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International Economic & Energy Weekly

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28 September 1984

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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Synopsis

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1 **Perspective—*Third World Military and Economic Austerity*** 25X1

We believe that the military by and large has been willing to accept austerity measures when they constitute part of a broader program aimed at economic stabilization. In our view, the most risky type of military cuts in terms of political stability would entail cuts in military salaries and perquisites—moves that so far have been avoided or kept to a minimum. 25X1

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15 **Mexico: The Impact of Austerity on the Military** 25X1

The Mexican military is coming through the current severe financial crisis in better shape than most observers expected. Military leaders have cushioned defense cutbacks by supporting President de la Madrid's austerity program while maneuvering for traditional pay and manpower benefits. 25X1

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21 **Western Europe: Export Surge to USSR Fading in 1984** 25X1

West European exports to the USSR—one of the few bright spots in Western Europe's poor overall export performance in 1983—probably will be down considerably in 1984. 25X1

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27 **Libya: Qadhafi's Great Manmade River Project** 25X1

Libyan leader Qadhafi has staked considerable personal prestige on meeting domestic water needs with a massive water-relocation project—the Great Manmade River. Completion of even part of this project is increasingly doubtful because of Libya's weakened financial position, the ambitious nature of the project, and growing domestic discontent over the regime's wasteful economic policies. 25X1

[redacted] 25X1

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Perspective

Third World Military and Economic Austerity [redacted] 25X1

Many military establishments in debt-troubled Third World countries are having to deal with financial constraints. In many instances, military-expansion programs have been cut back or postponed and planned equipment purchases have been reduced, in some cases sharply. While we have insufficient data to identify how individual services are faring in these cutbacks, the sketchy information we have suggests that all of the services are being hit. In the case of naval operations, for example, total Third World purchases of surface ships have been cut to only about one-third of the level that prevailed during the 1970s. LDC jet fighter purchases have also declined sharply in recent years. [redacted] 25X1

In general, Third World countries ruled or tightly controlled by the military are witnessing military budget austerity about as often as those under civilian governments. A rough indication of how the military is faring is the ratio of military spending to total government outlays. From 1980 through 1983, the military share of government spending declined in Argentina, Indonesia, Nigeria, and Panama. In Brazil, the military share—about 7 percent—rose slightly but is probably still below the average for Third World countries. Among major debtors, Mexico—with the lowest ratio—doubled its share to about 4 percent. Peru's share almost tripled to 25 percent, one of the highest. [redacted] 25X1

Although military concerns about morale and readiness are growing, the defense-spending cutbacks thus far have not resulted in regime-threatening instability. We have not observed much, if any, connection between military austerity measures and coup attempts or coup plotting. Thus far, the only military coup to occur in a debt-troubled country since the financial crises surfaced in mid-1982 has been in Nigeria. In that case, the coup action resulted from broader military dissatisfaction with the civilian-government performance rather than attempts to cut or change the military program. [redacted] 25X1

This is not to say that recent budget cuts have not caused concern within the military in key Third World countries:

- In the Philippines, low military salaries have resulted in moonlighting and increased military abuses against the civilian population.
- In Chile, there is some discontent among junior Army officers over low pay and inadequate housing.

- In Nigeria, the military government is concerned about placating junior- and middle-grade officers to forestall coup attempts.
- In Argentina, budget issues have heightened military criticism of the Alfonsin administration, especially among middle- and lower-ranking officers.
- In Morocco, military officials are concerned about dissension among junior and noncommissioned officers over basic problems such as pay and housing. [redacted] 25X1

It is not possible to determine whether or when this kind of military disgruntlement would lead to military actions against existing government authorities. We believe that the military by and large has been willing to accept austerity measures when it constitutes part of a broader program aimed at economic stabilization. In our view, the most risky type of military cuts from a political stability perspective would entail cuts in military salaries and perquisites—moves that so far have been avoided or kept to a minimum. [redacted] 25X1

[redacted] 25X1

Third World Military: Reaction to Economic Difficulties

Country	Status of Economic Adjustment Program	Impact of Economic Adjustment on Military [a]			Military's Response
		Budgeted Outlays [b]	Military Imports	Defense Industries	
Military Ruled					
Brazil	IMF-supported economic adjustment program	Up slightly	Remain low	Expanding exports	The military's concern about being held responsible for the failure of the current adjustment program has strengthened its commitment to return power to the civilians in March 1985.
Chile	IMF-supported economic adjustment program	Down from 1980	Some reductions	Expanding exports	Some discontent among junior Army officers over low pay and inadequate housing. Tight control of defense expenditures has not provoked a backlash in the armed services.
Indonesia	Widespread government-imposed measures	Sharp increase	Some increase	Delayed or cut back	Plans to streamline the military have caused some grumbling by young officers who see their prospects for advancement reduced.
Nigeria	Widespread government-imposed measures	Slightly down	Some reductions and delays	No change	The military government is concerned about placating junior- and middle-grade officers to forestall a coup attempt. 25X1
Pakistan	Limited government-imposed measures	Slightly increased	Increased significantly	No change	Morale in the armed forces is generally good. Pakistan's officers and enlisted personnel live better than most of their civilian counterparts.
South Korea	Limited government-imposed measures	Down very slightly	No significant effect	Scaled back	Reductions in defense expenditures have not been as significant as in other sectors of the budget and do not appear to have prompted any discontent within the military.
Military Dominant					
Argentina	Some government-imposed measures	Sharp increase	Reductions since 1982 Falklands war	New emphasis on exports	Budget issues have heightened military criticism of the Alfonsin administration, especially among middle- and lower-ranking officers. There are indications that senior officers are making the required cutbacks to maintain operational capabilities.
Egypt	Limited government-imposed measures	Increased sharply	Some increase	No change	Low pay for enlisted personnel has forced many servicemen to hold second jobs. Cairo is enhancing perquisites to maintain military morale.
Panama	IMF-supported economic adjustment program	Significant increase from 1980	Unaffected	Not applicable	Has not prompted any bad reaction from the military because it has not experienced budget cuts and relies on other sources for its income. Moreover, through Noriega, the defense forces are actually promoting economic adjustment measures.
Peru	IMF-supported economic adjustment program	Up sharply	Recent reductions and delays in procurement	Development slowed	Military has repeatedly warned the President over the past two years against drastic cuts in the military budget. Many officers hold second jobs.
Sudan	IMF-supported economic adjustment program	Slightly reduced	Significant reductions	Not applicable	The military perceives that a lack of key pieces of military equipment is hampering its fight against southern Sudanese dissidents.
Thailand	Limited government-imposed measures	Significant increase	Some increase	Unaffected	The military has been unaffected by the economic adjustment program. It continues to receive much of the equipment and materials it wants.
Turkey	IMF-supported economic adjustment program	Small increase	Unchanged	Development delayed or scaled back	The military has been generally supportive of the economic adjustment program. No significant discontent among military personnel.
Civilian Dominant					
Mexico	IMF-supported economic adjustment program	Moderately reduced	Significant reductions	Cutbacks in R&D and production	The military has been strongly supportive of the existing regime and accepted many of the budget reductions, particularly in imports of foreign military equipment. It has pushed successfully for wage and manpower increases to boost military morale and improve its ability to handle potential unrest.
Morocco	IMF-supported economic adjustment program	Large reduction	Extensive reductions	Not applicable	Economic problems affecting the flow of materials, a reduction in living standards, or political or military setbacks in Western Sahara may lead to disaffection in the military. Military officials are concerned over dissension among junior and noncommissioned officers over basic problems such as pay and housing.
Philippines	Widespread government-imposed measures	Down sharply	Some reductions	Not applicable	Low military salaries have resulted in moonlighting and increased military abuses against the civilian population.
Saudi Arabia	Limited government-imposed measures	Sharply increased	Steadily increased until 1983	Not applicable	Most expenditure cuts have been for military equipment and the reduced scale of the military city. Because the military continues to be showered with many expensive weapons, generous wages, and lavish facilities, there are no signs of opposition to the royal family. 25X1
Zaire	IMF-supported economic adjustment program	Cut sharply	Sharp reductions	Not applicable	Some disgruntlement among armed forces stationed outside the capital because of reductions in wages, food, and clothing.
Zimbabwe	IMF-supported economic adjustment program	Sharply reduced	Significant reductions	Not applicable	Budget was only recently released. If historical patterns are repeated, supplemental appropriations will be made to satisfy the military's demands.

[a] Comparison between early 1980s and present.
[b] Real terms.

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Briefs

Energy

OPEC Price Discounts Proliferate

[redacted]

Several OPEC countries are experiencing marketing problems [redacted] Nigeria recently joined Libya in adjusting the tax equity producers pay on their oil. Press reports indicate that Lagos is offering a discount of 30 and 50 cents per barrel on Bonny Light and Brass River crudes, respectively [redacted] Iran, Iraq, Saudi Arabia, Algeria, Qatar, and the United Arab Emirates also have resorted to price discounts or barter deals to sell crude. Widespread price cheating by OPEC members continues to place downward pressure on prices and will further strain OPEC's official price structure. [redacted]

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Major Oil Discovery in Beaufort Sea

[redacted]

Gulf Canada has issued what are described by energy analysts as the "best ever" test results from oil exploration in the Beaufort Sea. Gulf's Amauligak J-44 well—about 75 kilometers north of Tuktoyaktuk in the Northwest Territories—appears to have a production capability of 13,600 barrels per day (b/d), a total far higher than Gulf's largest previous Arctic discovery, which produced 2,500 b/d. Both Gulf and Ottawa are treating the discovery in a low-key manner to avoid the overheated speculation that in the past has embarrassed companies such as Dome Petroleum when apparently promising discoveries did not pan out. Nevertheless, a Gulf official is highly optimistic, and the company has indicated that it may apply for production licenses for several locations in the Beaufort Sea in early 1985. [redacted]

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Soviet-Turkish Natural Gas Agreement

[redacted]

Moscow last week agreed in principle to provide Turkey with up to 1.5 billion cubic meters (bcm) of natural gas in 1987, with the amount rising annually to 6 bcm in 1990. The Soviets also agreed to deliver the gas at less than the price of fuel oil, with payment in as-yet-unspecified Turkish goods. For Turkey to use these volumes, a spur off the Bulgarian leg of the Soviet gas pipeline system must be constructed to bring the gas to the Turkish border. Turkey, in turn, will have to build a gas trunkline from the border to the Istanbul-Izmit region and invest in gas distribution lines to the industrial plants in the area. [redacted]

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For Ankara, Soviet gas is unlikely to pose a significant energy-security risk. Imports of 6 bcm of Soviet gas would amount to only about 7.5 percent of Turkey's 1990 energy needs. In the event of a gas supply disruption, Turkish industries could readily switch to alternative fuels. Soviet gas sales to Turkey, however, could slow the development of indigenous gas resources. Soviet deliveries also could effectively block access to the European gas market by potential Middle Eastern suppliers, since the Turkish market would be a key steppingstone for such suppliers. [redacted] 25X1

Quebec Exports of Electricity to United States

[redacted] 25X1

Canada's National Energy Board in early September approved a request from Hydro-Quebec—Quebec's government-owned utility—to export 6,920 gigawatt-hours per year of electricity to the New England Power Pool between September 1986 and August 1995. The Board also approved Hydro-Quebec's request to construct a 450-kilowatt international powerline—to run from eastern Quebec to a location on the border between New Hampshire and Vermont at a cost of about $175 million—to carry the electricity to New England. Hydro-Quebec predicts that its revenues from the deal in the first year of the contract will be about $270 million and could be in the billions over the life of the agreement. The agreement provides a market for some of Hydro-Quebec's huge excess generating capacity and will provide the financially strapped Quebec Government with a significant source of additional revenue. [redacted] 25X1

[redacted] 25X1

Ottawa's Guidelines for Arctic Energy Production

[redacted] 25X1

Ottawa's Beaufort Sea Environmental Assessment Panel (BSEAP) recommended in late August that the federal government authorize a "phased in" approach to the production of oil and gas in the Beaufort Sea and Mackenzie Delta in Canada's Arctic region. In the first phase of strictly limited production, Arctic energy would be transported by a small, buried pipeline to be constructed along the Mackenzie Valley to Alberta. In the second phase, perhaps before the end of the decade, icebreaking tankers would be used to demonstrate that energy can be moved through Arctic waters safely and without endangering the environment. If the second phase is successful, the BSEAP recommends that tankers become the preeminent form of energy transportation. Ottawa probably will accept the BSEAP's proposals, which appear to go a long way toward protecting the interests of the Arctic's native people and meet the major objections of environmentalists—two of the most vocal opponents of northern energy development. [redacted] 25X1

China Establishes Natural Gas Corporation

[redacted]

China has set up a national corporation to supervise the exploration and development of natural gas. With output down 17 percent since 1979 and with natural gas providing only about 2 percent of China's energy needs, natural gas has been a low priority in China's energy plans. New discoveries onshore at the Zhongyuan and Liaohe oilfields, together with the discovery by ARCO of a major gasfield offshore near Hainan, have revived Chinese interest in developing natural gas production to supply fetilizer as well as energy needs. [redacted] 25X1 25X1

International Finance

Philippine Financial Developments

[redacted]

On Monday, Manila's 12-bank advisory committee begins rescheduling negotiations on the Philippines' $18 billion commercial debt. The committee is confident that all outstanding financial issues can be resolved, but a large number of Manila's 483 creditors are expected to refuse to provide new funds. Even though their total contribution would be small, their nonparticipation could generate sufficient adverse publicity to significantly reduce the amount of new financing obtained. [redacted] commercial bank financing may reach only slightly more than $1 billion—well short of the IMF's target of $1.65 billion. The shortfall would be absorbed either by rescheduling arrears owed to commercial banks or by reducing Manila's foreign exchange requirements through additional cuts in imports. [redacted] 25X1 25X1 25X1

[redacted] 25X1

Preliminary Venezuelan Debt Agreement

[redacted]

Venezuela's agreement in principle to restructure public-sector debts, reached last week with its bank advisory committee, will take several months to conclude. Loans maturing through 1988—about $21 billion—will be repaid over 12.5 years at 1.125 percentage points above the London Interbank Offer Rate, according to the US Embassy and press reports. Bankers emphasize that a formal debt accord will require sustained progress in repayment of $1.2 billion of overdue interest on private-sector loans. [redacted] 25X1 25X1 25X1

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We believe that the widespread optimism expressed by government officials and the Venezuelan press's portrayal of the agreement as final belie the difficulties of formalizing the restructuring plan. Caracas's 460 creditor banks could delay the preparation and signing of the thousands of contracts necessary to implement the agreement should debt payment from Venezuela's private sector prove inadequate. [redacted] 25X1 25X1

[redacted] 25X1

Peru's Difficulties With the IMF

[redacted] 25X1

The IMF representative in Lima has informed US Embassy officials that Peru is now ineligible to draw further on the IMF standby loan signed last April. According to the Embassy, Peru's fiscal deficit, currently projected at 9.7 percent of GDP, exceeds the 4.1-percent IMF target set in April, and we believe President Belaunde will have great difficulty reconciling differences with the Fund. Popular demands to relax austerity make politically risky either large tax increases or sharp cuts in spending. The July tax package did not significantly increase revenues, according to US Embassy analysis. Also, Lima will be reluctant to increase gasoline prices or tighten government social services spending before elections in early 1985. Government employees, whose strike forced the administration to impose a state of emergency in early June, held a 24-hour walkout on 20 September demanding wage increases. [redacted] 25X1

Peru's difficulties with the IMF will erode Lima's ability to obtain foreign financial support. We believe that failure to cooperate with the IMF will stall the pending commercial debt–refinancing package and cut access to $100 million in embargoed foreign bank credit. [redacted] 25X1

Tokyo Approves Yen Loan for USSR

[redacted]

Japan's Ministry of Finance (MOF) has decided to open up the rapidly growing syndicated yen loan market to Soviet borrowers on a case-by-case basis. Although recent Japanese press reports speculate such private credits may be offered to the USSR near the end of this year, we believe the first yen loan deal is imminent. [redacted] 25X1 25X1 If Japan continues to chalk up large curent account surpluses, we believe Tokyo will feel compelled to improve the access of foreigners—including Soviet Bloc countries—to yen loan markets. 25X1

More Soviet Borrowing in the West

Press sources report that the Soviet Foreign Trade Bank last week signed a $166 million European loan syndicaton. The loan was underwritten by a group of nine Western banks—with no US participation—and reportedly carried favorable interest rates. This is the third major loan the USSR has syndicated this year. stepped-up interest in credits to a Soviet desire to demonstrate to the international financial community the USSR's creditworthiness rather than an immediate need for cash. 25X1 25X1

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Global and Regional Developments

Big Six Exports Booming

The export volume of the six largest non-Communist industrialized countries—excluding the United States—increased sharply in the first half of 1984 largely because of the US economic recovery and the continued strength of the dollar. The volume of Big Six exports rose 12 percent in the first six months of this year compared with the same period in 1983—a sizable jump over the 3-percent average annual increase during the previous three years. Exports to the United States grew the most rapidly, an average 33 percent. In addition to strong US economic growth, the competitiveness of Big Six exports has improved dramatically over the past few years because of the dollar's 36-percent appreciation—on a trade-weighted basis—between January 1980 and June 1984. Of the Big Six countries, Canada and Japan saw their total export volume expand the most, largely because exports to the United States account for a larger share of those countries' total exports than do those of the other Big Six countries. 25X1 25X1

Big Six: Change in Real Exports, First Half 1984 [a] *Percent*

	World	Other Big Six Countries	United States	Other Developed Countries	LDCs
Big Six total	**11.9**	**7.4**	**33.4**	**9.4**	**4.8**
Japan	16.3	7.9	39.4	12.9	5.3
West Germany	8.8	3.7	47.6	9.4	4.4
France	9.2	9.6	42.1	9.7	2.4
United Kingdom	7.4	12.3	13.9	8.2	−4.9
Italy	7.9	5.0	48.0	7.1	5.3
Canada	27.3	18.7	27.7	18.3	55.3

[a] Percent change over the corresponding period in 1983.

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Details on Saudi Oil-for-Aircraft Deal

[redacted]

According to reporting from the US Embassy in Riyadh, the recent Saudi barter of oil for 10 Boeing 747 aircraft could involve 50 million barrels of oil rather than the 34 million barrels reported in the press. The larger volume reportedly is needed to compensate for oil price discounts and for commissions—up to $300 million—to the Swiss trading company (reportedly owned by brothers-in-law of King Fahd) involved with placing the barter oil. Although barter deals conflict with the officially stated Saudi oil policy, they have the advantage of hiding discounts and commissions. The recent deal has put OPEC and non-OPEC oil producers on notice that Saudi Arabia can market extra oil if other producers persist in sales that threaten the OPEC price structure. [redacted]

International Coffee Negotiations

[redacted]

Negotiations are under way in London on provisions for next year's International Coffee Agreement (ICA). Producer nations are expected to push for a 10-cent-per-pound increase in the current support price range of $1.20-1.40 per pound and to request that the global export quota be raised from 56 million to 58 million bags (60 kilograms each). Consumer nations are expected to resist any increases in the price-support range and will push for a higher quota of 62 million bags plus an additional 2.0 million bags should the price be above $1.40 on October 1. ICA price hikes over the past year triggered four quota increases, raising the final export quota to 60.2 million bags. Despite these adjustments, coffee prices have remained high for most of 1983-84 and currently stand at around $1.40 per pound. While the ICA talks are expected to be contentious, member nations are unlikely to allow the talks to collapse—the ICA has been among the strongest of the international commodity agreements—as has been the case with other commodity agreements such as sugar and tea. [redacted]

Possible Indian Wheat Sales to USSR

[redacted]

[redacted] USSR grain trade officials are currently negotiating with India for grain purchases. India is offering to sell as much as 1 million to 1.5 million tons of wheat currently in storage. Other potential buyers include Iran and several African states. If Moscow secures this wheat it will be the first such sizable import of wheat from India since 1979. With record production and swelling stocks of grain in storage, India—which imported almost a million and a half tons of wheat from the United States last year—has apparently decided to export grain this year. Moscow also has been buying grain from other countries. Recent purchases of 500,000 tons of corn from Thailand and 400,000 tons of corn from China bring Soviet grain imports and commitments to just over 25 million tons three months into the current market year. [redacted]

Possible Libyan-Moroccan Airline Merger

[redacted]

[redacted] Morocco and Libya may combine their national airlines. A merger—the latest example of economic cooperation between the two countries since the union last month—would provide the Moroccan carrier access to Libya's more abundant financial resources and extensive traffic rights, while offering Tripoli the strong organizational skills and efficiency of Morocco's airline. Qadhafi also might use the agreement to pressure Morocco to channel US aircraft and spare parts denied him under current US trade restrictions against Libya. [redacted]

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West European Unemployment Rises

[redacted]

Unemployment in the EC reached 12.4 million in August, up 150,000 from July and 1.3 million higher than in August 1983. The seasonally adjusted unemployment rate of 11.3 percent for last month, however, equals the rate for July—an alltime high. Over the past year, the sharpest rises in joblessness have occurred in France, where several large industries are being restructured to cut costs, and in Ireland, where the government is pursuing a stringent fiscal policy to slash the budget deficit. [redacted]

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Joblessness almost certainly will continue climbing through the end of the year and into 1985. In a report released this week, the OECD secretariat forecast that unemployment in the 19 West European countries will rise to 20 million—11.5 percent of the labor force—by the end of 1985, an increase of 1 million from the current total. Despite expected 1985 GNP growth of 2.5 percent in Western Europe, creation of new jobs probably will be insufficient to absorb workers laid off from declining industries and youth entering the job market for the first time. [redacted] 25X1

National Developments

Developed Countries

Israeli Moves Toward Austerity

[redacted]

The Israeli Cabinet is still discussing budget cuts of $1 billion following its adoption on Sunday of measures designed to cut the deficit and reduce consumer purchasing power. The Cabinet decided that an 8- to 10-percent surtax will be imposed on October income taxes, and monthly compulsory loans of 5 to 7 percent of wages will be made to the government over the subsequent three months. Recent press reports, however, indicate that the government may be backing away from the surtax. Prices of basic commodities were increased by 18 to 55 percent. The government probably will not receive the full revenue expected from the surtax and compulsory loans because of increased tax evasion. Moreover, until the Cabinet adopts a mechanism to enforce budget cuts, the ministers are likely to exceed their spending ceilings. The price hikes will boost inflation above the current rate of 400 percent unless the cost-of-living adjustment formula is revised. [redacted]

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Japan's Economic Planning Agency Boosts Growth Forecast

Japan's Economic Planning Agency (EPA) has issued a revised estimate of GNP growth, calling for a 5.3-percent increase in fiscal year 1984, which began on 1 April. The Agency's initial forecast, issued in January, called for growth of 4.1 percent. The EPA has labeled the revision an "estimate" rather than an official forecast to avoid giving ammunition to critics of Prime Minister Nakasone's tight fiscal policy, who might argue that increased government revenues would permit greater government spending. 25X1 25X1

The newly revised forecast predicts personal consumption will increase by 3.6 percent, with housing investment to increase by 4.0 percent and private capital investment by 8.1 percent. We believe that, except for private capital investment, these targets for the domestic economy are overly optimistic, and that the foreign sector—especially exports to the United States—will continue to provide significant stimulus to the current expansion. With net exports continuing to grow, the Japanese probably will succeed in hitting their overall GNP growth target this year. 25X1

Less Developed Countries

Egypt Increases Bread Price

Prime Minister Ali told US officials that next month the government will increase prices for bread, first in the wealthier sections of Cairo and Alexandria and then gradually in other districts. A new, larger loaf—costing about 6 cents, double the price of the older loaf—was offered in some areas last weekend alongside the old size. President Mubarak also has announced plans to convene a conference of government and opposition leaders to consider further reductions of subsidies, which cost at least $2 billion a year. Mubarak hopes the planned conference will produce agreement on the need to reduce subsidies and thereby keep opposition members of the People's Assembly from exploiting the issue. By aiming its initial subsidy cuts at wealthier Egyptians, the government has reduced temporarily the danger of a popular backlash similar to the bread riots of 1977. 25X1 25X1

Food Crisis in Niger

The US Embassy in Niamey estimates that Niger must have at least 300,000 tons of emergency food by December, when the Nigerien Government reports that its food stocks will be depleted. Severe drought has resulted in widespread crop failures and the loss of large numbers of cattle and other livestock, raising the prospect of widespread famine. With rainfall this year only 54 percent of the 30-year average, cereal production is less than 50 percent of last year's harvest. AID statistics indicate that agricultural production this year may dip below levels recorded during the great drought of the early 1970s; at the same time, Niger's population has grown by some 1.8 million people since 1973. President Kountche has formally appealed to the United States for food assistance. 25X1 25X1

Somalia Preparing for New IMF Negotiations

[redacted]

Earlier this month, Mogadishu devalued its currency by 50 percent and promised to pay $5.5 million in arrearages due to the IMF in hopes of obtaining a new standby agreement in negotiations with the IMF in October. The discussions probably will be difficult because of strong Somali resistance to the Fund's demands for a further devaluation. In addition, President Siad probably will continue to reject IMF-proposed measures to liberalize the state-run economy, largely because he fears they would limit his ability to dispense patronage, an important source of his power. We expect a Somali economic delegation visiting the United States this week to ask for debt relief and increased payments support, in the hope that if Somalia can obtain sufficient aid from Western donors and Arab states the IMF will soften its requirements for an agreement. [redacted]

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Nigerian Doctors' Strike

[redacted]

[redacted] 25X1

the military regime caved in to a nationwide doctors' strike protesting Nigeria's deteriorating economic conditions and the poor state of health care. Buhari accepted the doctors' demands in order to halt the closure of federal hospitals after medical personnel refused to obey a back-to-work order. Many Nigerians are speculating that university students and leftist unions now may be tempted to confront the nine-month regime over escalating food and housing costs. [redacted]

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Libyan Distribution Problems

[redacted]

Libyan officials continue to grapple with the problem of distributing goods to a disgruntled population long beset with harsh austerity measures. [redacted] Tripoli, which for some time has been considering rationing consumer goods to conserve foreign exchange, has held back because of bureaucratic inefficiencies but may consider a more generalized program if current measures appear workable. Libyan officials also are discussing ways to improve the efficiency of state supermarkets, which replaced private food-distribution systems and are the source of a growing number of consumer complaints. Without a major improvement in Libya's foreign exchange position, however, consumer needs will continue to take a backseat to military equipment purchases and costly development schemes. [redacted]

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Thai Central Bank Governor Ousted

[redacted]

After months of conflict over the conduct of monetary policy, Finance Minister Sommai Huntrakun earlier this month forced the resignation of Nukun Prachuapmo, the internationally respected head of the Bank of Thailand. Kamchon Sathirakun, a US-educated technocrat, who had been the Director of Fiscal Policy in the Foreign Ministry, was named the new governor. Over the past year, tight money policies aimed at slowing Thailand's burgeoning imports had aggravated a domestic liquidity crisis and precipitated

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a record number of small business bankruptcies. Nukun's politically motivated ouster may undermine the ability of the central bank to implement an independent monetary policy in the future and may eventually damage Thailand's international creditworthiness, now among the best in the developing world. [redacted] 25X1

Communist

Small Soviet Grain Harvest Predicted [redacted]

[redacted] 25X1

Detailed weather reports and open-source information indicate to us, however, that Soviet grain production is likely to reach almost 185 million tons, with little probability that the crop will drop to 160 million tons. At this level, Moscow will need to import at least 45 million tons to meet planned livestock-sector goals. [redacted] 25X1

Soviet Import Needs in New Five-Year Plan [redacted]

Soviet economic officials have told [redacted] that the Soviet Economic Plan for 1986-90 will emphasize the Food Program—especially the storage and transportation of agricultural products—development of East Siberia, social welfare programs, and the renovation of factories. Computer technology, automation, and robot technology apparently will play important roles in efforts to meet the goals of the plan. None of the programs reportedly planned for the 1986-90 Plan are surprising, and all of them are carryovers from the current five-year plan. The Soviets, in spelling out their import needs to non-Communist officials, appear eager to move ahead with contracts for Western machinery and equipment. [redacted] 25X1

Hungarian Reform Attempts [redacted]

Budapest has taken its first tentative step to implement a policy announced last April to permit worker participation in the selection of plant directors. In mid-September, union shop stewards at the Glovita knit-glove factory acted as representatives of the plant labor force and elected a new factory manager by secret ballot from a choice of two candidates. The previous practice had been for the Minister of Industry to appoint all industrial managers directly. 25X1
Despite Budapest's wide media coverage of the event, the Hungarians are likely to move very cautiously in permitting future elections. The Glovita case was a carefully planned "trial run" in a situation where the previous manager had been transferred to another senior post and the Ministry of Industry fully backed the candidates. [redacted] 25X1

Mexico: The Impact of Austerity on the Military 25X1

The Mexican military is coming through the current severe financial crisis in better shape than most observers expected. Military leaders have cushioned defense cutbacks by publicly supporting President de la Madrid's austerity program while quietly maneuvering for traditional pay and manpower benefits. Government worries about domestic unrest, oilfield vulnerability, and the potential spillover of instability from Central America have encouraged a more active military role in domestic security affairs, although defense leaders do not play a key role in policy formulation.

Political and Economic Backdrop

As oil revenues increased during the 1970s, President Lopez Portillo encouraged a military modernization program that included purchasing sophisticated military equipment from abroad, funding numerous domestic military construction projects, expanding defense industries, and establishing a full-fledged National Defense College patterned after war colleges in the major Western countries. Moreover, the ability of defense leaders to secure and effectively disburse large military budgets suggested improved managerial capability within the military and behind-the-scenes influence on government decisionmaking.

A weakening world oil market beginning in 1981 and subsequent government moves to control the overheated economy forced budgetary retrenchment. Major portions of the long-term modernization plan were put on hold. President Miguel de la Madrid took office at the end of 1982 faced with the dilemma of how to strengthen security forces to handle potential domestic unrest at a time of fiscal stringency.

Living with Austerity

Tough austerity measures succeeded in reversing the decline of Mexico's external accounts, but at the cost of a sharp drop in economic activity and living standards. In 1983, domestic output fell about 5 percent, while the cost of living soared 100 percent. At the same time, Mexico ran the first trade and current account surpluses in nearly three decades. While Mexico stemmed the decline in economic activity in the first half of 1984 and inflation probably will be about 65 percent for the year, there is no evidence that recovery is under way. Throughout this difficult period, de la Madrid has kept the support of organized labor—despite a 30-percent fall in real wages—reflecting in part the President's success in promoting his program as well as the high priority workers place on job preservation. Opposition parties have had only minimal success in exploiting the economic crisis. Parties on the left lack unity, while the center-right National Action Party, which scored an unprecedented string of victories in local elections in 1983, does not appear to be making more headway. Nonetheless, political tensions are growing as the country prepares for gubernatorial and congressional elections in 1985. 25X1

25X1

Military Support for Stabilization

De la Madrid's efforts to rescue the Mexican economy and restore confidence in the government have been aided by the strong endorsement of his policies by the armed forces. Secretary of Defense Arevalo responded to belt-tightening by sharply reducing imports, suspending many defense construction projects, and limiting training to save on fuel and ammunition. 25X1

Mexico: Military Budget

	Defense as a Share of Federal Budget *(percent)*	Defense as a Share of GDP *(percent)*	Defense Purchasing Power *(million 1975 pesos)*	Defense Expenditure per Soldier *(thousand 1975 pesos)*
1930	26.2	1.7	1,177	24
1940	19.3	1.5	1,532	31
1950	9.9	0.9	1,584	32
1960	5.3	0.7	2,513	46
1970	4.5	0.6	4,139	55
1980	2.4	0.6	9,424	83
1981	2.1	0.6	10,409	88
1982	2.1	0.5	8,900	74
1983	3.8	0.5	8,389	67
1984 [a]	3.4	0.5	6,755	52

[a] Based on preliminary budget figures before supplementary appropriations. Final figures will be higher.

[redacted] 25X1

While cutting back on its expensive weapons modernization program, the military began to take low-cost steps to improve its efficiency and responsiveness. [redacted]

25X1

[redacted]

25X1

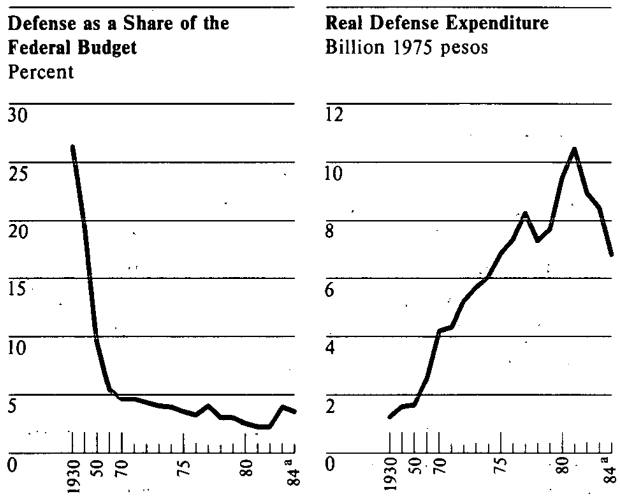
Presidential Favor

To bolster the armed forces' sense of importance and determination to carry out their internal security mission, the President has steadily cultivated the defense establishment through symbolic gestures as a substitute for some of the economic rewards he can no longer dispense. De la Madrid's inauguration featured warm praise for the armed forces and the first military parade in recent memory. [redacted]

President de la Madrid also has endorsed a more active domestic role for the armed forces as a result of his concern over potential domestic unrest, threats to vital oil installations, and the spillover of instability from Central America. Expanded antinarcotics operations, civic action, and field maneuvers have increased military visibility over the past two years. Troops have stepped in as necessary to back up police forces in restoring order when local political, agrarian, student/teacher, or labor protests have gotten out of hand. The government's creation of a new military zone along the Guatemalan border, deployment of additional units to the south, and other moves to decrease Guatemalan

25X1

Mexico: Defense Budget, 1930-84



a Projected.

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Mexico: Military Manpower

	Size of Armed Forces [a] *(number of men)*	Population [a b] *(thousand persons)*	Military-Civilian Ratio
1914	125,000	14,000	1:110
1920	100,000	15,763	1:160
1930	50,000	18,366	1:370
1940	50,000	21,915	1:440
1950	50,000	28,485	1:570
1960	55,000	38,579	1:700
1970	74,675	52,775	1:710
1980	113,400	70,111	1:620
1984 [c]	129,500	77,659	1:600

a Estimated.
b Based on adjusted Mexican census figures.
c Midyear.

25X1
25X1

insurgent resupply in Mexico—(including removal of refugees from the border to reduce guerrilla safehavens)—suggest that the military's warnings about the danger of the insurgency's spreading into Mexico have not fallen on deaf ears. 25X1

Defense Budget

After an initial standdown while the new President settled in, the military began to maneuver behind the scenes to protect its budgetary position. Leaders tailored their arguments to pragmatic government security concerns rather than to the more abstract concept of force modernization that had been prevalent in the 1970s. Although defense expenditures remain extremely modest, US Embassy figures indicate that the military share of the budget has risen during the economic crisis. Despite continued high inflation and severe fiscal restraints, the real purchasing power of the defense budget has been less affected than other programs. For example, defense purchasing power dropped only 6 percent from 1982 to 1983, while overall federal outlays fell 40 percent. 25X1

Military leaders also succeeded in both 1983 and 1984 in gaining midyear supplemental appropriations despite increased demands on the budget that are likely to cause the public-sector deficit to exceed IMF targets this year. Military personnel received a 100-percent pay increase in 1983, in contrast to significantly lower civilian wage gains. The 1984 supplemental appropriation of $16 million was earmarked for further expansion of the armed forces. We expect manpower increases under de la Madrid to match the roughly 5,000-per-year gains made during the oil boom years.[1] 25X1
25X1

Although military industries and equipment purchases, both heavily dependent on imports, have suffered from foreign exchange shortages and the cutoff of presidental discretionary funds during the recession, some deals have gone through:

[1] The Mexican military, however, remains one of the smallest forces in relation to civilian population in Latin America. 25X1

- Stressing its role in defending the oilfields, the Navy has received a green light for construction of several large patrol boats.

- The Air Force ordered much-needed spare parts and armament for aircraft purchased in the late 1970s.

- The Army has received new riot control equipment to contend with urban disorders.

In addition to the military, municipal police forces have made out well. The Mexico City Police Department, for example, has taken delivery of more than 1,000 new vehicles over the past year costing over $12 million. Increased budget allocations have allowed the Directorate of Federal Security, Mexico's nonuniformed internal security force, to double its size to 2,500, buy new equipment, and expand training and operations. [redacted]

The Military's Political Role

Despite its growing domestic security role and enhanced prestige, the military has maintained its traditionally quiescent political stance within the civilian administration. The President recognizes the advantages of a loyal and supportive military that can endorse specific governmental policies, provide valuable intelligence on outlying areas, and quell disorders. Furthermore, the administration is undoubtedly counting on the military to deliver elections to the ruling party if necessary. [redacted]

The military has long believed that its own fortunes are inexorably bound up with the prevailing political order, a perception strengthened by current experience. The military has found it comfortable to work with the present administration. We believe de la Madrid's technocratic credentials and businesslike leadership style appeal to the military. Moreover, his moderate-to-conservative domestic programs, his anticorruption stance, and his more pragmatic policy toward Guatemala have struck responsive chords [redacted] we expect that the defense establishment will continue to support de la Madrid. [redacted] 25X1 25X1

Performance Outlook

Although sacrifices have been necessary and performance varies from unit to unit, in our view the Mexican Armed Forces appear in somewhat better shape to meet current security threats than they were before the economic crisis. Economic circumstances have forced Mexico to use its limited funds for equipment geared to internal security needs and abandon the efforts to acquire sophisticated equipment for prestige purposes. Still, some critically needed items—such as air transport (including helicopters) for rapid response in emergencies—remain too expensive. [redacted] 25X1 25X1

Manpower increases are extending troop presence, albeit modestly, in outlying areas. Low-cost moves, such as decentralization of military administration and logistics, have given commanders greater flexibility in handling local problems expeditiously on their own. Experiments with standardized recruit training are leading to enhanced troop quality, [redacted] Increases in troop activities around the country are exercising command and control procedures and improving readiness, while providing useful services. [redacted] 25X1 25X1

Window-shopping in a dozen countries has laid the foundation for a resumption of equipment modernization when the economy improves. [redacted] 25X6 25X1 25X1

Implications for the United States

The Mexican military's relatively strong showing is helping to preserve stability in the United States closest southern neighbor. The armed forces have stood firmly behind the de la Madrid government, voting for continuation of the current governmental system by word and deed. The military has stayed sufficiently in the background, both in policy discussions in the government and in domestic security assignments, that its favorable popular image remains intact, allowing it, we judge, to keep more repressive measures in reserve for future contingencies. [redacted] 25X1

De la Madrid's interest in improving relations with the United States has allowed more latitude for contacts between military officers and their US counterparts. For the first time, a National Defense College class visited Washington and US military installations last spring. [redacted] 25X1 Mexico has not sought US military aid, preferring, we believe, to reduce purchases in difficult times rather than accept politically compromising alternatives. Although traditional Mexican insistence on diversifying sources of supply, timely deliveries, and kickbacks has limited the military trade with the United States, many defense leaders value the quality of US equipment and the reliability of US supply lines. Given continued improvement in the bilateral political climate, we would not be surprised to see greater Mexican interest in US training and equipment when the economy rebounds, although Mexico City will undoubtedly maintain strong contacts with European firms for balance. [redacted] 25X1

[redacted] 25X1

Western Europe: Export Surge to USSR Fading in 1984 [redacted] 25X1

West European exports to the USSR—one of the few bright spots in Western Europe's poor overall export performance in 1983—probably will be down considerably in 1984. In the first quarter alone, exports dropped $1 billion from the level of a year earlier. For the year as a whole, deliveries will reflect the almost 40-percent falloff in export orders for machinery and equipment recorded last year. Any resurgence of major orders for the new Soviet five-year plan will not show up for a year or so. With economic recovery in Western Europe shaky at best and unemployment very high, this decline in sales is likely to intensify competition in the Soviet market. Further clashes with US policy interests over export credit subsidies and export controls are likely. [redacted] 25X1

1983 Export Rebound Cuts Deficit

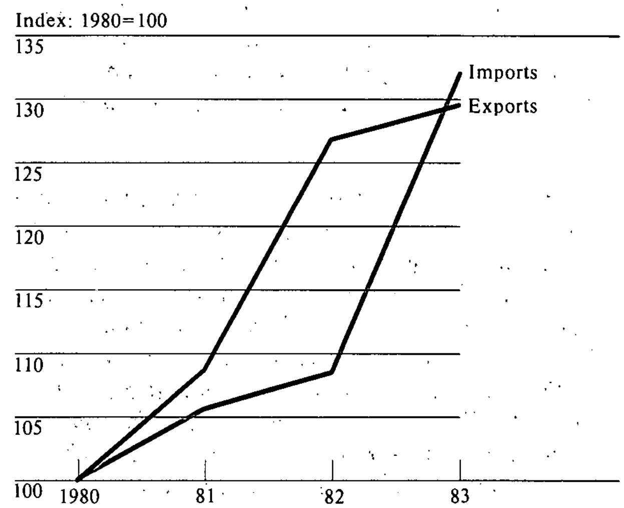
Western Europe's exports to the USSR last year rose to $15.4 billion, a $1.7 billion increase over the 1982 level. This reversed a two-year decline, and total sales to the Soviet market eclipsed the 1980 peak of $15.0 billion. In value terms, exports rose by about 13 percent over the previous year, reflecting the impact of the appreciation of the US dollar against the European currencies; in volume terms the increase was almost 24 percent. [redacted] 25X1

Almost all the West European countries posted gains, with the bulk of the increase going to three of the major exporters in the region—France, West Germany, and Italy:

- French exports jumped $681 million, a 44-percent increase in value and 51 percent in volume.
- West Germany, the West European leader in the Soviet market, posted a $548 million gain, up 14 percent in value and 19 percent in volume.

[1] Trade data, unless otherwise noted, are from West European sources and differ from Soviet trade data. Volume figures are in constant 1980 US dollars. [redacted]

Western Europe: Trade Volume With the USSR, 1980-83



[redacted] 25X1

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- Italian sales grew $385 million, with value and volume growth of 26 and 33 percent, respectively.
- Among the other suppliers, substantial increases were made by Belgium ($133 million) and the Netherlands ($117 million). [redacted] 25X1

Although complete commodity details for Western Europe for 1983 are not available, available data show that most of the growth came in manufactures and foodstuffs—items that traditionally dominate their exports to the USSR. Equipment under contracts for the Siberian gas pipeline accounted for much of the increase in manufactures. West German machinery deliveries rose over $400 million and French and Italian machinery sales rose more than $300 million each. French grain deliveries subsidized by the EC were up $350 million. [redacted] 25X1

Competition for the Soviet Market

West European countries compete heavily—among themselves and with other developed countries—for sales to the Soviet market. In addition to the economic benefits of such exports, many countries view expanded economic relations with the USSR in the broader context of improving East-West relations. While this market is a small slice of Western Europe's total exports, the importance of major Soviet contracts to certain industries and individual firms helps shape national trade policy toward the USSR, particularly in the areas of export credits and controls on strategic exports.

Except for Finland, West European countries trade with the USSR on a private basis. Most countries have some sort of general trade agreement that usually involves annual meetings of government-level mixed commissions where trade problems are discussed but no fixed levels of trade are set. For members of the EC, such agreements are strictly limited by EC regulation and predate their entrance into the Community. Moscow's initiative on an EC-CEMA trade agreement has seen little progress over the past few years. Negotiations stalled in 1981 over technical details and a worsening political climate, and there appears to be little interest on either side for resumption of serious talks.

Government-backed export credits for Soviet equipment purchases are used to compensate for the generally weaker competitive position of West European firms vis-a-vis US and Japanese firms. Government-backed credits play a major role in West German–Soviet deals, and commitments to the USSR are already at a high—13 percent of total exposure. West German credits, however, generally carry no government subsidies. For France and Italy, credit subsidies are an important factor in competing for Soviet contracts. Paris is a leader in extending government-backed credits at below-market rates, while Rome's willingness to provide generous guaranties and subsidized trade credits has been a major factor in the Italian-Soviet economic relationship. Tighter domestic credit availability, however, has recently constrained Italy's ability to provide this export financing. Although London also insures export credit and can provide subsidies, the United Kingdom's overall level of activity is low.

West European attitudes toward export control of strategic goods also influence competition for Soviet business. West European countries take a more liberal approach to the appropriate level of control on technology exports. Exports by NATO countries are regulated by the COCOM mechanism, while sales by non-NATO members are subject to only national controls. The economic importance of Soviet deals to individual firms can generate intense pressures for approval of the sale of restricted technology. In a recent case, for example, the Belgian firm, Pegard, contracted to sell a sophisticated machining center to the USSR. Belgium pressed hard against US objections in COCOM because loss of the sale threatened bankruptcy for the firm, which would add to high unemployment in a politically sensitive region of the country. In the end, export was avoided by the purchase of the equipment—subsidized by the United States—by the Belgian military. Moscow, of course, uses West European policy on export control to advantage to purchase advanced technology that is more tightly restricted in other countries.

Western Europe–USSR Trade, 1982-83

Million US $

	Exports to USSR		Imports From USSR		Balance	
	1982	1983	1982	1983	1982	1983
Western Europe	**13,687**	**15,417**	**23,432**	**22,592**	**−9,745**	**−7,175**
Of which:						
West Germany	3,870	4,418	4,690	4,631	−820	−214
Finland	3,469	3,287	3,254	3,278	215	9
France	1,559	2,240	2,884	2,801	−1,324	−561
Italy	1,499	1,884	3,529	3,582	−2,030	−1,697
United Kingdom	620	676	1,101	1,101	−481	−425
Austria	551	599	990	826	−439	−227
Belgium/Luxembourg	533	666	1,460	1,169	−927	−503
Netherlands	425	542	2,571	2,332	−2,146	−1,790
Sweden	353	291	797	951	−444	−660
Switzerland	215	223	834	677	−619	−454

Source: West European Country Data.

25X1

The export surge, along with a modest decline in the value of West European imports from the USSR last year, cut bilateral deficits that all the major West European trading partners, except Finland, have run with the Soviet Union since their major purchases of Soviet energy began in the late 1970s. The largest improvements were scored by West Germany, which cut its deficit by 75 percent, France 60 percent, and Belgium and Austria almost 50 percent each. Imports regionwide fell more than $800 million, a 4-percent decline in value. Import volume, however, was up 2 percent over the previous year, reflecting both the dollar exchange rate impact and the softness in energy prices. As a result, the aggregate trade deficit with the USSR dropped $2.6 billion to $7.2 billion.

On the basis of EC data, it appears that the drop in imports was in nonenergy products, usually only 20 percent of the import total. Of these, semifinished manufactures and raw materials showed the most substantial declines. Despite slack energy demand and soft oil prices, the Soviets boosted exports of fuels to the Community by about $200 million; oil accounted for all of the gain, as a 15-percent rise in volume more than offset lower prices. Because of warm weather in Western Europe, EC imports of Soviet natural gas declined about 4 percent in volume. 25X1

Benefits of the Export Recovery

Despite the relatively small share—about 2 percent—of the Soviet market in Western Europe's total exports, the $1.7 billion increase in 1983 sales was a major bright spot in the region's otherwise dismal export performance last year. In LDC markets, for example, West European exports last year plunged more than $13 billion as the LDCs were forced to cut imports because of falling oil revenues, debt-imposed austerity programs, and slack demand in the stagnating West European economies themselves. The export gain to the Soviets

25X1

USSR: Orders Placed With Western Europe for Machinery and Equipment *Million US $*

	1980	1981	1982	1983	January-March 1983	January-March 1984
Total	**2,409**	**5,820**	**3,912**	**2,469**	**767**	**255**
Chemicals and petrochemicals	411	361	455	373	NEGL	90
Oil and natural gas	254	3,572	1,161	373	291	3
Metalworking and metallurgy	749	681	783	113	46	1
Food processing	23	93	141	81	NEGL	NEGL
Vehicle manufacturing	45	196	74	59	10	NEGL
Ships and port equipment	384	567	820	983	163	89
Mining and construction	20	125	NEGL	9	4	NEGL
Other	524	226	478	478	252	71

25X1

compares favorably to the $4 billion increase last year in sales to the rapidly growing US market, which as an export market is more than three times the size of the Soviet market. For France, exports to the USSR last year increased by about $0.7 billion, compared with less than $0.5 billion to the United States; for West Germany the comparable increases were $0.5 billion and $1.2 billion; and for Italy roughly $0.4 billion each. 25X1

Although not large in themselves, these export increases to the Soviet Union are important because of the heavy dependence of the West European countries on foreign trade. In the larger countries, exports account for around 25 percent of GNP; among the smaller countries, the share ranges as high as 70 percent for Belgium. Moreover, sales to the Soviet Union are important to individual industries in these countries and to the firms that benefit from large Soviet orders. In particular, exports are vital to West European steel and machinery and equipment producers faced

USSR: Trade With Western Europe *Million US $*

	First Quarter 1983			First Quarter 1984		
	Exports to	Imports From	Balance	Exports to	Imports From	Balance
Western Europe	**5,504**	**5,130**	**374**	**5,504**	**4,045**	**1,459**
Austria	208	263	−55	213	292	−79
Belgium	322	212	110	246	180	66
Finland	642	1,090	−447	539	849	−309
France	605	687	−83	726	600	126
Italy	1,043	549	495	915	374	541
Netherlands	529	181	348	472	74	398
Sweden	163	101	62	164	85	79
Switzerland	195	168	27	105	114	−9
United Kingdom	318	291	27	390	233	157
West Germany	1,191	1,316	−126	1,419	1,016	403

Source: USSR trade data.

25X1

Western Europe: Export Trends, 1982-83

	1983 (Million US $)	Change From 1982 to 1983	
		Million US $	Percent
Exports to world	**692,285**	**−17,214**	**−2.4**
United States	52,074	4,076	8.5
Japan	8,385	472	6.0
Canada	6,038	713	13.4
Western Europe	450,690	−6,071	−1.3
Other developed	21,975	−1,770	−7.4
Less developed	116,545	−13,377	−11.5
USSR	15,417	1,730	12.6
Eastern Europe	9,879	−1,017	−9.3
Other Communist	3,733	368	10.9
Other	7,549	−537	−6.6

Source: West European country data.

[redacted]

with stagnant domestic markets, a weak competitive position overseas, and rising unemployment. Agricultural sales to the Soviets, which have grown in importance since 1980, provide a useful outlet for the surplus farm production in the EC countries. [redacted]

Outlook for 1984

We expect that West European exports to the USSR in 1984 will fall back, perhaps to the 1982 level of $13.7 billion. Soviet orders for West European machinery and equipment fell in 1983 to $2.5 billion, only 60 percent of the 1980-82 average, and, in the first quarter of 1984, orders totaled only $255 million—one-third the total signed in the first quarter of last year. Soviet trade data for the first quarter of 1984 show a drop of more than $1 billion in West European deliveries, roughly a 20-percent decline over the same period last year. Limited data from Western Europe for the second quarter indicate that this trend is continuing. [redacted]

The first-quarter drop was due mainly to sharp cuts in deliveries of industrial supplies and machinery and equipment—down 34 percent in the case of West Germany and 33 percent for France. Shipments under Siberian gas pipeline contracts are virtually complete and, although delivery of equipment for projects contracted in the past few years continues, the level of orders is down partly because the current five-year plan is winding down. [redacted] 25X1

Western Europe's trade deficit with the USSR also has risen to past levels as purchases from the Soviet Union have held steady. For the first three months of 1984 the deficit hit $1.5 billion—almost four times the level of the same period in 1983. As they did last year, the Soviets have compensated for declining energy prices by boosting the volume of deliveries to Western Europe. During annual trade talks with the USSR, West European representatives complained about the deficit, but Moscow appears to be making no serious effort to expand imports. [redacted] 25X1

Soviet orders for West European equipment could pick up in coming years as Moscow firms up its next five-year plan. Some major projects under negotiation with West European firms include: 25X1

- West German bids on a $100 million coal slurry pipeline and a sour gas processing plant worth $200 million.
- A letter of intent with Italy for a $40-50 million polycarbonates plant and a deal to modernize Soviet motor vehicle facilities. 25X1
- French and Italian proposals to supply equipment for oil refineries costing $1 billion.
- Revised bids from a French–West German–Canadian consortium for a gas desulfurization project originally pegged at $250-300 million.
- Early talks with Norwegian and possibly UK, West German, French, and Italian firms on participation in a multibillion dollar offshore oil development project. [redacted] 25X1

Implications

With exports in 1984 likely to be down and given fairly gloomy domestic prospects, competition for the Soviet market is likely to intensify among West 25X1

European countries. Because Moscow is likely to insist on interest terms below the minimum specified in the OECD Export Credit Agreement, disputes over European observance of the agreement on official credits are probable and could be intense. Another point of contention will be the use of "contract rates"—the West German practice of granting a low interest rate to satisfy Soviet demands but compensating for it by higher prices. Likewise, clashes may increase within COCOM over approval of sales of strategic goods. [redacted] 25X1

[redacted] 25X1

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Libya: Qadhafi's Great Manmade River Project [redacted] 25X1

As Libya's over-extended water resources are rapidly becoming unsuitable for human or agricultural use, Libyan leader Qadhafi has staked considerable personal prestige on meeting domestic water needs with a massive water-relocation project—the Great Manmade River. Completion of this project—or even part of it—is increasingly doubtful because of Libya's weakened financial position, the ambitious nature of the project, and growing domestic discontent over the regime's wasteful economic policies. Without it the government will be forced to pursue costly desalination and strict water rationing to sustain minimal needs. [redacted]

The Project

Qadhafi last month inaugurated his long-awaited Great Manmade River Project, Libya's most ambitious project to date. Libya has long harbored dreams of tapping the huge inland water resources discovered in 1964 by a US petroleum company. It was not until 1980, however, that Tripoli appointed a British subsidiary of a US company as management consultant for the project. Last fall, Dong Ah, a South Korean construction firm, received a $3.3 billion contract for the project's first phase. Tripoli projects a total project cost of $11 billion, but independent estimates exceed $20 billion. [redacted]

Libya has stipulated that domestic construction materials be used whenever possible. Factories to produce the 75-ton pipe segments—the largest in the world—are under construction at Sarir and Marsa al Burayqah. A US company—under a $700 million contract—is supplying the equipment for these factories with an annual capacity of over 630 kilometers (km) of four-meter-diameter pipe.

[redacted]

25X1

The water for the scheme will come from wells to be drilled at Tazirbu, Sarir, and Al Kufrah in the east, and Sawkanah in the west. Gravity will move the water north to coastal areas. The precise origin of the project's water supply is unknown, [redacted] 25X1

25X1

The project will proceed in five separate phases:

- Phase I is the construction of two 1,800-km pipelines in eastern Libya from Tazirbu to a 4-million-cubic-meter reservoir at Ajdabiya and on to Banghazi by 1989. The two pipelines will be one-and-a-half-times longer than the Alaskan oil pipeline and about four times the diameter. This first phase will bring 3 million cubic meters of water per day from underground desert wells to Libya's coastal cities.

- Phase II includes the construction of a 450-km pipeline from the Sawkanah well field in the Fezzan to Tripoli—the Western Libya Water Project. Tripoli probably will ask for contract bids next year, a year behind schedule. 25X1

- Phase III will involve an extension of the Phase I pipeline to the Al Kufrah well field.

- Phase IV will use the added water provided from Phase III to support extension of the Phase I pipeline from Banghazi to Tobruk.

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- Phase V of the pipeline will connect the eastern system with the western portion by way of Surt.

A completion time of about 13 years is anticipated for the entire system. Capacity will be six million cubic meters of water per day. [redacted]

The Economic Impact on Libya

Libya's water supply is increasingly precarious. Coastal aquifers that supply the bulk of Libya's water suffer from saltwater encroachment because of overuse. Water shortages are a growing health concern, a source of consumer disgruntlement, and an obstacle to agricultural development. Libya had to import $500 million in foodstuffs last year—about 50 percent of domestic needs—primarily from Italy, the Netherlands, and Ireland. The decline in food imports since 1981—down from $1.1 billion—reflects Qadhafi's harsh austerity measures. [redacted]

Plans call for the creation of 180,000 hectares of new irrigated grain land along the coast—twice the current area—with planned yields of four tons per hectare. The area would also support two million sheep or 200,000 dairy and beef cattle. Industry experts, however, believe that these goals are optimistic. Previous attempts by the government to develop irrigated farming at desert sites have been unsuccessful. At Al Kufrah, for example, grain yields have been only half the two tons per hectare originally expected. Rain-fed areas along Libya's coast produce only half a ton per hectare. Even excluding transportation expenses, cereal-production costs on some irrigated land in Libya exceed the world-market price by at least five times. [redacted]

The pipeline does provide a cost advantage over alternative sources of fresh water currently in use such as desalination plants. The Libyan construction manager, Mohamed Mangoush, claims that water from such facilities costs at least $2 per cubic meter compared with the anticipated cost of water from the river project of 17 cents per cubic meter. The project's water also is of superior quality, having a low mineral content. [redacted]

Is There Enough Money?

We believe that Libya's weakened financial position will limit its ability to finance the Great Manmade River Project. The soft oil market has ravaged Libya's economy since 1980; export earnings of $11 billion are down by over 50 percent and foreign exchange reserves have plummeted 72 percent since 1981 to about $4 billion. Payments obligations on project contracts already awarded total about $700 million annually through 1989. The government has proposed a special direct tax on cigarettes, transportation, and luxury goods to provide as much as $1.5 billion in annual project financing outside the national budget—an added burden on a population already beset with harsh austerity measures. Press reports say that some salaries already have been reduced to meet project financing needs. [redacted]

The government claims that it will not need foreign financing for the project. [redacted]

Tripoli has met its payment commitments so far, including the initial $160 million installment to the South Korean contractor in January. The agreement with Dong Ah obligates the company to accept 25 percent of its fees in dinars to purchase Libyan goods. The contract has no provision for oil-barter arrangements [redacted]

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Prospects for Completion

Qadhafi probably will pull out all the stops to complete the Great Manmade River Project:

- He has made the project the centerpiece of Libyan development efforts. He probably views the project as a means to create a sense of national purpose and to revitalize his revolution at home.
- Libya's water shortage may become critical by the early 1990s.
- Timely completion of the project would offset a growing list of failed or delayed development schemes.
- The project is essential to Qadhafi's goals of agricultural self-sufficiency and the industrial development of coastal areas. [redacted]

Qadhafi's support of the project, in our judgment, will not overcome significant technical problems. [redacted] In addition, we believe that port facilities and transportation links are inadequate to handle the expected volumes of construction-related goods. Significant project delays will damage Qadhafi's personal prestige and may increase domestic discontent among groups already faulting Qadhafi for wasteful adventures and squandering the nation's wealth. [redacted]

Implications for the United States

Despite superior US expertise in pipeline construction, Qadhafi's primary motive in involving US firms in the project may have been to encourage an easing of US trade sanctions against Libya.[1] Qadhafi may hope that the presence of these firms in Libya will lead to division within the US Government over its Libyan policy. The use of US firms may also help Tripoli to exploit differences between West European countries and the United States over their disparate policies toward Libya. [redacted]

[redacted]

[1] US economic sanctions include a ban on US purchases of Libyan crude oil, the withdrawal of US oil companies and oil industry personnel, and a ban on US exports of military equipment and high-technology items with military applications. Washington also has the option of reviewing each export-license application for items that do not fall in the above categories. [redacted]

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