rome Completes Policy Review

[redacted]

Italy's Socialist-led government recently agreed on its economic policy objectives through 1985. The five-party coalition, however, set only broad goals such as reducing the inflation rate from about 10.5 percent—the highest in the Big Seven—to 7 percent, lowering the budget deficit as a share of GDP from last year's 17-percent figure, and creating new jobs, especially in the depressed southern region. Meeting these goals—particularly on the budgetary objective—will prove difficult: 25X1

- Labor unions already have criticized government proposals to reduce mounting pension costs by gradually increasing the retirement age from 60 to 65 for men and from 55 to 60 for women.
- A tax-amnesty proposal—a key part of the deficit-cutting package—is stalled in Parliament.
- New proposals to broaden the tax base and reduce tax evasion by small businesses and professionals face substantial opposition from the private sector. [redacted] 25X1

Continued wrangling within the coalition itself is likely to impede policy implementation. For example, Christian Democratic Treasury Minister Goria's vague plans for spending cuts are meeting sharp criticism from coalition members such as Socialist Labor Minister DeMichelis. At the same time, the US Embassy in Rome reports that Italy's moderate recovery and lower inflation rate are easing short-term pressures on Prime Minister Craxi and most coalition partners to deal effectively with the budget-deficit issue. [redacted]

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Japan Changes Industrial Support Legislation

[redacted]

Japanese press reports indicate that MITI has decided not to renew the Extraordinary Measures Law for Promotion of Specific Machinery and Information Industries when it expires in June of 1985. This law has been the basis for MITI support of microelectronics, data processing, optoelectronics, and other information industries. MITI officials have stated that support is no longer required for industries such as computers because they are now mature and able to compete in the global marketplace. [redacted] 25X1 25X1

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Despite the failure to renew the legislation, we believe that Tokyo will continue to support the computer industry in other ways. Indeed, MITI has already proposed new legislation—New Industrial Technology Guidelines—that would cover the biotechnology, materials, and electronics industries (excluding computers). In addition, there are myriad support programs that will be unaffected by the lapse of the Extraordinary Measures Law. [redacted] 25X1

New Zealand Labor Party Continues Trade Liberalization

[redacted]

Prime Minister Lange this week accelerated the government's shift to the use of tariffs instead of import licenses—with the aim of lowering the overall level of trade protection. Wellington also decided to continue its phaseout of the $1 billion a year export subsidy program. Lange, however, was forced by leftwing parliamentarians to extend the phaseout by two years—until 1987—in the hope of softening the adverse impact on employment. Unless Lange can consolidate support within the party, he will be forced over the next several months to make additional compromises in implementing his relatively conservative economic policies. [redacted] 25X1 25X1

Less Developed Countries

Record Argentine Inflation Complicates Talks With IMF

[redacted]

Consumer prices jumped 18 percent in July and are 615 percent higher than the same month last year, according to press reports. This makes Argentina the world leader in inflation and adds to the government's problems in reconciling budget, exchange rate, and wage policies with the IMF. Moreover, the failure of the Alfonsin government to curb inflation—prices were rising at a 430-percent rate when Alfonsin took office last December—is encouraging union leaders to be more aggressive in demanding wage increases. Despite ongoing efforts at establishing a social contract between government and labor, the Trade Union Confederation (CGT) is already asking for a 23-percent increase for August. Such an increase would be approximately in line with the President's promise of a 6-to-8-percent real increase in wages this year. Although Alfonsin claims that workers have enjoyed a 4-percent real gain since last December, the US Embassy calculates [redacted] that the large public-sector work force has received few if any gains. We believe the unions are becoming aware that nominal wage increases are quickly eroded because of the government's inability to control inflation, and we foresee increased strikes. Alfonsin has not been willing to confront the unions and, barring a shift in his approach, it is unlikely his government will achieve the social pact needed to control the wage-price spiral and make progress in reaching an agreement with the IMF. [redacted] 25X1 25X1 25X1 25X1

New Mexican Development Plan Underscores Policy Drift [redacted]

[redacted]

Mexico's National Program for Industrial Development and Foreign Trade, announced late last month, is unlikely to boost private-sector investor confidence. Moreover, the difficulty in constructing the program underscores growing divisions in the economic Cabinet concerning future policy directions. The plan calls for the development of internationally competitive firms in order 25X1 25X1 to promote the expansion of manufactured exports. Despite objections from the private sector, the plan retains the government's paramount position in setting public- and private-sector investment goals, although some objectionable passages were tempered or deleted during a six-month consultation period. The plan offers no new incentives to foreign investors, promising only that state interests in several "nonstrategic" industries such as food processing, textiles, and appliances will be sold to the private sector. While the financial press reported friction between the plan's authors in the Commerce Ministry and officials in the Finance Ministry who argued for less government intervention, President de la Madrid apparently sided with those favoring government direction of the economy. Similar divisions among policymakers over the role of foreign investment also have been reported, but once again those favoring tight restrictions appear to be in control. [redacted] 25X1

Philippine Foreign Exchange Reserves Fall [redacted]

[redacted]

The Philippine Central Bank's foreign exchange holdings declined from almost $900 million in March to $560 million last month—the lowest level since last October, when Manila imposed a principal repayments moratorium on foreign debt. The IMF attributes declining reserves to a disappointing export performance and the Central Bank's strategy of relying heavily on the black market to allocate foreign exchange. Althrough this approach has softened the impact of the foreign exchange shortage by allowing businessmen to import manufacturing inputs, it has prevented the Bank from capturing sufficient foreign exchange. With current reserve levels now equal to slightly more than one month's imports, Manila will find it increasingly difficult to pay for critically needed goods while maintaining interest payments on foreign loans, and pressure to reach agreement with the IMF will grow. [redacted]

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Costa Rica Plans To Host Economic Conference

[redacted]

Costa Rica plans to host an economic conference in late September which will include participants from the European Economic Community, Central America, and the Contadora countries. The principal agenda item calls for opening negotiations to create a new structure for increased EEC economic cooperation with Central America, similar to the preferential tariff pact between the EEC and the Association of Southeast Asian Nations. The impetus for this meeting grew out of President Monge's state visits in June to 12 West European capitals, where he proposed the conference and also sought bilateral economic aid. According to US Embassy reports, Costa Rican officials believe that negotiations for a pact between the EEC and Central America would take at least a year, in part because British Prime Minister Thatcher is opposed to giving aid to Nicaragua. For the foreseeable future, most West European assistance to the region will continue to be in the form of bilateral aid. [redacted]

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Ethiopian Debt Problems

[redacted]

Ethiopia probably will have to reschedule its debt to Western governments and banks unless it quickly takes steps to reverse negative financial trends. The current account deficit is widening because exports are stagnating while the government remains reluctant to cut imports as it prepares for the September

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celebration of the 10th anniversary of the Ethiopian revolution. The burden of servicing the largely official debt continues to grow: servicing obligations are expected to jump about one-third this fiscal year, reaching almost 25 percent of projected earnings from exports of goods and services. Moreover, the US Embassy reports that foreign exchange reserves are sufficient to cover six weeks of imports at most, compared with the 14 weeks' coverage of a year ago. [redacted] 25X1

The government still has several options before resorting to a formal rescheduling. Addis Ababa already has approached the IMF to discuss balance-of-payments assistance, but has not requested formal negotiations. The regime also is likely to ask Libya or the Soviet Union for hard currency support, although substantial assistance probably will not be forthcoming. In the absence of increased aid flows, Ethiopia will have to slash imports, seek additional commercial loans, or begin to build up arrearages. [redacted] 25X1

Communist

USSR Moving Early on Grain Purchases

[redacted]

The current marketing year is only six weeks old, and the USSR has already contracted for about half of the 40 million tons of grain it will need to import if it is to sustain growth in meat and dairy products. The United States will be the dominant supplier over the coming year. Some 10 million tons have been purchased in the United States since early July, including most recently 1 million tons in early August for immediate shipment. [redacted] 25X1 25X1

The latest purchases from the United States add a sense of urgency to Soviet behavior. Although the USSR is possibly planning political or military actions that would raise the risk of a US embargo, there are other sufficiently persuasive reasons for the early grain purchases. The Soviets may be concerned that the 1984 harvest, now estimated at about 190 million tons, will not reach that level. In addition, the production of potatoes—potatoes are a substitute for grain—is expected to be nearly 10 percent below last year's production, and the harvesting of forage crops is still running behind the 1983 pace. [redacted] 25X1

Moscow has demonstrated a capability to handle at least 50 million tons of imports annually, but to do so shipments must be scheduled fairly evenly throughout the year. Almost all of the recent purchases are scheduled for delivery during the July-December portion of the marketing year. Current low international grain prices provide the USSR an opportunity to rebuild stocks drawn down by a series of poor to mediocre harvests. Imports would have to exceed 40 million tons for any stock rebuilding. If Moscow's need for grain increases substantially over 40 million tons because of shortfalls in domestic production of feed, it will have to choose between reducing feed rations and pushing imports beyond the record 45 million tons imported in the 1981-82 marketing year. The Soviet leadership would be reluctant to give up the hard-won gains in meat and dairy production made in the past year and a half. 25X1
[redacted]

The United States probably will supply the largest share of grain to the USSR during this marketing year, even though world wheat production and stocks are expected to reach near-record levels. Less-than-favorable weather conditions in Canada, Argentina, and Australia may prevent these countries from satisfying sharp increases in Soviet demand and maintaining exports to their other customers. Even if total imports are limited to 40 million tons, purchases from the United States could rise to at least 15 million tons. [redacted]

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USSR: Grain Purchases for Delivery During the July-June Marketing Year

Million metric tons

Country	1983/84 Purchases	1984/85		
		Purchases to Date	Additional Commitments Under LTAs	Total Commitments
Total	**32.1**	**19.4-20.9**	**8.5**	**27.9-29.4**
United States	10.2	10.1	3.0	13.0
Canada	5.8	5.0	1.5	6.5
Argentina	7.7	1.0	3.0	4.0
EC	3.7	2.5-4.0	0.0	2.5-4.0
Australia	1.5	0.75	0.0	0.75
Other	3.2	0.0	1.0	1.0

[redacted]

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Major Soviet Coal Project in Trouble

One of the largest Soviet projects for integrating coal mining with "mine mouth" power plants has received sharp criticism for its poor performance. According to *Pravda*, the first of five planned coal-fired power plants at Ekibastuz has failed to operate at better than two-thirds of capacity, in part because of the poor quality of the coal being produced. Interruptions in electricity output from the flawed plant cause costly disruptions in industries that rely on it for power. [redacted]

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This major project in the northern Kazakstan coal basin is scheduled to provide about 15 percent of Soviet coal and nearly 5 percent of electricity output by 1990. The power plant has been plagued with design and operating problems since its startup in 1979, however, and the Soviets may need considerable Western assistance to resolve the difficulties. West German and Italian manufacturers of coal-cleaning equipment have already won multimillion dollar contracts for the project. [redacted]

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East German Recovery Continuing

[redacted]

East Berlin announced earlier this month that national income in the first seven months of the year was 5.1 percent above the year-earlier period, indicating that the recovery that pushed income growth to 4.4 percent last year is continuing. The steadily improving monthly reports suggest that growth in

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1984 will again be relatively high by East European standards. Industrial production reportedly rose 4.3 percent in the January-July period, and productivity growth reached 7.4 percent. Retail sales climbed 4.9 percent, a sharp change from 1982/83, when real personal consumption probably declined and consumers bore the brunt of East Germany's efforts to avoid a financial crisis. Foreign Trade Bank officials meanwhile told the US Embassy that East Germany ran another trade surplus with the West in the first half and that the chronic trade deficits with the USSR had been eliminated with the help of an 18-percent increase in exports. [redacted] 25X1

We attribute the recent strength of the East German economy largely to the efforts of the Honecker regime, including:

- Structural changes that have improved the efficiency of the economy and produced marked savings in the use of energy and raw materials and provided more salable export goods.
- A successful export push that allowed renewal of growth of imports from the West.
- Administrative changes designed to boost managerial and worker incentives.
- Improved use of investment resources. [redacted] 25X1

Uneven Impact of Hungarian Economic Reforms

[redacted]

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Budapest is concerned that stagnating living standards have created serious social tensions and could lead to public disturbances, [redacted] 25X1 [redacted] major problems growing inflation and the increasing income disparity between poorly paid industrial workers and more 25X1 prosperous private sector employees. [redacted] since 1982 the 25X1 real income of a worker receiving only a state salary has been dropping, while private-sector income has climbed 45 percent. [redacted] 25X1

The problems result from austerity measures that Hungary has adopted to meet foreign-debt obligations and from the uneven impact on the population of the economic reform program. Reforms to reduce consumer-price subsidies and encourage private initiatives are hurting individuals on fixed incomes and those with fewer economic opportunities. The resulting tensions, however, are almost certainly not serious enough to cause unrest soon or to cause the government to retreat from its reform policies. [redacted] 25X1

Closer Chinese-East European Economic Ties

[redacted]

China will establish bilateral economic commissions with Poland, Hungary, and Czechoslovakia, according to agreements signed in June and July during the Chinese Foreign Trade Minister's visit to Eastern Europe. China also 25X1 signed bilateral agreements on economic and technological cooperation with all three countries. US Embassy contacts in Warsaw and Budapest say that Moscow approves such measures. In addition to the economic benefits that both sides will derive, Beijing has been pursuing better relations with East European countries to encourage them to be more independent from Moscow and to probe the limits of Soviet tolerance. [redacted] 25X1

The Soviets may see benefits for themselves and their allies in allowing the East Europeans to move ahead on economic cooperation with the Chinese. They are in no mood, however, to tolerate much diversity on any key political issues. Beijing could be signaling an interest in moving ahead with the USSR on economic issues, an area where progress slowed following the Soviet postponement of First Deputy Premier Arkhipov's visit in May. Since then the Chinese have sought to put themselves in a position to be the more flexible of the two parties while portraying the USSR as increasingly intransigent and isolated internationally. Such a policy costs China little as it tries to put pressure on Moscow to adopt a more flexible position. [redacted] 25X1

USSR: The Economy at Midyear 1984 [redacted]

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The Soviet economy continued a moderate recovery in the first six months of 1984. The industrial sector, in particular, appears to be sustaining the better performance of last year, when growth in output picked up after several sluggish years. The railroads also are continuing to do a better job of moving freight—bottlenecks and freight car shortages have become less frequent. Taking into account the declining prospects for agricultural production, we estimate that GNP growth probably will be in the 2-to-3-percent range for the year. [redacted]

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Industry—On a Par With 1983

Soviet industrial production in first half 1984 was 3.5 percent above the year-earlier level, according to our calculations. The industrial sector's record during the past year and a half represents an improvement over recent years—industrial output grew 2.5 percent a year on average during 1979-82—but is still well below the pace of the early 1970s. [redacted]

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Industrial Materials. The production of industrial materials grew at about the same rate as in first half 1983, although performance fell off in several key branches. Output of ferrous metals and construction materials, for instance, increased at a rate below that of first half 1983 because of shortages of critical raw materials and skilled labor as well as inadequate investment. However, most branches of the chemical industry, nonferrous metals industries, and the wood and paper industry equaled or bettered last year's performances. [redacted]

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In the energy sector, results were mixed. Oil output was down slightly in the first six months because of inadequate inventories of good-quality oilfield

USSR: Growth in Industrial Production *Percent change*

	1982	1983	First-Half 1983	First-Half 1984
Industry	**2.3**	**3.4**	**3.7**	**3.5**
Machinery	3.8	3.5	4.1	4.1
Industrial materials	1.4	3.4	3.3	3.4
Ferrous metals	0.4	4.0	2.5	1.8
Crude steel	−0.9	4.0	2.3	2.0
Rolled steel	−0.7	4.0	1.9	2.1
Steel pipe	−2.0	4.0	5.0	0.7
Nonferrous metals	1.5	3.0	4.0	4.0
Fuels	1.8	1.2	1.7	1.0
Coal	2.0	−0.3	−0.1	−0.5
Oil (including gas condensate)	0.6	0.6	1.3	−0.1
Gas	7.7	7.1	7.3	8.7
Electric power	3.1	3.6	3.5	5.5
Chemicals	1.8	6.0	5.2	4.9
Mineral fertilizer	2.7	11.1	9.0	4.0
Synthetic resins and plastics	−0.8	8.9	7.0	11.0
Chemical fibers	2.0	9.6	4.6	6.8
Tires	2.0	0.5	0.4	3.0
Wood, pulp, and paper products	0.4	3.0	3.4	4.0
Construction materials	0	3.1	3.4	2.8
Consumer nondurables	1.3	3.3	3.7	2.2
Soft goods	−0.5	0.9	0.8	1.0
Processed foods	2.8	5.2	6.0	3.2

[redacted]

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USSR: Production of Major Fuels

	1981	1982	1983	First Half 1983	First Half 1984	1984 Plan	1984 Projected
Oil *(million b/d)*	12.18	12.25	12.33	12.38	12.31	12.45	12.23-12.35
Coal *(million metric tons)*	704.0	718.1	716.0	363	361	723	710-715
Gas *(billion cubic meters)*	465.3	500.7	535.5	265	288	578	582-585

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equipment, shortages of well-maintenance crews and other skilled labor, bad weather early in the year, and delays in the massive program to add pumps to West Siberian oil wells. The production goal for 1984 now is beyond reach, and Moscow will do well to match 1983's output. Coal production was also down somewhat in the first half, and the modest 1-percent growth planned for 1984 is probably also unattainable; output could fall below last year's level of 716 million tons.

On a more positive note, gas and electric power production both advanced at rapid rates. With first-half gas output above plan, this year's goal should be easily surpassed. Production of electricity increased by a healthy 5.5 percent compared with first half 1983—well above the 3.5-percent rate of increase planned for the year. The major reason for the improvement has been the ample fuel supplies available this year because of a mild winter and the conversion from oil to gas at a number of power plants.

Machinery. Machinery output increased by about 4 percent in the first six months of 1984, above the average for industry as a whole but considerably lower than the 7-percent rate planned for 1981-85. Machine building is a pivotal sector, producing military hardware as well as consumer durables and machinery for investment. Reduced availability of rolled steel products and inadequate investment in the machinery industries, however, have held back growth in this sector during the 1981-85 Plan.

Consumer Goods. Growth in the production of nondurable consumer goods slowed in the first six months of 1984. The dropoff was especially apparent in processed foods such as butter, vegetable oil, and canned foods. Production of other nondurables increased at about the same low rate as last year.

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Transportation

Total freight turnover totaled 3.8 trillion ton-kilometers during the first half of this year—up over 3 percent compared with first half 1983, and slightly ahead of plan. The road and river transport sectors, however, did not do well, and the decline in highway traffic is the only one in the last 10 years. Transport of natural gas, on the other hand, advanced rapidly as new pipelines were commissioned. Five of the six gas pipelines planned for construction during 1981-85 have now been completed.

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Much of the responsibility for the dropoff in industrial performance in recent years can be traced to the railroads, which bear the major share of the transportation burden in the USSR. This sector now appears to be in the process of righting itself. Rail freight traffic increased by about 2 percent during the first half—less than last year's 4-percent growth but still a solid showing in view of the major

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USSR: Growth of Freight Turnover *Percent*

	1981	1982	1983	First Half 1984
Total	**4**	**1**	**5**	**3**
Rail	2	−1	4	2
River	4	3	4	−7
Highway	7	2	0	−4
Oil pipeline	4	3	4	2
Gas pipeline	14	13	12	15

[redacted]

problems in this sector since the late 1970s. Although plans for shipping some commodities—such as coal and lumber—were not met, the problems appear to be local and not a signal of widespread disruptions in the rail network. [redacted]

Investment and Employment

State capital investment, which typically accounts for about seven-eighths of total capital investment, rose 2 percent in the first six months of this year—one-third the rate at which it increased during first half 1983. It is too early to tell whether this reflects a conscious effort to slow the growth of investment. Earlier during the current five-year planning period a decision apparently was made to step up the growth of investment, and it has been rising at an average annual rate of about 4 percent, more than double the rate called for in the 1981-85 Plan. [redacted]

Growth in employment continued to slow during January-June 1984, reflecting demographic trends. Total employment rose less than 1 percent and the increase in industrial employment was even smaller. Using last year's trends as a guide, we assess that the biggest gains probably occurred in the service sectors—particularly education and health—and in state agriculture. [redacted]

USSR: Growth of Capital Investment *Percent*

1981	1982	1983	1984		Plan 1981-85
			First Half	Plan	
3.8	3.5	5.0	2.0 [a]	3.9	1.6 [b]

[a] State capital investment.
[b] Average annual rate of growth.

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[redacted]

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Consumer Well-Being

Data for the first six months of 1984 do not indicate any shifts in the Kremlin's policies in the area of consumer welfare: 25X1

- The increase in the average monthly pay of wage and salary workers was in line with the 2.7-percent annual rate called for in the 1981-85 Plan.
- Support for the Brezhnev Food Program has continued. Over one-third of state capital investment was allocated to the agro-industrial complex during January-June 1984, roughly the share called for in the 1981-85 Plan. 25X1
- Rationing of selected food items is continuing. The system of special distribution of foodstuffs through the workplace (which originated in the 1970s and is considerably more extensive than the traditional special stores for selected elites) is still in use. [redacted] 25X1

Meanwhile, increased supplies of some foodstuffs and many nonfood items in the first six months of this year have reduced the imbalance between consumer purchasing power and the availability of consumer goods. Meat output is at record levels as meat production on state and collective farms—which account for about two-thirds of the total—rose 8 percent. Production of clothing, textiles, and

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USSR: Selected Indicators of Consumer Welfare

	1981	1982	1983	First Half 1983	First Half 1984 [a]
Percent increase in average monthly wages of workers and employees	2.1	2.8	2.7	2.3	2.4
Percent increase in retail trade turnover [b]	4.1	0	2.8	1.6	5.1

[a] Compared with first half 1983.
[b] Although the Soviet series reflects some disguised inflation, the difference in growth rates between 1982 and first half 1984 is substantial.

knitwear also increased. Reductions in retail prices of selected consumer goods early in the year may have boosted consumer spending as growth in retail trade turnover tripled during first half 1984. Still, imbalances in consumer markets continue, mainly because of the inability of the planners to get enterprises to produce the right assortment of goods and services, the failure to adjust relative retail prices, and the lack of effective quality control.

Foreign Trade

Moscow finally appears to be making progress in implementing its foreign trade policy for 1981-85, which calls for an increasing share of trade to be conducted with Communist countries. Trade turnover with the Communist Bloc rose 11 percent in first quarter 1984 compared with the year-earlier period—slightly above the 10-percent increase called for in this year's trade plan—and the Communist share of total Soviet trade rose from 56 to 60 percent. As in 1983, a sharp increase in purchases of East European machinery and equipment probably accounted for the bulk of the growth in imports from the Communist countries. The trend in machinery deliveries is generally consistent with the statements Soviet leaders have made about the need to rely less on Western goods and technology. These statements reflect the Soviet reaction to Western trade restrictions and a longstanding desire to conserve hard currency. 25X1

Hard currency exports and imports both declined in the first quarter. However, because exports dropped much less than imports, Moscow recorded a $700 million trade surplus as opposed to a $500 million deficit in the year-earlier period. Imports from Italy, Japan, and West Germany fell sharply mainly because of lower purchases of machinery and equipment and reduced imports of large-diameter pipe for the nearly completed Siberia–to–Western Europe natural gas pipeline. Imports of agricultural commodities from Argentina, Australia, and Canada also were down, while purchases from the United States remained at about the level of first quarter 1983. The decline in exports was mainly the result of a reduction in military sales to less developed countries. The Kremlin offset a more-than-10-percent fall in oil prices by boosting the volume of its oil exports to the West. 25X1

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The hard currency surplus helped the Soviets boost their assets in Western banks during first quarter 1984 by about $1.8 billion; liabilities increased by approximately $1.3 billion. We estimate that Moscow's total net hard currency debt was about $10.5 billion at the end of the quarter. 25X1

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Reasons for the Better Performance

We believe that much of the recent economic improvement is the result of earlier policy decisions:

- Some major personnel and management changes were made. Last year's replacement of the Minister of Railroads and the special responsibility given Politburo member Geydar Aliyev to oversee the rail system, for example, appear to have streamlined rail operations and improved discipline and morale.

- The decision to raise capital investment above planned levels was also important, because planners have been able to direct badly needed investment resources to troubled areas.

- The cumulative effect of what we estimate as little or no growth in military procurement during 1976-82 relieved pressure in the machinery sector and made it possible to support a larger investment program.

Particularly encouraging to the regime is the apparent accelerated growth in labor productivity in the face of tighter labor supplies. Andropov apparently succeeded in his efforts to boost productivity through his discipline and anticorruption campaigns. Chernenko, in turn, has continued if not intensified these programs. Nevertheless, the positive effect of these efforts probably would not have occurred if food supplies and the availability of other consumer goods had not improved.

Another important factor in the recovery has been the attack on various bottlenecks in the economy. Problems in the transportation, power, and metals sectors all have eased. One of the reasons for the more comfortable position has been better weather. Relatively benign winters the last two years, for instance, have helped to ease rail freight snarls. Hydroelectric power production also has improved because of higher water levels resulting from more typical rainfall in Siberia.

The new regime appears to have had little impact on economic performance in the first half of the year. Chernenko took power well after the 1984 Plan had been approved and put into effect, and he has largely adopted the tactics and programs of his predecessor. Few new initiatives have been put forth, although Chernenko has advocated an increased role for local governments in overseeing the economy and has called for trimming the size of the bureaucracy and for educational reforms. Such programs, in effect for only a short time, will have minimum impact on the economy this year.

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Outlook

We estimate that Soviet GNP will increase by 2 to 3 percent this year. For GNP growth to be at the high end of the range, both the industrial and livestock sectors will have to maintain their recent performances. Livestock production in turn will depend on Moscow's willingness to spend hard currency on grain imports needed to cover any deficits caused by lower domestic production. The outlook for the hard currency trade balance will depend mainly on how oil prices hold up and on how much grain Moscow imports.

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Argentina: Financial Imperatives Versus Struggling Democracy

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President Raul Alfonsin believes creditors should ease the repayment burden to support Argentina's fragile democracy, but his attempts to strike deals with creditor banks so far have failed. Even sympathetic governments in the industrialized world have told Buenos Aires that new financing will become available only after an IMF stabilization program is established. Despite the difficulties, there is a strong chance that Argentina will conclude an economic stabilization accord with the IMF this year. Even so, we believe Buenos Aires will make only partial progress in arranging the debt rescheduling and new loans to resolve financial difficulties. This would hinder the chances for a strong economic recovery and cause political troubles for Alfonsin but probably would not be serious enough to destabilize the government. Even with an IMF program, Argentina probably will face recurring financial crunches throughout the 1980s.

There is, however, a substantial possibility that the Argentine debt talks could collapse because of inability to conclude an IMF agreement or a new clash over repayment terms. In this worst-case scenario, the inevitable payments moratorium could snowball into an outright debt repudiation with grave consequences for the Argentine economy, the civilian government, and world bankers.

The Roadblocks to Financial Progress

President Alfonsin took office in December 1983 with an electoral mandate that would have permitted him, in our view, to deal with Argentina's debt problems. He failed to meet his goal of securing a package of new loans and reschedulings under IMF auspices by June 1984, however, primarily because of the social democratic philosophy of Alfonsin's Radical Party, domestic political pressures, technical problems with the IMF, and inexperience in dealing with creditors. 25X1

Alfonsin's Views. Alfonsin has publicly reiterated that the austere adjustments advocated by the IMF are neither relevant nor politically feasible for Argentina. Instead, he believes that debt servicing must be reconciled with the need to create more jobs and to raise real wages to maintain social peace. Alfonsin's Radical Party believes that its commitment to honesty has produced a more trustworthy government and that bankers should show more flexibility in negotiations. The Radicals also believe they deserve an IMF program at least as favorable as that accorded the previous military regime. 25X1 Because the IMF approved a 5-percent-growth target as an integral part of that program, it has become a minimum negotiating position for the Alfonsin government. Alfonsin is also seeking preferential repayment terms from creditors.

Political Pressures. Pressures from within Alfonsin's electoral coalition as well as from his political rivals have confused the administration's approach to debt management. His party is divided into at least two major blocs on the debt issue: 25X1

- Hardliners, led by Economy Minister Grinspun and Foreign Minister Caputo, favor confrontation with international creditors to obtain more favorable terms. 25X1
- Moderates, led by special presidential adviser Raul Prebisch and Central Bank President Garcia Vasquez, argue for accommodation. 25X1

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The Peronists—the leading opposition party, which is fragmented but dominates organized labor—have been even more troublesome. Peronists have vowed to resist IMF and lender pressures for austerity measures and are insisting that Alfonsin honor his commitment to economic growth and real wage increases. In late June, for example, an estimated 90,000 people demonstrated in the streets in Buenos Aires against "international usury" and the IMF. Alfonsin, fearing political unrest, has thus far acceded to their demands for wage increases. [redacted]

Labor rank-and-file has been even more vocal in demanding economic concessions—such as reinstituting monthly indexation of wages to offset inflation—and local strikes have increased dramatically since mid-May. Congress has yet to exercise a direct role in the IMF negotiations but must approve the federal budget—the linchpin for any accord with creditors. As submitted in late June, the budget was already out of line with banker requirements, according to the press, in part because Congress was insisting on increased social welfare spending. [redacted]

Technical Disagreements with the IMF. [redacted] the most difficult issue bogging down the IMF negotiations has been the target for 1984 public sector deficit. Because of the political difficulties encountered in cutting expenditures and raising taxes, Grinspun has abandoned his initial view that the deficit could be cut to 4 percent of GDP and now believes the target should be 8 percent—a figure the IMF considers too high. [redacted]

Argentine wage policy has proved to be another major sticking point. Alfonsin has sought to placate labor by setting monthly salary hikes to fulfill his pledge to boost real wages. Because this policy fuels inflation—now above 600 percent—it has proved unacceptable to the Fund. According to recent Embassy reports, the Argentines are willing to modify their wage policy but have not yet been able to develop a compromise acceptable to the IMF. [redacted]

According to US Embassy and press reports, Buenos Aires has been unable to resolve several other policy disagreements with the Fund over exchange rate, credit, and commercial policies:

- Although the pace of small daily exchange rate adjustments has been increased, the IMF is pushing for a large devaluation.
- Despite the IMF's desire for tight monetary policies, Grinspun contends that credit expansion is necessary to support economic recovery. 25X1
- Because of rules requiring equal treatment among its members, the Fund is insisting that Buenos Aires lift restrictions on remittances to British banks and businesses and work towards a plan for clearing interest arrearages. [redacted] 25X1

Tensions in the Negotiations. Grinspun's inexperience in conducting financial negotiations has complicated the situation, 25X1 [redacted] Under pressure, he has become aggressive 25X1 and even combative in dealing with bankers. As the 30 March US regulatory deadline for reviewing the 25X1 status of Argentine loans approached, creditors insisted that Argentina pay overdue interest and 25X1 lay out a stabilization program. Grinspun reacted 25X1 angrily, [redacted] and refused to use Argentine reserves to make interest payments. 25X1 Only direct intercession by President Alfonsin and support from a Latin lending consortium averted a collapse in the debt negotiations. In June, the dramatics continued with Grinspun threatening to walk out on bank negotiations. Eventually Argentina paid $325 million in overdue interest when the 25X1 banks temporarily dropped their demand that an IMF agreement be in place and agreed to lend $125 million to cover the remainder of the amount due. [redacted] 25X1

Challenges Ahead

Alfonsin's inability to move the IMF discussions along rapidly has precluded any progress in negotiations with commercial banks. An agreement with the Fund is a prerequsite, in our view, for Buenos 25X1

Aires to reschedule $16 billion in outstanding 1982-84 debts. We expect the Argentines will request a 10-year repayment period with five years of grace, comparable to the terms approved for other Latin debtors such as Peru and Brazil. We also believe the Argentines will petition for a reduction of front-end fees and the interest rate spread in order to reduce the impact of higher US interest rates.

Without an IMF plan, commercial bankers have been unable to discuss new loans necessary to close Argentina's projected balance-of-payments gap for 1984. The Argentines will probably request about $3.5 billion in new money, although the US Embassy calculates that as much as $4.5 billion might be required. At a recent banking conference, most lenders recognized the need to extend additional credit but indicated that any new lending would only be in support of an IMF program. Even so, these bankers also believe that it will be quite difficult to get all 320 banks in the consortium to agree to any substantial increase in exposure because of the ill will toward the Argentines stemming from past negotiations.

Although Alfonsin's unprecedented step in June of proposing a stabilization program directly to IMF management has complicated matters, we judge that the Argentines are willing to make additional compromises in order to reach agreement with the Fund. On 29 June, for example, the Central Bank announced a sharp increase in interest rates, followed by hikes in gasoline prices and transport fares aimed at eliminating subsidies to public-sector corporations. By the end of July, Alfonsin was urging top economic officials to reach an agreement with the IMF, and the peso was devalued 3 percent. We believe the IMF will compromise with the Argentines on wage increases—the Fund acceded to Brazil's more generous wage settlements last year—but will insist on additional spending cuts to control the deficit. In the end, we believe this stumblingblock will be overcome through higher taxes.

A Hard Sell at Home

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Convincing the Argentine electorate to accept any IMF agreement will be very difficult. We believe it will require substantial expenditure of Alfonsin's political capital and almost certainly entail concessions to Peronist labor bosses. He will be under pressure to demonstrate that the program is growth-oriented—a tactic the military used to sell the 1983 IMF agreement—and leaves room for real wage increases and social welfare spending. Hints of Alfonsin's emerging strategy surfaced in late June, when, in a national address, he claimed that further public sacrifices would be required to resolve debt problems, but that the adverse impact of any austerity measures would be blunted for the poor.

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We expect Alfonsin to use a "carrot and stick" strategy to buy him the manuevering room required to reach agreement with the IMF. His personal popularity and appeals for national unity will give him some protection from opposition attacks. We judge that the Peronist factions will be unable to unite and block an IMF accord because many members fear it would leave the party vulnerable to charges of destabilizing Argentina by blocking access to funds needed to sustain economic recovery.

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Outlook For Debt Negotiations

Although the Alfonsin government's current willingness to compromise makes an IMF accord likely, we believe formal Fund approval will be time consuming. It may become necessary for creditors to provide another bridge loan at the end of September to prevent writeoffs of Argentine credits. Even when an IMF accord is finally in hand, however, we believe that progress in completing debt agreements with commercial banks will be slow and uneven.

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Debt Talks Collapse?

We believe that the danger of a collapse in debt talks stems from the Argentine penchant to react impetuously to unanticipated events. If the volatile Grinspun has trouble concluding an IMF accord, he could in a fit of pique advise Alfonsin to halt negotiations abruptly. The President will also remain vulnerable to congressional attacks on the IMF agreement. Resurgent labor unrest could cause Alfonsin to scuttle a wage policy favored by the IMF. [redacted]

Continued rises in international interest rates could also cause financial negotiations to collapse. With interest rates rising, we believe Argentine negotiators will exert even stronger pressure on creditors to reduce spreads and lending charges for new loans and for rescheduling of 1982-84 maturities. We judge that bankers would be only partially responsive to such requests because eased repayment terms have generally only been used as a reward for successful economic adjustments. Under these circumstances, the chances that the Argentines would walk out of the talks would increase materially. [redacted]

A breakdown in financial negotiations—probably accompanied by a temporary moratorium—would entail major dangers, in our opinion. Alfonsin's inclination to verbally attack lenders would probably increase, straining foreign bank and IMF willingness to support the rescue program. We judge that he would also become more assertive in coordinating joint action by Latin American debtors. Because these developments probably would cause banks to resist new lending at a time when cash strains would be mounting, the likelihood that Buenos Aires would repudiate its debt would increase sharply. [redacted]

We believe there is a strong chance that Argentina will be unable to conclude its negotiations with commercial banks on debt restructuring and new credits by yearend. Even if an accord with the IMF is reached before the end of September—when US bankers will be legally obligated to set aside loan loss reserves—Buenos Aires probably will only be beginning talks with the bank advisory committee. We expect, however, that as soon as a letter of intent is agreed upon in principle, bankers would probably release frozen loans to enable Buenos Aires to settle past due interest payments. The foreign bank advisory committee would then begin the difficult task of developing a plan for providing new financing. Given recent experiences with Brazil and Chile, negotiations for new money will be tough and the loan difficult to syndicate. [redacted] 25X1 25X1

Even if both sides cooperate fully, the restructuring of some $12 billion in loans will require protracted negotiations, because the Argentines have already indicated publicly that they expect easier repayment terms. Should bankers resist a substantial softening of terms, Alfonsin—who was dismayed at recent interest rate hikes, probably would toughen his negotiating stance. In this case, we believe that only partial progress would be made in completing debt rescheduling this year. In our view, protracted debt negotiations probably will impede domestic economic recovery. Difficulties in obtaining trade financing would continue to curtail imports necessary for industrial reactivation. Buenos Aires would experience temporary cash flow difficulties during seasonal export declines and would probably again resort to temporary suspension of payments to ease financial strains. [redacted] 25X1 25X1

We believe that protracted debt negotiations would also erode Alfonsin's popular support. With an electorate anxious for economic improvements, the Peronists could profit from an apparent financial deadlock. Labor and the media would probably begin to question continuing economic sacrifices for few apparent benefits. Members of Alfonsin's own party might also press him to abandon the IMF program to preserve social peace. Governing would become more difficult, although the strains probably would not be serious enough to destabilize the Alfonsin government. [redacted] 25X1 25X1

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Longer Range Prognosis

Beyond 1984, Argentina will remain vulnerable to a resurgence of cash problems:

- We expect that Buenos Aires will be clearly out of compliance with any IMF program by early 1985.
- This breach would again cut Argentina's access to fresh flows of foreign exchange, resulting in another moratorium on debt payments.
- Our research also indicates that Argentina probably will face a large bulge in payments during 1986-87, when—on top of the increasing interest burden from past heavy borrowing—government bonds covering private-sector debts come due.

Even under favorable economic conditions, we believe bankers may need to offer substantially stretched-out repayment terms in order to avoid demands from Buenos Aires for some innovative form of relief from interest payments.

Implications for the United States

We believe that Buenos Aires expects the US Government to bolster Argentine democracy by taking extraordinary steps to help resolve its financial difficulties. In our opinion, the Argentines believe Washington has the power to elicit cooperation from bankers and the IMF and to control the interest rates that banks charge. We believe this perception made Buenos Aires responsive to US demarches in March and June to take actions to prevent the debt talks from collapsing. On the other hand, developments that the Argentines perceive as detrimental to their interests—such as a rapid rise in interest rates—could cause Buenos Aires to attempt to take retribution against US banks.

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Should Argentina reach an IMF agreement by 30 September, we would expect interest payments to get back on track and remain reasonably current through the end of the year. The earnings of US banks and the integrity of the international financial system would escape serious damage. Under these conditions, however, we believe that large money center banks will face growing pressure to lend more to Argentina. Alternatively, if the IMF financial program derails, US banks would see only a trickle of payments and probably would begin writing off Argentine credits. In this situation, we would expect Alfonsin to call on other Latin debtors to act in concert against lenders.

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Zaire: The "Bitter Pill" of Economic Reform

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Zaire has been making a strong effort this year to stick to its latest economic stabilization program. The country has been experiencing economic and financial difficulties almost continuously since 1974 and has had only limited success with a series of earlier corrective measures. To achieve economic stability it will have to maintain strict adjustment policies for several years. Expected low levels of new investment and continued foreign exchange shortages promise slow economic growth for the rest of the decade.

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Mixed Results in 1983

Following negative economic growth in 1982, a near-record current account deficit of $432 million, and the virtual exhaustion of foreign exchange reserves, Kinshasa introduced a number of stronger measures last year to halt the economic and financial deterioration. These measures, programed for 1983-84, were intended to smooth the way for a new IMF standby arrangement for balance-of-payments support. Kinshasa's actions anticipated restrictive conditions that the IMF probably would have required. The measures included:

- A massive 77-percent devaluation of the zaire in terms of the IMF's Special Drawing Rights (SDR).
- A floating exchange rate and the temporary establishment of a dual system of official and free market exchange rates in September 1983. (The two rates were unified in March 1984.)
- A program of fiscal austerity, with strengthened budgetary controls and tax reform, including a new fiscal regime for GECAMINES, the huge parastatal mining concern.

Zaire: Selected Economic Adjustment Measures

Economic Adjustment Measure	***Status***
Devaluing the zaire by 77.5 percent in terms of the SDR.	*September 1983*
Floating the zaire and introducing a temporary dual exchange rate system.	*September 1983*
Adopting a new fiscal regime for GECAMINES.	*September 1983*
Easing controls on prices.	*September 1983*
Rescheduling official debt to the Paris Club.	*December 1983*
Establishing a blocked Bank of Zaire account for external debt service payments.	*January 1984*
Unifying official and free market exchange rates.	*January 1984*
Auctioning Treasury Bills to help create a domestic money market.	*June 1984*
Substantially reducing customs duties.	*Incomplete*
Listings of all government employees.	*Incomplete (S)*

- Liberalization of the trade and exchange system by reducing, for example, restrictions on trade in diamonds and gold, removing restraints on commercial bank retention of foreign exchange receipts, and simplifying import licensing regulations.

- A substantial easing of controls on consumer prices and agricultural producer prices. [redacted]

These economic stabilization measures contributed substantially to the halt in Zaire's economic and financial decline last year. Real GDP grew by 0.5 percent, after a 2-percent fall the previous year, while the budget deficit was reduced to 2 percent of GDP, compared with 9 percent in 1982. Export-volume increases for cobalt, zinc, diamonds, and crude oil also helped. The foreign trade surplus rose to $410 million, up from $326 million in 1982, while the current account deficit fell by $110 million to $320 million. [redacted]

Some developments clouded the economic picture, however. The inflation rate doubled to 76 percent, mainly because of the currency devaluation. The agricultural sector was also disappointing, particularly for the main cash crops. Production of coffee, Zaire's chief agricultural export, was down 21 percent while palm kernel output fell 30 percent, sugarcane 21 percent, and rubber and tea, 7 percent each. [redacted]

Zaire's success in rescheduling some $920 million of Paris Club debt obligations in December 1983 enabled the present 15-month IMF standby arrangement to become effective later that month. The standby will provide some $240 million in balance-of-payments support, payable in installments and subject to periodic review of performance criteria. Kinshasa also received in December a $122 million loan from the IMF's Compensatory Financing Facility, for previous shortfalls in export earnings. [redacted]

Adjustment Program Remains on Course

Zaire's 1984 economic adjustment program focuses on improved financial management under a regime

Zaire: Current Account Balance *Million US $*

	1981 [a]	1982 [a]	1983 [a]	1984 [b]
Current account balance	**−424**	**−432**	**−320**	**−338**
Trade balance	210	326	410	465
Exports f.o.b.	1,500	1,454	1,523	1,642
Copper	757	791	781	778
Imports f.o.b.	1,290	1,128	1,113	1,177
Oil	249	187	171	194
Net services and transfers	−634	−758	−730	−803

[a] Estimated.
[b] Projected.

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[redacted] 25X1

of fiscal austerity. The key objectives are to curb the budget deficit, reduce the rate of credit expansion, remove excess liquidity from the banking system, develop the interbank foreign exchange market, and establish a money market to help absorb domestic currency and reduce the demand for foreign exchange. [redacted] 25X1

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Zairian President Mobutu and his principal economic advisers, including Prime Minister Kengo Wa Dondo and Bank of Zaire Governor Sambwa Pida, have shown unusual resolve this year in implementing the economic reforms. In addition, the country has been meeting its newly negotiated debt service obligations. [redacted] 25X1

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[redacted] 25X1

The current package of economic reform measures goes far beyond previous efforts. To strengthen budgetary controls, an increasing number of government operations have been centralized under the Ministry of Finance. A comprehensive listing of government employees—compiled for the first

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time—will tend to eliminate payments for nonexistent workers while Kinshasa seeks to control a salary mechanism that preempts some 25 percent of government receipts. [redacted]

The June 1984 dissolution of SOZACOM, the parastatal marketing agency for GECAMINES, has been an additional important move toward greater financial responsibility. The elimination of the marketing middleman should speed both GECAMINES' receipt of export earnings and its payments to the Zairian Treasury. In addition, a major source of leakage of foreign exchange receipts—unaccounted-for minerals sales through SOZACOM—has been removed. [redacted]

Kinshasa has passed three IMF reviews of performance criteria this year, for the periods ending in December, March, and June. During the IMF reviews, Zaire obtained minor waivers of performance criteria or slight modifications in its program, because of mitigating circumstances. [redacted]

[redacted]

Sluggish Economy in 1984

In our estimation, Zaire's economic performance this year will not be vigorous. We expect only a 1-to-2-percent increase in real GDP, mainly because of the tight fiscal and monetary policies in an economic program that emphasizes longer term stability over short-term economic expansion. [redacted]

In the international accounts, the foreign trade balance should improve slightly. Prices for cobalt, zinc, and coffee are climbing, and higher export volumes are expected for cobalt, diamonds, and

Zaire: Selected Economic Indicators, 1980-84

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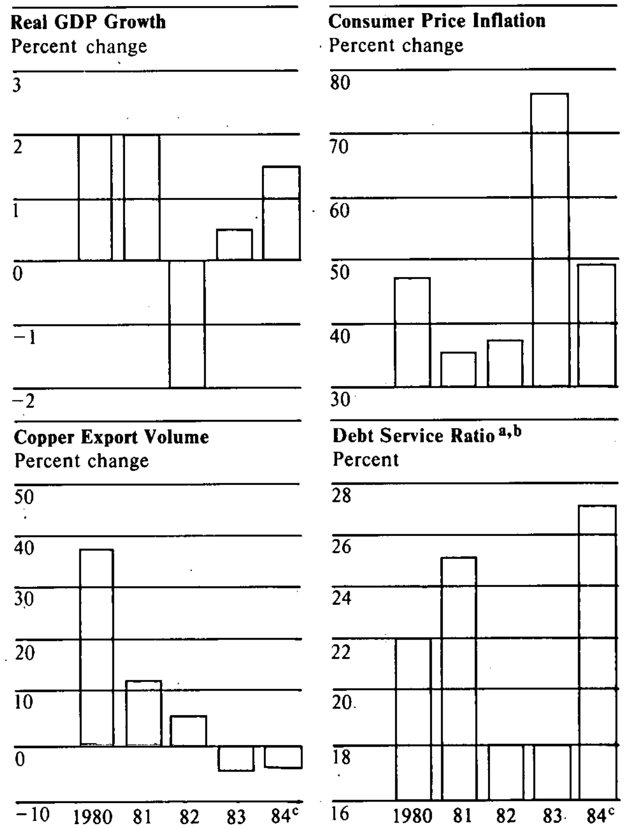

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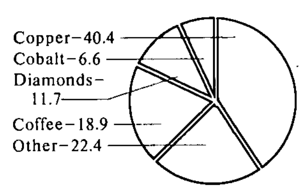
Composition of Exports, 1982
Percent



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[a] Debt service payments as a percent of exports of goods and services.
[b] Based on actual or projected payments.
[c] Projected.

[redacted]

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crude oil. Copper production by GECAMINES through midyear has been on target at its production capacity of 470,000 metric tons annually. Copper prices, however, remain soft and show no signs of an early recovery. Imports should rise only slightly, because of the austerity program and foreign exchange shortages. We believe the current account deficit will widen by perhaps $20 million, mainly because of increased interest payments to non–Paris Club creditors. [redacted]

The Longer View

Zaire's economic problems do not lend themselves to an early solution. Even with continued resolve by the Zairian authorities, serious obstacles to economic recovery remain:

- The inflation rate—expected to be around 50 percent this year— needs to be reduced.

- Much of the economic recovery program depends on the ability of GECAMINES to maintain its productive capacity and, consequently, its key contributions to foreign exchange earnings and government revenue (about 50 percent and 22 percent, respectively, this year). GECAMINES urgently needs capital for plant rehabilitation. In the recent past, it has postponed capital investment and has fallen behind in removing the overburden of the open-pit mines at Kolwezi that supply 60 percent of its copper. To further complicate the problem, the deteriorating rolling stock of the national railroad may not be able to move sufficient copper concentrates from mines to refineries.

- Agricultural production probably will continue to be restrained by the shortage of investment funds, both for agricultural projects and for improving the domestic transport network for moving crops to markets. World Bank Group funds are available for railroad and road improvement projects in both agriculture and mining, but the required counterpart funds are hard to come by because of the tight budget.

- Servicing its large foreign debt—estimated at $5.2 billion at the end of last year—will leave Zaire little room for applying new resources to economic growth. Even with the latest rescheduling, debt service consumes 50 percent of government expenditures. The IMF believes that debt rescheduling will be required each year for the rest of the decade, [redacted] 25X1 25X1 25X1

The Political Fallout

Despite its hardships, we do not expect the economic adjustment program to seriously threaten President Mobutu even if it is maintained for several years—as now appears necessary. There may eventually be protests by mineworkers, students, and civil servants, but Mobutu remains firmly in control, following his election this month to a third seven-year term. Zaire's living standards have been falling for nearly a decade and most of the population has apparently adopted a fatalistic attitude toward hard times. We believe that none of the 50 or so anti-Mobutu groups—mostly outside Zaire—seriously challenge the regime. [redacted] 25X1

President Mobutu apparently has resigned himself to swallowing the self-described bitter pill of rigorous and more honest economic and financial management. However, even if sustained economic adjustment programs eventually succeed, aspects of the present regime will continue to prevent the country from realizing the full economic potential of its rich endowment of natural resources. These negative attributes include pervasive corruption at high levels, a concentration of power in Mobutu's hands that stifles administrative initiative in the government, and the official practice of favoring certain groups and regions at the expense of the national economy. [redacted] 25X1

[redacted] 25X1

Smaller Gulf States: Cutting Back on Foreign Aid

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Acutely sensitive to external pressures and threats from revolutionary forces in the region, Kuwait, Qatar, and the United Arab Emirates have tried to use foreign assistance to bolster their security. With the surge in their oil revenues, these countries boosted foreign assistance to phenomenal levels in the late 1970s and early 1980s. Indeed, total aid disbursements reached $6.1 billion in 1981, or 10 percent of GDP, compared with the one-half percent provided by the United States.

The current oil glut, however, caused the Gulf states to slash aid disbursements by about 70 percent in 1983. Foreign assistance, nonetheless, remains a major policy tool for these countries and they will attempt to maintain their present aid levels through 1985.

Smaller Gulf States: Bilateral Economic and Military Disbursements to LDCs, 1981-84 [a] *Million US $*

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	1981	1982	1983 [b]	1984 [c]
Total	**5,855**	**5,530**	**1,775**	**1,520**
Arab states	5,660	5,250	1,730	1,480
Iraq	4,000	3,570	1,250	1,000
Jordan	535	360	255	240
Lebanon	90	30	0	0
Morocco	5	140	5	0
Sudan	40	50	NEGL	0
Syria	775	935	180	180
Other [d]	215	165	40	60
Non-Arab Islamic states	140	200	10	10
Bangladesh	25	0	NEGL	NEGL
Pakistan	85	185	NEGL	NEGL
Other	30	15	10	10
Non-Islamic states	55	80	35	30

[a] Data is rounded to the nearest $5 million.
[b] Estimated.
[c] Projected.
[d] Includes PLO and Israeli-occupied territories.

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Foreign Relations

We believe the smaller Gulf states provide aid to:

- Strengthen other conservative, pro-Western Arab states, particularly Morocco, Jordan, Tunisia, and the poorer Gulf states of Oman and Bahrain.
- Ingratiate themselves with countries, especially Syria and Iraq, that threaten their security.
- Prevent the spread of Iran's Islamic revolution by supporting Iraq's war effort.
- Bolster their legitimacy at home by supporting the Palestinians.
- Enhance their international prestige and make LDCs more responsive to Gulf Arab desires in international forums.

While foreign assistance has become a principal foreign policy tool and a vital element in the security policy of the smaller Gulf states, these states have had only limited success in buying allies and conciliating enemies. Aid to Syria and the Palestinians has afforded some protection from extremists in those camps, but it has achieved only limited influence in Arab and Islamic capitals. For example, Kuwaiti financial assistance to Iraq has not softened Baghdad's claim to Bubiyan Island, and the Gulf states were unable to influence Syrian policies toward Lebanon or Iran.

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Aid Reductions

The effectiveness of the Gulf states' foreign aid programs has been reduced by the current oil glut, which caused oil revenues to fall from $34 billion in 1981 to $22 billion last year. Cuts in foreign assistance have far outpaced overall budget reductions as the governments of these states have attempted to minimize cuts in politically important domestic welfare and subsidy systems and to expand military capabilities in response to the Iran-Iraq war. [redacted]

Total aid disbursements probably will reach only $1.6 billion, or about 3 percent, of GDP this year. Contributions to multilateral lending institutions will amount to only an estimated $100 million. Bilateral assistance—which includes economic and military grants and loans—probably will reach only $1.5 billion compared with a peak of $5.9 billion in 1981. [redacted]

The Donors

Kuwait is the leading aid donor of the smaller Gulf states, providing more assistance—over 11 percent of GDP in 1981—than Qatar and the UAE combined. Although the weak world demand for oil has reduced Kuwait's earnings by about 25 percent since 1981, this is not as significant a problem for Kuwait as for most other oil-exporting countries, because Kuwait now earns almost as much income from investments as it does from oil production. According to Embassy reporting, some Kuwaiti financiers believe that Kuwait's leaders are exaggerating domestic economic problems and the impact of weak oil demand to avoid fulfilling aid requests. [redacted]

Kuwait has given over $6 billion to Iraq since 1981—more than 65 percent of Kuwait's total foreign aid disbursements over this period—to support Baghdad's war effort. In 1983, however, we estimate that Kuwait gave Iraq only $800 million—a decrease of 60 percent from the 1982 level—almost half in oil sales on Baghdad's behalf. Kuwait last year began selling about 70,000 barrels per day of crude oil from its share of the Saudi-Kuwaiti Neutral Zone to some of Iraq's customers, turning the receipts over to Iraq. [redacted] 25X1

Under the Baghdad Agreement of 1978, Kuwait pledged $291 million annually to Syria, $196 million to Jordan, and $63 million to the PLO. The Kuwaitis maintained these aid levels until 1983, when payments to Syria and the PLO were reduced by some $150 million. The US Embassy in Amman reports that Kuwait's National Assembly recently cut the country's total Baghdad Agreement payments by 38 percent to $340 million annually. 25X1
[redacted] Syria probably will 25X1
receive $180 million, while $160 million will be divided between Jordan and the PLO—with Jordan receiving most of this sum. The Assembly turned down a proposal by its financial committee to stop all aid to Syria, according to some Arab weeklies. The US Embassy in Kuwait, however, reports that the government intends to apply any future payments reductions primarily to Syria. [redacted] 25X1

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Kuwait's aid to other countries also has been reduced. It gave $5 million to Morocco and nothing to Lebanon in 1983, compared with $115 million and $30 million, respectively, the previous year. [redacted] 25X1

The **United Arab Emirates** was one of the most generous aid donors in the world, giving as much as 20 percent of GDP in 1979. A 45-percent decline in oil revenues since 1981, however, has resulted in the UAE's sharp reduction of aid payments. We estimate that total bilateral grants and loans amounted to almost $2.2 billion in 1981, but dropped to $580 million in 1983. Abu Dhabi, the richest and most generous donor of the seven Emirates, is all but halting foreign aid, according to the US Embassy. To our knowledge, the UAE gave no assistance to non-Arab countries in 1983. [redacted] 25X1

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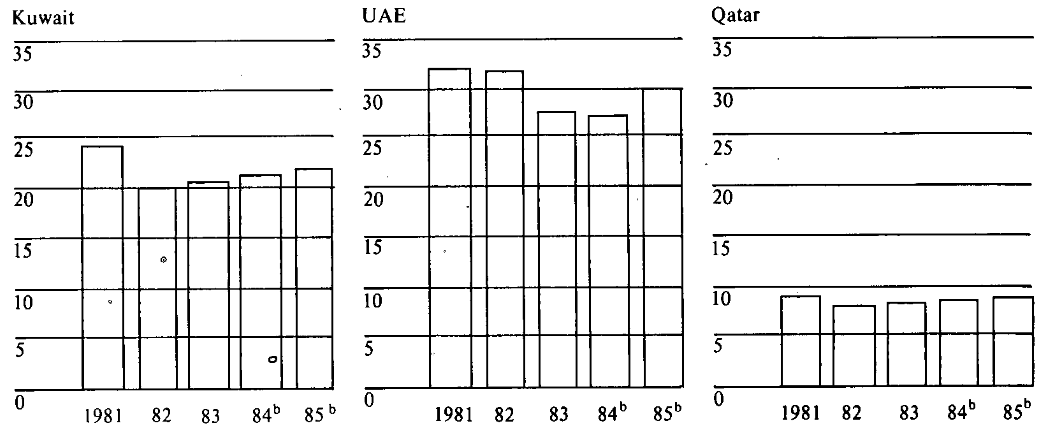
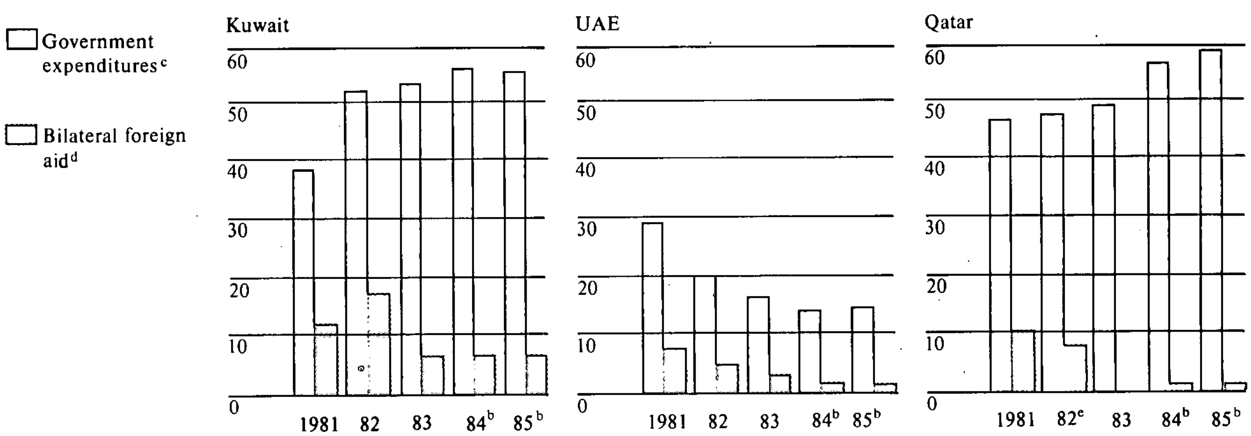
Since the start of the Iran-Iraq war, we estimate that the UAE has given about $3.5 billion to Iraq. We believe that about 80 percent of all UAE aid in

Smaller Gulf States: Economic Indicators, 1981-85

Gross Domestic Product[a]
Billion US $



Government Expenditures and Bilateral Foreign Aid as a Share of GDP
Percent



[a] Current dollars.
[b] Estimated.
[c] For Kuwait fiscal year 1 July through 30 June.
[d] Mulilateral aid is not included because of difficulty in distinguishing each country's contribution. In any case, it represents a small portion of total aid.
[e] Budget year lasted 18 months as the Qatari Government changed to Hijri fiscal year–roughly mid-April to mid-April. This expenditure figure is prorated to represent 12 months.

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1983 went to Iraq. The government paid $200 million to Iraq early this year, but we judge that the Emirates are unlikely to give any more. The UAE, because of its traditional commercial and cultural ties to Iran, is more susceptible than the other Gulf states to Iranian pressure to reduce aid to Iraq. The UAE President Shaykh Zayid, who dislikes Saddam Husayn, threatened to stop aid to Baghdad in 1982 and now has a financial excuse for doing so. [redacted]

The UAE has pledged to give about $400 million annually to Jordan, Syria, and the PLO under the Baghdad Agreement. The UAE was late in providing its Baghdad payments in 1982, however, and met only 15 percent of its commitments in 1983, [redacted] The UAE has paid $15 million to Jordan toward its 1984 commitment, according to the US Embassy. The Embassy believes—and we concur—that the UAE is unlikely to make significant additional Baghdad payments this year. [redacted]

Qatar once gave as much as 16 percent of GNP in concessional assistance during the mid-1970s. Aid payments dropped by one-third in 1982, when oil revenues fell by a similar amount, and Qatar reportedly terminated all foreign assistance in 1983. In sharp contrast to last year's austerity measures, Qatar's FY-1984 budget probably will include expenditure increases of 19 percent, primarily because of higher oil production. Although aid payments in 1984 have revived slightly, we do not expect them to match earlier levels. [redacted]

We estimate that Qatar had disbursed about $1 billion to Iraq between 1980 and late 1982 when payments were stopped. Qatar's Amir Khalifa insists that his country ended aid to Iraq to avoid antagonizing Iran. [redacted]

Under the Baghdad Agreement, Qatar is supposed to give $122 million annually to Syria, $83 million to Jordan, and $26 million to the PLO. The US Embassy in Amman reports that all these payments ceased following the November 1982 summit of the Gulf Cooperation Council states—primarily to punish Syria for its ties with Iran—we have no evidence that the government made any of its scheduled Baghdad payments in 1983. Qatar has made a partial payment of $27 million to Jordan so far in 1984, and Jordan's Central Bank expects 25X1 more aid, according to the US Embassy. However, we expect Doha to delay subsidy payments as long as possible. [redacted] 25X1

Outlook and Implications

Because of aid reductions, potentially troublesome recipients like Iraq, Syria, and the Palestinians now may be more antagonistic toward the smaller Gulf 25X1 countries. In part because of concern over this, we believe that Gulf states will not cut aid further in 1985. However, it is not likely that they will be able 25X1 to increase aid disbursements until the oil market improves. [redacted] 25X1

We believe that aid recipients will turn first to Saudi Arabia to fill the gaps created by reduced 25X1 Gulf assistance. We doubt, however, that the Saudis, given their own aid priorities and lower oil revenues, will compensate for the reduced assistance from Kuwait, Qatar, and the UAE. [redacted] 25X1

Some Gulf aid recipients—particularly Jordan, Morocco, Pakistan, and Sudan—probably will turn to the United States and international aid organizations for additional assistance. We judge that they could request a total of almost $1 billion. 25X1 Without such assistance, these states will have to curtail development or military modernization programs. [redacted] 25X1

The greatly reduced amount of Gulf aid in 1984 and 1985 particularly threatens the economies of the non-Arab Islamic states. Bangladesh and Pakistan—the major recipients of Gulf aid to non-Arab 25X1 Islamic countries over the last decade—will be the most affected. Pakistan had been trying to line up about $800 million in military assistance from the

Gulf states since 1980, and probably delayed or canceled weapons purchases from Western Europe in 1983 when it did not receive the requested aid. Pakistan has since had to rely more heavily on Saudi Arabia and the United States to finance military purchases. [redacted] 25X1

Syria, which has been hardest hit by Gulf aid reductions, probably will try to offset the cutbacks by maintaining ties with Iran, which provides significant economic aid to Damascus. We believe that the Syrians could also try to intimidate the smaller Gulf states into loosening their purse strings by threats of terrorism. [redacted] 25X1

[redacted] 25X1

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Western Europe: Growing Demands for a Shorter Workweek

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Settlement of the West German metalworkers strike by shortening the standard workweek from 40 to 38.5 hours with no cut in pay, has opened the door for similar labor demands throughout Western Europe. Unions view this as a device for reducing joblessness and are bracing for difficult negotiations with employers and governments. We believe the shift to shorter workweeks will continue but will have little impact on Western Europe's double-digit unemployment because it does not address the underlying causes of the problem. Indeed, restructuring the region's industries will become even more difficult if shorter hours boost costs and erode competitiveness.

The Trend Toward Shorter Working Hours

Average weekly working hours in Western Europe have declined steadily for two decades. As recently as 1965, industrial workers in most countries were working 44 to 46 hours a week. By the late 1970s, the average actually had dropped to about 40.

The downward trend is likely to continue. French, Belgian, British, and Swedish unions are expected to be particularly adamant in their demands for a shorter workweek with no loss of pay; Dutch, Italian, and Danish unions appear to be more willing to give up part of their salaries in return for shorter hours.

In several countries unions have laid the groundwork for demanding shorter workweeks in upcoming contract negotiations and seem likely to get government support for their demands. A number of government leaders and the OECD are pushing for reduced working hours because they believe it will lower unemployment:

- Dutch Social Affairs Minister Jan de Koning has called for a 36-hour workweek by 1986-87 provided that real wages fall.
- To maintain employment, Italian Labor Minister De Michelis has endorsed a reduction in working time—not necessarily through a shortened workweek, but perhaps by providing additional vacation time and holidays.
- Socialist Party leaders from the 10 EC countries, Spain and Portugal on 1 June called for an EC-wide 35-hour workweek, a lower retirement age, and longer vacations to help cut unemployment. 25X1
- The OECD, in a report last winter, suggested that reduced working time can play a major role in alleviating unemployment.

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Implications

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We believe that shortening the workweek will have little impact on unemployment in Western Europe. In our view high labor costs are a major cause of the region's unemployment problem and one that would be aggravated by a shorter workweek if there is no offsetting reduction in pay or increase in productivity. Nor would reduced working hours affect underlying causes of unemployment such as structural rigidities, continued support of outmoded industries, and lack of adequate investment in new, more dynamic industries. With a gradual decline in working hours, most firms will have time to adjust both capital and labor without additional hiring. In fact, the relatively high labor costs—both wage and

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Western Europe: Recent Developments Concerning Shorter Workweeks

West Germany
The recent metalworkers strike settlement granting workers a 38.5-hour workweek beginning next April marked the end of a six-year struggle by labor unions to break the 40-hour barrier. Although the metalworkers publicly have stressed the job-creating aspects of a shorter workweek, job creation was not part of the negotiations, and neither West German economic experts nor employers believe the cut will bring more jobs.

France
The Socialist government reduced the standard workweek to 39 hours in January 1982, but President Mitterrand has since shied away from his plan to progressively cut it to 35 hours—partly because of France's deteriorating international competitive position. Nonetheless, since the West German strike, the CFDT, France's largest union, has increased its calls for a 35-hour week. Even before the West German strike ended, Andre Bergeron, the leader of the FO—a relatively apolitical union—stated that if the metalworkers obtained a shorter workweek, the European Trade Union Confederation (ETUC) would call for European-wide movement in the same direction. Bergeron promised that the FO would support ETUC efforts to introduce the 35-hour week throughout Europe.

Italy
In June, Italian Labor Minister DeMichelis advocated reduced work time to maintain employment—perhaps by increasing vacation time and holidays rather than a shorter workweek. He called for flexibility in defining the workweek with more part-time and flex-time work. The response by organized labor and the employer's association, Confindustria, has been positive. Both groups foresee automation displacing many workers and believe that new job creation is essential. They disagree on whether workers should receive a proportional reduction in pay in return for working fewer hours. In principle, labor is willing to accept some reduction in wages and benefits provided the costs are shared by labor, government, and management. "Solidarity contracts," whereby proposed worker dismissals have been replaced by shopwide reduced working hours, have been signed by unions with several firms. 25X1

United Kingdom
British unions have followed events in West Germany with close interest. Peter Evans, National Secretary of Britain's Transport and General Workers' Union, declared in late 1983 that "if the German unions break through, it does away with the argument that British employers can't do it because the German workers are working more hours." The Amalgamated Union of Engineering Workers has again raised demands for shorter hours; the engineering industry had previously reduced working hours from 40 to 39 in 1982. At least one British firm, General Electric Company, has been successful at work-sharing, and the government agreed in 1982 to a small subsidy plan to persuade others to follow suit. 25X1

Belgium
Belgium was a leader in cutting work hours during the 1970s, when the average workweek declined by 14 percent. Nonetheless, Belgium's unemployment rate is the third highest in the EC. Since 1983, Belgian Government employees have been hired for a 32-hour week at 20 percent less pay than their predecessors. As part of its two-year austerity program, the government is encouraging teachers to take early retirement and promoting discussions with employers and unions on a maximum 38-hour workweek. During the West German strike, both major Belgian trade union confederations expressed solidarity with the West German workers. National labor-management negotiations began in July with shorter working hours and job creation as the main issues. 25X1

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Netherlands

The Dutch Government announced in June that it will support a 38-hour workweek together with a proportional cut in real wages. Dutch Social Affairs Minister de Koning has also suggested that pay raises next year be given up in return for new agreements on workweek reductions.

Both major union federations, the FNV and CNV, accept that workers must be prepared to make some financial sacrifices in order to safeguard the total number of jobs. The Dutch printing industry moved to a 38-hour week on 1 January 1984, and so far the total number of jobs—which had been falling steadily—has stabilized. The government also began actively encouraging work-sharing agreements a year ago. Over 1 million workers have negotiated such deals already, although none will take effect until 1985. The CNV, the smaller union federation, called for a indexed wage increases to which workers are entitled under Dutch wage-price legislation.

Norway

The Norwegian Federation of Trade Unions is demanding a 37.5-hour workweek in upcoming wage negotiations this year as a first step toward the goal of a 6-hour workday. The union position on pay adjustments for reduced work hours is unclear. The government has appointed a committee to look into cutting the workweek but remains opposed to any radical steps because of Norway's precarious international competitiveness.

Denmark

The Danish Federation of Trade Unions will present demands for a gradual reduction to a 35-hour workweek at its fall labor congress. The unions are demanding reduced hours with "differential compensation"—that is, probably a partial drop in wages except for the lowest paid workers. The federation and its close ally, the opposition Social Democratic Party, stress sharing available work and are demanding that the current high unemployment rate—about 10 percent—be reduced by a third in the next three years. The largest industrial employers' union has laid the groundwork for difficult negotiations in the fall by announcing in May that they would rather see large-scale conflict than a 35-hour workweek. 25X1

Sweden

Earlier this year the Swedish Confederation of Trade Unions made an unsuccessful bid for a 38-hour workweek, with full pay, for persons working alternate shifts. This demand probably will be repeated when contracts begin to come up for renewal beginning in early 1985. The government regards as a model the 1983 agreement between the SAB railway equipment company and its workers. The settlement called for a 35-hour week with a 5-percent cut in real wages except for the lowest paid workers. 25X1

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Spain

Madrid's Socialist government reduced the standard workweek from 43 hours in 1980 to 40 hours in mid-1983, with no cut in salaries. New negotiations among unions, employers and the government began in July, and although the small Communist union, the CCOO, is pressing for a 38-hour workweek, it does not have the support of the larger socialist union, UGT. 25X1

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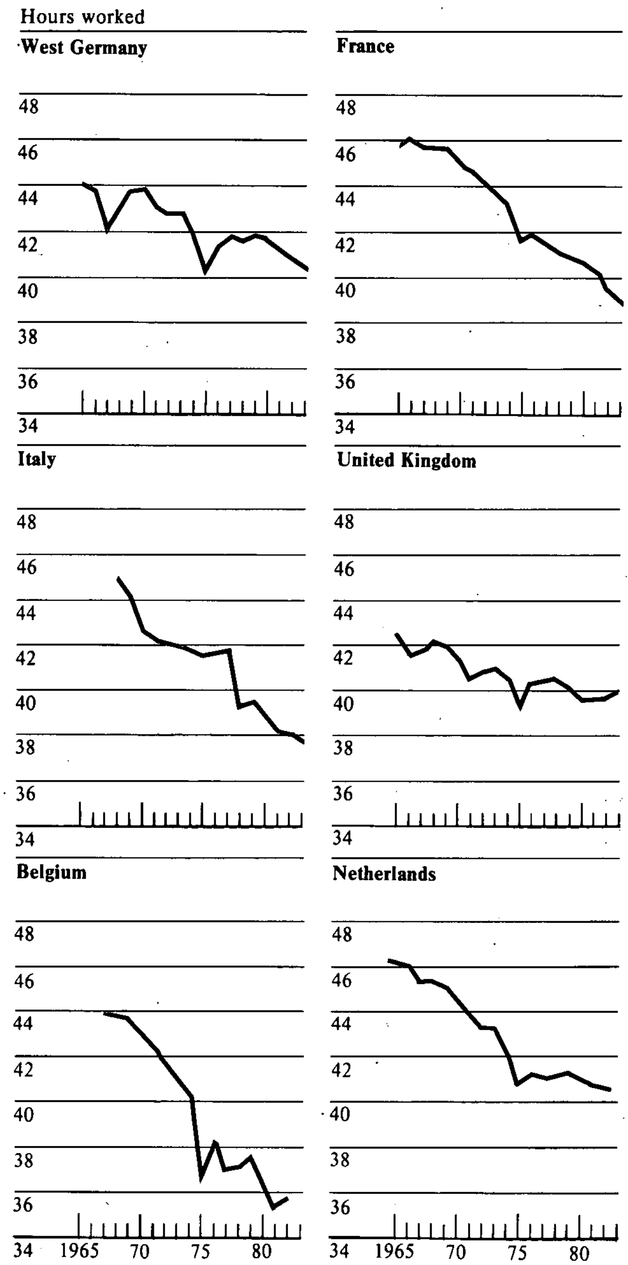
Western Europe: Average Workweek in Manufacturing, 1965-83[a]



[a] West Germany: average weekly hours paid; United Kingdom: average weekly hours worked; Belguim, France, Italy, Netherlands: average weekly scheduled hours.

non-wage—make it likely that businesses will expand capacity by acquiring labor-saving equipment—as they have consistently done throughout the 1970s and early 1980s. The high cost of hiring new workers also points to more use of overtime rather than new hires. 25X1

Shorter workweeks without offsetting pay cuts would add to the difficulty of restructuring traditional industries. The higher hourly labor costs would reduce profits and thus slow the transition to innovative production methods. In addition, should production costs rise because of shorter hours, traditional industries may increase their demands for subsidies at a time when West European governments are attempting to reduce their support of these industries and shift funds to newer high technology industries. 25X1

Any increase in costs associated with shorter work hours is likely to be passed on to consumers and exporters, thus eroding international competitiveness. At present, this effect is swamped by the weakness of most West European currencies relative to the US dollar but could become a serious problem should the dollar depreciate. 25X1

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