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Directorate of Intelligence

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International Economic & Energy Weekly

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5 October 1984

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International Economic & Energy Weekly [redacted] 25X1

Synopsis

1 **Perspective—*Implications of the IMF/IBRD Annual Meetings*** [redacted] 25X1

The joint annual meetings of the IMF and IBRD ended last week with a feeling of optimism among members of the international financial community. [redacted] 25X1

13 **Nicaragua: Declining Levels of Foreign Assistance** [redacted] 25X1

Most developed and Latin nations will continue to scale back aid as their government leaders become more pessimistic about their ability to buy political moderation in Managua. Although support from Communist nations is expanding substantially, we do not believe that it will fully compensate for the loss of Western and Latin funds. [redacted] 25X1

17 **Israel: Growing Union Militancy** [redacted] 25X1

The new Israeli Government cannot carry out any effective austerity program without the cooperation of the Histadrut, the powerful trade union organization. Histadrut leaders acknowledge the need for emergency measures to deal with Israel's rapidly declining foreign exchange reserves and 400-percent inflation rate. Histadrut leaders are coming under growing pressure, however, from younger union militants demanding more aggressive protection of worker interests. [redacted] 25X1

21 **USSR: Dependence on Western Equipment for Oil and Gas Development** [redacted] 25X1

Although the USSR has relied largely on domestic equipment in the production of crude oil and natural gas, it has turned to the West for selected high-quality equipment. Any embargo of technology by the developed West would raise Soviet costs and entail delays of 18 to 36 months before alternative supplies emerge. [redacted] 25X1

25 **India: Defense and Development** [redacted] 25X1

India has undertaken a massive modernization of its armed forces—fourth largest in the world—without straining its economy or hampering its development programs. Any increasing flow of more sophisticated and costly weapons from the Soviet Union and Western suppliers, however, is likely to aggravate India's foreign payments problems later in the 1980s. [redacted] 25X1

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5 October 1984

Perspective

Implications of the IMF/IBRD Annual Meetings [redacted] 25X1

The joint annual meetings of the IMF and IBRD ended last week with a feeling of optimism among members of the international financial community. A number of proposals were discussed and acted upon during the formal sessions, but the most significant developments occurred just before the start of the meetings. These events included a developed country proposal for a debt conference next spring and the signing of IMF letters of intent by Argentina and the Philippines. [redacted] 25X1

The convening of a debt conference—which has long been advocated by Mexico—was proposed by the United Kingdom at a meeting of G-10 finance ministers in Washington and at a meeting of Commonwealth finance ministers in Toronto during the week preceding the IMF/IBRD meetings. The initiative:

- Emphasized the need for creditors and debtors to discuss in a medium-term context external indebtedness, international capital flows, trade policies, and the role of surveillance in dealing with these issues.
- Underlined the importance of preparing now for the next phase of the debt crisis—restoration of LDC growth and development.

The IMF's Interim Committee endorsed the proposal and agreed to use the Committee's meeting next spring for the discussion. [redacted] 25X1

Agreement by Argentina and the Philippines to initial letters of intent with the Fund ended long and arduous negotiations with the two financially troubled countries. Following on the heels of the Mexican and Venezuelan debt restructurings, creditors—particularly commercial banks—were pleased that the current case-by-case approach to the debt problem is working. They emphasized, however, that they expect further difficult negotiations among themselves over new money and rescheduling for Argentina and the Philippines. [redacted] 25X1

The recent developments have eased tensions between debtors and creditors. At a time when debtor countries are seeking to politicize the debt issue and move it beyond the plane of basic creditor-debtor negotiations, the international financial community was able to point out the bright spots of the debt situation and illustrate that the issue is being handled. The call for the debt conference was strategically timed in that it both answered and defused debtors' calls for more drastic actions. Moreover, major US banks lowered the prime interest rate by 0.25 to 0.5 percentage point last week, answering another major complaint of debtors. [redacted] 25X1

Now that the major creditor governments have expressed their commitment to deal with the longer term aspects of the global debt situation, they have their work cut out for them. The establishment of a debt meeting under the auspices of the IMF next spring has bought some time, but creditors must work to resolve some of the problems facing debt-troubled countries or face a renewed round of debtor calls for more radical action. Among the issues that must be dealt with are protectionism, increased loans, aid, and investment to developing countries, and global interest rates. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

Spot Oil Market Trends

[redacted]

Spot crude oil prices have crept up slowly in the last few weeks, with prices for most crudes gaining 5 cents to 10 cents per barrel over the month of September. The spot price for Arab Light approximated $28 per barrel in early October—compared with its official price of $29—and spot prices for light African and North Sea crudes are now about $28.50 per barrel, about $1.50 below official levels. Spot prices for West Texas Intermediate have risen about 50 cents per barrel over the month; most of this increase probably is due to preliminary oil-inventory rebuilding following the onset of cooler weather. Preliminary data indicate that in recent months commercial oil stocks have held steady or declined slightly, compared with the normal seasonal third-quarter increase. As a result, inventories are about 3 to 5 percent below usual levels, and, as long as OPEC production does not significantly exceed demand, we expect spot prices to continue to strengthen in coming weeks as buyers move to replenish stocks. [redacted]

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Nigeria Bids for Another Production Increase

[redacted]

[redacted] The cartel granted Nigeria an increase of 100,000 barrels per day (b/d) above its assigned quota of 1.3 million b/d in August and a 150,000-b/d increase in September. Lagos was unable to take advantage of OPEC's reprieve in August, however, and oil output fell 250,000 b/d short of the target. As a result, Lagos in September resorted to aggressive marketing tactics, including bartering oil for $1 billion worth of Brazilian goods and equipment—a departure from its usual practice. Nigeria's output increased to the 1.45-million-b/d level allotted by OPEC in September. [redacted]

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If demand for OPEC oil remains weak in October, we believe Nigeria will meet strong resistance to an extension of its quota increase. Libya's representative to OPEC recently stated that Nigeria's reprieve was temporary [redacted]

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Algerian-French Gas Agreement

[redacted]

Sonatrach, the Algerian state oil and gas corporation, and the French utility, Gaz de France, have reached an agreement that allows for a 10-percent reduction in the volume of LNG that France was previously scheduled to import from Algeria, according to US Embassy reporting. High-ranking French officials have indicated that the agreement does not involve any price adjustments—Gaz de France is currently paying about $4.40 per million Btu

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including transportation and regasification—and that the question of Gaz de France's making up contractual volumes at a later date remains open to further discussion. The agreement reduces Gaz de France's annual contractual commitment of 9.1 billion cubic meters (bcm) by about 1 bcm and will help ease the current gas glut in France. The press reports that the utility's natural gas stocks exceeded normal levels by about 1 bcm last year, costing the company about $20 million to finance. The agreement reflects an apparent willingness on the part of the Algerians to make concessions rather than jeopardize relations with their largest customers and risk losing them to other natural gas suppliers over the long term. 25X1

Strong US Dollar Increases Crude Oil Costs

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The continued strength of the US dollar is still a major factor limiting oil demand in the developed countries. In March 1983, OPEC reduced crude oil prices by $5 per barrel to stimulate demand for oil and economic recovery. Because crude oil prices are denominated in US dollars, however, the appreciation of the dollar against West European currencies has largely offset lower dollar crude oil prices. Partially as a result of these increases, West European oil demand grew by less than 0.5 percent in first half 1984. In contrast, Japanese yen crude costs have declined 13 percent, contributing to an 8-percent increase in oil demand. 25X1

Crude Oil Cost Per Barrel *National Currency*

	February 1983	April 1983	August 1984	Percent Change August 1984/ February 1983
US (*Saudi benchmark, US dollar*)	34	29	29	−14.7
Japan (*yen*)	8,032	6,894	7,018	−12.6
France (*franc*)	234	212	258	10.0
West Germany (*DM*)	82	71	84	1.6
Italy (*lira*)	47,532	42,120	51,852	9.1
United Kingdom (*L*)	22	19	22	−0.5
Greece (*drachma*)	2,841	2,436	3,341	17.6
Netherlands (*guilder*)	91	80	94	3.8
Norway (*Nkr*)	242	207	240	−0.7
Spain (*peseta*)	4,412	3,940	4,791	8.6
Sweden (*Skr*)	253	217	241	−4.7
Turkey (*lira*)	6,622	6,007	11,248	69.8

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Turkish-Iraqi Pipeline

The Turkish State Petroleum Pipeline Company (BOTAS) expects to award preliminary design contracts in October for a second Iraq-Turkey crude oil pipeline, according to the US Embassy in Ankara. Turkish officials say the line will add 500,000 to 800,000 b/d to the existing capacity of 1 million b/d for Iraqi crude oil shipments through Turkey, and will be economical even if the Iraqi-Saudi pipeline is built and the Persian Gulf is reopened to Iraqi exports. Bidders have been asked to include financing plans in their proposals. Turkish enthusiasm for greater revenues from transit fees on Iraqi crude probably has caused BOTAS to take the lead in soliciting bids for this project. For its part, Baghdad is preoccupied with the Iraqi-Saudi pipeline. Moreover, even if the Turkish pipeline is built, Iraq's need for favorable financing is likely to delay Ankara's proposed January 1987 completion. [redacted] 25X1

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Construction of New Soviet Oil Production Platforms

The Soviets have begun constructing offshore oil production platforms at their new construction yard at Primorsk, although production buildings are not yet operational [redacted] production platforms being assembled manually. The new yard, the largest of its kind in the world, is being constructed with French technical assistance and will use French equipment. Annual capacity is estimated to be at least four deepwater platforms when the yard is fully operational, probably by late 1985. The output from this yard will greatly enhance Soviet capabilities for the production of oil and natural gas in deepwater areas of the Caspian Sea. [redacted] 25X1

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Australian Coal To Be Shipped To China

Australian coal is being shipped to China for the first time in 45 years. Press reports indicate that BP Australia recently signed an estimated $9 million contract to export steam coal to the People's Republic of China. The reports state that 250,000 metric tons will be shipped by the end of this year, and an additional 750,000 tons may be shipped in 1985. China is attempting to expand coal production and to develop a coal export capacity. Thus, we believe the deal is only an interim arrangement to meet essential needs. The contract underscores Australia's aggressive marketing efforts. Coal exports in 1984 are expected to exceed last year's record level of 61 million tons. [redacted] 25X1

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International Finance

Argentine Financial Update

[redacted]

Argentina's accord with the IMF will stave off the worst of the country's financial problems for now, but difficult negotiations with commercial creditors lie ahead. Buenos Aires will gain access to up to $1.6 billion in IMF lending once the Fund formally approves the stabilization package finally hammered out in September. According to the press, IMF Managing Director de Larosiere told the Argentines that he would recommend approval of the program if the country's creditors are willing to provide sufficient funding in support. [redacted] Late last month, Argentina repaid a $100 million bridge loan extended by US banks in March and $100 million toward the $1 billion in interest arrearages. Because of the Argentine actions, the banks agreed to roll over a $750 million bridge loan until 15 January and to open negotiations on rescheduling debts and new money. In the interim, Buenos Aires faces the difficult task of complying with its IMF program. [redacted]

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Senegal-IMF Negotiations Stalled

[redacted]

President Diouf's recent decision not to raise rice prices this year will defer any possible IMF standby agreement until at least early 1985. The US Embassy estimates that, without a Fund program and accompanying financial relief from donors and international creditors, Senegal will face a financing gap of nearly $100 million by yearend and fall further behind in meeting foreign debt obligations. Dakar reportedly is counting heavily on Saudi Arabia to provide about $50 million in budgetary support, but—according to IMF staffers—the Saudis are unlikely to disburse funds until Dakar comes to terms with the Fund. We believe that, at least for now, Diouf would rather face the loss of outside financial aid than risk adverse popular reaction to further food-price hikes as he prepares for local government elections this fall. [redacted]

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Global and Regional Developments

[redacted]

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Komatsu: Production in the United States

Japan's Komatsu Limited, the world's second-largest heavy equipment manufacturer after Caterpiller Tractor, plans to build bulldozers and other construction machinery in the United States. According to press reports, Komatsu is negotiating with several US construction-machinery firms to acquire existing manufacturing facilities and distribution links; if an agreement cannot be reached, Komatsu may build its own plant. The move underscores Komatsu's desire to increase its market share in the United States. It has 15 percent of the international construction-machinery market, but only 7 percent of the US market because of high transport costs and its limited dealer network. By establishing a US manufacturing base, Komatsu is aiming to double its share of the US market in the next five years.

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EC-China Trade Accord Signed

The European Community and China have concluded a second five-year trade agreement that establishes a broad framework for expanding economic relations but does not include specific deals or dollar amounts. The accord calls for increased investment opportunities for EC businessmen in China and foresees economic cooperation in agriculture, energy, and high technology. The Ten reaffirmed their intent to expand economic aid to Beijing, which last year totaled less than $5 million, but the near-bankrupt Community was unable to commit specific sums. Since the 1978 agreement, which extended reciprocal MFN treatment, total EC-China trade has grown about 50 percent to about $4.8 billion in 1983, with the balance slightly in favor of the Community. Major EC imports from China include textiles, clothing, and agricultural products; exports are mainly machinery, steel, and chemicals.

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West European Stock Prices Rise

Stock prices on the major West European exchanges rose in the third quarter. Gains were concentrated in export-oriented firms, particularly those benefiting from the dollar's rise and from continued strength in US import demand. According to the *Financial Times* All-Share Index, prices on the London exchange rose 9.8 percent, surpassing the 8.4-percent increase posted by New York's Standard & Poor's 500-stock index. Almost every stock with good export prospects gained in London. Consumer-oriented companies with strong markets in the United States fared particularly well on the Paris Bourse, pushing up the index by 5.3 percent. Led by chemical, machine-tool, and automotive firms that account for much of West Germany's exports to the US market, prices on the Frankfurt exchange increased 4.6 percent.

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USSR-Morocco Relations Warming

A visiting Soviet trade delegation is receiving unusually prominent press coverage and attention from high-level Moroccan officials, according to the US Embassy in Rabat. The two sides reportedly signed protocols to revive both a previous trade agreement and a joint venture to develop Moroccan phosphate. Meanwhile, discussions are continuing on a broader oil-supply arrangement and an agreement to increase trade. The USSR accounts for 4 percent of Rabat's foreign trade but supplies 20 percent of its oil.

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Soviet trade delegations have made annual visits to Morocco for many years. King Hassan probably arranged the increased press attention this year to demonstrate his eagerness to address deteriorating social and economic conditions. He also wants to improve trade with Moscow, particularly the sale of phosphates—Morocco's primary export—because of the growing trade deficit with Moscow and the weak international market for phosphates. [redacted] 25X1

Mexico Increases Exports to Cuba

[redacted]

Mexico's drive to increase exports to Cuba is working. First-quarter 1984 exports to Cuba reached $18 million, twice last year's average quarterly level. Expanded trade credits, which now total $90 million, are the primary factor boosting sales of light manufactures, including copper wire and clothing. Nevertheless, even with the recent surge in sales, Mexican exports to Cuba still constitute only 0.3 percent of Mexico's total merchandise exports. [redacted] 25X1 25X1

While Cuba lacks the market and hard currency to become a major importer of Mexican goods, Mexico City will continue broadening its trade relations with Havana. In part, this reflects Mexico's efforts to maintain its nonaligned credentials. Mexico City and Havana currently are negotiating an expanded bilateral trade pact to include tariff reductions and other measures to facilitate trade. [redacted] 25X1

National Developments

Developed Countries

British Concern About Unemployment

[redacted]

In a speech before the IMF last week, Chancellor of the Exchequer Nigel Lawson announced that the British Government will give top priority to the battle against unemployment, which is still rising toward 13 percent despite the economic recovery. New government measures will be consistent with Thatcher's noninterventionist strategy for managing the economy. Under consideration is a further deregulation of both labor and product markets to improve economic efficiency and spur job creation. Wage restraint will continue to be encouraged to stem the negative effect of rising labor costs on employment. Specific job-creation programs probably will not be considered. Government officials believe that this could jeopardize progress made so far in reducing government spending, inflation, and interest rates. [redacted] 25X1 25X1

Icelandic Labor Troubles

[redacted]

A growing number of labor disputes—newspaper printers and some state employees and teachers are already on strike—are disrupting the Icelandic economy. Union leaders are reopening industry agreements under the comprehensive 13.8-percent wage settlement negotiated with the government last February. Labor is demanding additional wage increases of 8 to 30 percent to compensate for losses since indexation was abolished in 1983. The center-right coalition government is threatening to mandate wage settlements to deter more strikes despite fears that such a move could provoke a crisis within the coalition. [redacted] 25X1 25X1

Less Developed Countries

NICs' Trade Surplus With Big Seven Increases

The six newly industrializing countries' (NICs) trade surplus with the Big Seven rose over 70 percent in first half 1984, reaching $9.7 billion. Most of the increase reflected gains by Brazil and Taiwan. Trade statistics for the Big Seven show that NIC exports to the Big Seven were up 25 percent from a year earlier; imports increased only 16 percent. While Singapore and South Korea are the only NICs with trade deficits with the Big Seven, a 40-percent jump in exports cut Singapore's first-half deficit to $1.8 billion. Taiwan and South Korea followed with increases of 37 and 35 percent, respectively. 25X1

NICs: First-Half Trade Balance With Big Seven [a]

Billion US $

	First Half 1983	First Half 1984
NICs		
Exports	**35.5**	**44.5**
Imports	**29.9**	**34.8**
Balance	**5.6**	**9.7**
Brazil		
Exports	5.2	6.7
Imports	2.8	2.9
Balance	2.4	3.8
Hong Kong		
Exports	5.1	6.0
Imports	4.9	6.0
Balance	0.2	0.0
Mexico		
Exports	9.8	10.8
Imports	5.4	7.0
Balance	4.4	3.8
Singapore		
Exports	2.5	3.5
Imports	5.3	5.3
Balance	−2.8	−1.8
South Korea		
Exports	5.5	7.4
Imports	6.5	7.7
Balance	−1.0	−0.3
Taiwan		
Exports	7.4	10.1
Imports	5.0	5.9
Balance	2.4	4.2

[a] Both import and export data are valued f.o.b. NIC exports were derived by dividing Big Seven imports from the NICs by 1.1; NIC imports were obtained by using Big Seven export data.

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Drought Cuts Pakistan's Wheat Harvest

Drought reduced wheat production by 10 percent to 11 milliion tons during the fiscal year that ended 30 June. The drop in output already is causing higher prices—wholesale wheat prices in Lahore have increased by 16 percent from a year earlier and open-market prices for flour in Karachi are about 50 percent above the price in government ration shops. The government is planning to fulfill its export commitment to Iran but is not making additional export sales. Islamabad claims the bad harvest will make advances of wheat to the Afghan 25X1 refugees more difficult. The US agricultural attache believes the government will have to import 600,000 tons of wheat to supply ration shops, maintain adequate buffer stocks, and retain some flexibility to moderate price increases. The adverse trade impact will add to the deterioration in the current account caused by a decline in workers' remittances. [redacted] 25X1

Malaysian Bank Rescue Attempt

[redacted]

Malaysia's national oil company, Petronas, plans to acquire the financially troubled Bank Bumiputra—the country's largest commercial bank—from another government corporation. Malaysian officials hope the takeover by the highly profitable Petronas will strengthen public confidence in the bank, which last July assumed responsibility for about $1 billion in bad loans incurred by its Hong Kong subsidiary. The bailout, however, faces possible legal obstacles. Opposition politicians and a leading Malaysian lawyer contend that Petronas's parliamentary charter prohibits investment in any venture that is not directly related to the petroleum industry. If the Petronas bid is blocked, the Malaysian Government would be hard pressed to find another rescuer and could be forced into providing the bank with a direct infusion of funds—a move that would be politically controversial for Prime Minister Mahathir. [redacted] 25X1 25X1

Nigeria's Disaffected Private Sector

[redacted]

Overtures to the beleaguered private sector by General Buhari's military regime were recently rebuffed. Attendees at a government-sponsored conference were sharply critical of government import licensing and foreign exchange policies that threaten import-dependent industries and favor fly-by-night businesses over established enterprises. Private-sector arguments were strengthened when for several weeks the central bank did not release any foreign exchange for imports. The regime's offer of five-year, no-interest promissory notes to cover outstanding government debts to local firms was rejected outright by the firms, even though most companies apparently believe they eventually will be forced to accept the arrangement. [redacted] 25X1 25X1

Ecuador Begins Economic Liberalization

[redacted]

According to US Embassy reports, Ecuadorean President Febres-Cordero is gradually implementing free market policies. In the first eight weeks of this administration, domestic economic policy changes have focused on the easing of widespread price controls. While seven essential consumer items will remain subject to price ceilings, most product prices will be determined by market forces. We judge that the move is consistent with Febres-Cordero's plan to decrease government intervention and make the economy more competitive. The government hopes the immediate inflationary impact of price liberalization will be offset by new investment and increased production over the longer term. [redacted] 25X1 25X1

More Austerity Under New Panamanian President

President-elect Barletta plans to tighten Panama's austerity program to gain additional support from the IMF, World Bank, and commercial creditors when he takes office on 11 October. Agreements for a new standby loan and subsequent external debt rescheduling will be necessary if Panama is to

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continue servicing its debt, which is equal to 85 percent of GDP. The new measures—including reductions in consumer subsidies and cuts in public-sector spending—will be strongly resisted by opposition groups and the left wing of the ruling party. We expect that Defense Chief Noriega, the military strongman who handpicked Barletta, will probably support Barletta's initial efforts. [redacted] 25X1

Communist

Soviet Grain Harvest Lagging

According to data released by Moscow last week, the grain harvest is now two weeks behind the average pace of the past five years. By 24 September, Soviet farmers had cut only about 101 million hectares of grain compared to the average of nearly 110 million hectares for 1979 to 1983. The latest slowdown has been caused by a combination of unfavorable weather in the northern Urals and late-maturing crops in Siberia. Because some 1 to 2 million hectares of grain probably will not be harvested, total Soviet grain production is now expected to be only about 180 million tons. This would be 15 million tons less than the estimated output last year and 60 million tons below the target. The crop could be even smaller if the weather deteriorates markedly during the next few weeks, but there is little probability that it will drop to the 160-million-ton level estimated by a Soviet trade official in mid-September. [redacted] 25X1

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Soviet Meat Production Up

Meat production is almost certain to reach or slightly exceed government goals for the second consecutive year. Published production figures for the first eight months of this year indicate that Soviet meat production increased 7.6 percent over the comparable period in 1983. The growth in meat output this year is due largely to a record harvest of forage crops last fall, a second consecutive mild winter that reduced the demand for feedstuffs, record livestock inventories, and near-peak grain imports. [redacted] 25X1

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The Soviets could achieve a slight increase in consumer meat consumption if meat imports remain high, but they may choose instead to rebuild low meat inventories. The impact on meat production of this year's poor grain crop will be felt mainly next year. [redacted] 25X1

1984 Soviet Gold Sales

[redacted] Moscow has sold about 50 metric tons of gold as of mid-September, compared with the 60 metric tons we estimate the USSR marketed in calendar year 1983. The pace of sales probably reflects continuing improvement in Moscow's hard-currency position. In first half 1984, the USSR ran an unprecedented surplus in its trade accounts, the result of continuing high levels of energy exports. While Soviet cash requirements will be higher in the second half of the year—agricultural purchases alone could be perhaps $1 billion higher than in the January-June period—other alternatives allow Moscow to avoid depressing prices by selling

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gold in an already thin market. In addition to sizable cash reserves, the USSR has been generating syndicated loans among West European banks, and tapping its own overseas banks for credits to finance grain purchases. 25X1 25X1

Cuban Sugar Outlook

Cuba continues to set ambitious sugar production targets despite adverse domestic conditions and a world sugar glut that has sent prices to 13-year lows. 25X1 Production in 1983/84—a near-record high of 8.2 million metric tons—still fell short of Havana's 9-million-ton target largely because of equipment failures, fertilizer shortages, and unseasonable rains. Because of the premature harvesting of seed cane last year, delayed planting this year, and the spread of cane diseases, output in 1984/85 probably will fall well below the 10-million-ton target. Moreover, Havana's highly touted goal of producing 12 million tons of sugar by 1990 is regarded by most industry analysts as an overly optimistic propaganda ploy. 25X1

Havana's apparent decision to devote massive resources to sugar production over the next few years probably was influenced heavily by Moscow and is likely to be reflected in the 1986-90 CEMA plans now under consideration. The Soviet Union—which purchases at premium prices more than half of Cuba's sugar exports—reportedly rebuffed Havana's longstanding desire to cut its economic dependence on sugar. 25X1

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Nicaragua: Declining Levels of Foreign Assistance [redacted]

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Financial assistance to Nicaragua from non-Communist countries has begun to decline. With a few exceptions, we believe that most developed and Latin nations will continue to scale back aid as their government leaders become more pessimistic about their ability to buy political moderation in Managua. Although support from Communist nations is expanding substantially, we do not believe that it will fully compensate for the loss of Western funds. Loss of foreign financing will further depress living standards, intensifying already widespread popular discontent over the economy. The Sandinista Directorate will use a combination of carrot-and-stick tactics to try to forestall the spread of strikes and other antiregime demonstrations. To the extent that Western governments perceive increased internal repression, we believe they will tend to scale back aid even further, helping to perpetuate the cycle. [redacted]

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Latin Support Tumbles

Financing from Latin American nations beset by financial crisis has fallen dramatically this year, largely because of concern among leaders in the region about the regime's repressive policies and its closer ties with Cuba and Eastern Europe. We expect Latin American economic support to reach $135-145 million this year, compared with about $220 million in 1983. We project a further decline in the total again next year. [redacted]

Mexico, Nicaragua's largest Latin donor since the 1979 revolution, has slashed its aid from about $150 million in 1983, to at most $90 million this year. We believe President de la Madrid's cutback was prompted by his willingness to respond to US concerns, by Mexico's financial problems, and by his dissatisfaction with the direction of the Nicaraguan revolution. The major cut has been in Mexican oil shipments, which until 1984 had been financed by credits that neither side anticipated would be repaid. We expect that Mexican oil shipments this year will reach at most $80 million, down from roughly $130 million last year. [redacted]

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Nicaragua: Current Account Balance, 1983-84 *Million US $*

	1983	1984
Current account balance	**−750**	**−755**
Trade balance	−555	−555
Exports (f.o.b.)	400	390
Coffee	157	140
Cotton	108	110
Imports (c.i.f.)	955	945
Oil	130	150
Weaponry	105	150
Services balance	−195	−200

[redacted]

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Financing from **Venezuela** and **Brazil**, substantial donors in the early years of Sandinista rule, fell to about $10 million each in 1983 and probably will total roughly $5 million each this year. Nicaragua's credit lines with Brazil are exhausted and are not likely to be renewed. [redacted]

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[redacted] Venezuelan President Lusinchi's strong opposition to Sandinista policies probably precludes a resumption of any major assistance. [redacted]

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Argentina is the only Latin American nation to have substantially increased its credits this year, and those seem likely to be cut back after November. President Alfonsin, arguing that economic leverage might induce the Sandinistas to open the political process, agreed in March to a $45 million line of credit. Argentine aid had previously been limited to a $15 million credit line extended in appreciation for Nicaragua's support during the 1982 Falklands war. Should Managua adopt more repressive tactics after the November elections, Alfonsin, in turn, probably would discreetly scale down disbursements under the current credit and take a harder stance in the future. [redacted] 25X1

Slowdown From the West

Economic support from the West has passed its peak, but will decline more slowly than Latin financing. We estimate that assistance from Western industrial nations will total at best $80 million this year, down about $8-10 million from 1983, and that it will decline again next year. [redacted] 25X1

Few leaders of Western industrial nations remain persuaded that their assistance can be used as leverage to induce the Sandinistas to adopt a different political course. For some, however, small financial gestures to the Sandinistas will remain a relatively cheap way to shore up domestic support from the left. [redacted] 25X1

The **Netherlands** committed itself in 1981 to a five-year reconstruction program disbursing $10-15 million per year. The Hague, however, recently told US officials that it will phase out its aid almost completely after the program expires next year, largely because of dissatisfaction with Sandinista political and military policies. In August, Dutch officials decided to step up their assistance to Costa Rica. [redacted] 25X1

Nicaragua: Projected Official Foreign Financing, 1984 *Million US $*

Total	**662-686**
Western Europe	71-80
Austria	2-3
Finland	4
France	18
Italy	2-4
Netherlands	14-18
Norway	8
Spain	10
Sweden	11
West Germany	2-4
Western Hemisphere	148-158
Argentina	25
Brazil	5
Canada	13
Colombia	5-10
Mexico	90
Peru	5-10
Venezuela	5
Other	47
Algeria	14
Iran	27
Japan	3
Taiwan	3
Communist countries	370
For:	
Oil	85
Weapons	150
Other	135
Multilateral	26-31
World Bank	2-6
Inter-American Development Bank	20
European Economic Community	3-4
UN Food and Agriculture Organization	1

[redacted] 25X1

Financing from **West Germany,** which averaged about $19 million annually during 1979-81, will also disappear. West German officials have told the US Embassy that no new commitments will be made. Like the Dutch, German officials have told US diplomats that this policy shift is motivated in

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large part by the Sandinistas' failure to allow political pluralism. [redacted]

Spain has been one of Nicaragua's most consistent financial supporters, disbursing by our estimates $10-20 million in supplier credits and humanitarian aid every year since 1979. Madrid also rescheduled Managua's $62 million bilateral debt in early 1981 on fairly easy terms, and forgave $2.3 million in overdue interest, according to the US Embassy in Managua. Madrid's current program—a $45 million, three-year line of supplier credits—will expire in 1986. Nicaragua has been trying to negotiate a second, $5 million line from Madrid, but reporting from reliable sources indicates that officials are frustrated with the slow pace of negotiations. [redacted]

We doubt that Madrid will grant the additional credits soon or be willing to renew the $45 million package after the current one expires. Since it was announced in mid-1983, we believe that Prime Minister Gonzalez has become increasingly disillusioned about the nature of Sandinista rule. Moreover, we believe that Gonzalez—like Argentina's Alfonsin—might discreetly slow the pace of disbursements should there be a return to substantially tougher domestic policies after the upcoming Nicaraguan elections. Thus, we project that Spanish financing in 1984 will probably total $10 million, in contrast to an estimated $15-20 million last year. [redacted]

We expect **French** support, however, to remain at roughly the same level this year as last—an estimated $18-22 million. Should plans for a new geothermal project go forward next year, Paris would lend $9 million toward its cost, and probably provide some $10 million in other assistance. Foreign Minister Cheysson, however, has made statements increasingly critical of the Sandinistas in recent weeks. We believe that this emerging concern over Nicaragua's political direction will, at a minimum, preclude Paris from significantly increasing its financing, and perhaps induce a gradual decline. [redacted]

France is the only West European power to have granted military assistance—$16 million in a mix of credits and grants in 1981. There is little prospect that more French military aid will be forthcoming. [redacted] 25X1

Aid from **other Western nations** will remain roughly constant this year. Austrian aid amounting to $8 million in 1983 probably will not be repeated this year. Canadian assistance could approach $13 million, roughly double 1983 levels, but almost half the money is to go for a water-purification project and does nothing to ease Managua's most pressing problems of paying for consumer and industrial imports. [redacted] 25X1

Declining Multilateral Aid

25X1

Prospects of substantial funding from multilateral sources are increasingly poor. Nicaragua is $10 million in arrears to the International Monetary Fund, which this summer cut off Nicaragua's access to Fund resources. Similarly, Managua's roughly $7 million arrearages to the World Bank recently prompted Bank management to declare Nicaragua in default—the first such case in Bank history, according to US officials. Bank rules specify that no disbursements can be made to countries in default. [redacted] 25X1 We believe that roughly $3 million is being held up by the default. 25X1 Disbursements from the Inter-American Development Bank will probably total about $20 million in the year ending June 30, 1985, down from the previous year's $33 million. [redacted] 25X1

The Soviet Response

We expect total Communist financing to reach $370 million this year, compared with $270 million in 1983. Moscow and its allies have increased their support substantially this year, in part to help compensate for the decline from other sources. Moscow's decision to make up entirely for the 25X1 decline in Mexican oil deliveries is the major factor in the increase. We estimate that Soviet oil deliveries will total $85 million this year, up from just $2 million in 1983. In a marked departure from usual Soviet policy, we believe that Moscow is requiring little or no immediate payment for the petroleum. It seems most unlikely that Managua will repay any substantial part of its debts to the USSR over the next several years. We expect disbursements of nonoil economic assistance from the Communist countries to reach $135 million this year, down slightly from about $165 million in 1983. This consists mainly of supplier credits for manufactured goods, but also includes substantial technical assistance and some donations of foodstuffs and fertilizers. In addition, we have noted a few instances of loans or donations of hard currency from Cuba, but believe that these remain relatively small. We estimate that Communist financial assistance for military purchases will top $150 million. [redacted]

In general, however, Communist help is a poor substitute for Western assistance. A shipment of Soviet aviation fuel, for instance, was [redacted] of such poor quality that it damaged airplane engines. [redacted] persistent problems with the quality of Communist-origin goods. The quality of technical assistance also appears to be inferior. [redacted]

Uncertain Support From the Middle East

Although three Middle Eastern nations have provided economic support in the past, we do not believe that any of them will be reliable in the future. In 1983, **Algeria** agreed to pay preferential prices for Nicaraguan sugar after the United States slashed Managua's sugar quota. [redacted] We doubt that Algeria will provide substantial new aid in the future. [redacted]

In both 1982 and 1983, **Iran** lent Nicaragua roughly $27 million by allowing Nicaragua to resell a tanker load of Iranian crude and deferring payment until 1985 and 1986. [redacted]

[redacted] 25X1

Implications

On balance, we doubt that Communist aid will fully compensate for the decline in aid from other sources. These trends will markedly affect both living standards in the short run and the country's industrial base over the longer term. [redacted] 25X1

Discontent over worsening living standards erupted in work stoppages in August and September, shortly after the regime restored the right to strike. The Sandinistas have taken a hard line, however, threatening to declare one strike illegal and refusing to negotiate on several others until workers returned to work. Rather than again revoking the right to strike after the elections, and incurring additional international disapproval, we expect the regime to continue with the less visible, but still hardline, tactics it has used recently. The Sandinistas are likely to attempt a strategy of dividing the workers by providing substantial pay raises to nonstrikers. As living conditions continue to worsen, however, and most wage hikes are wiped out by inflation that will approach 90 percent this year, we expect more labor unrest, and open opposition from small business. [redacted]

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These problems will be aggravated by the Sandinistas' unwillingness, or inability, to revive the economy. We foresee little if any change in domestic policies that have consistently increased the government's role in business and claimed additional sectors of commerce and industry as the exclusive preserve of the state. [redacted]

[redacted]

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Israel: Growing Union Militancy 25X1

The new Israeli Government cannot carry out any effective austerity program without the cooperation of the Histadrut, the powerful trade union organization. Histadrut leaders acknowledge the need for emergency measures to deal with Israel's rapidly declining foreign exchange reserves and 400-percent inflation rate. Histadrut leaders are coming under growing pressure, however, from younger union militants demanding more aggressive protection of worker interests. Increasing militancy within individual unions belonging to the Histadrut was most recently demonstrated in July, when the engineers and the academics won the right to negotiate separate wage agreements with the government. Histadrut Secretary General Kessar faces a Histadrut reelection campaign early next year and, as a result, probably will be reluctant to support government proposals on economic austerity that could spark major Histadrut divisions.

One More Obstacle

Prime Minister Peres's new national unity government has approved in principle spending cuts of $1 billion and wants to negotiate an agreement with the Histadrut to restrain wages. Talks are likely to focus on real wage cuts, reducing the cost-of-living adjustment formula, and unemployment. Histadrut leaders are already expressing concern about increasing unemployment, up from 5 percent at the end of 1983 to 5.9 percent at the end of June.

Disagreement within the Histadrut over the issues of high unemployment or lower real wages will make it even harder to reach a "package deal" with the new government on wages, prices, and taxes. Histadrut Secretary General Kessar recently told a US Embassy officer that he was committed to working out such an arrangement. He has indicated that workers would be prepared to accept a sacrifice in real income, perhaps in the 7-percent range. Another Histadrut official, however, has said that the price labor would be willing to pay as its part of a "social contract" would be to forgo additional real wage gains. He said that higher unemployment and lower real wages are not acceptable. 25X1

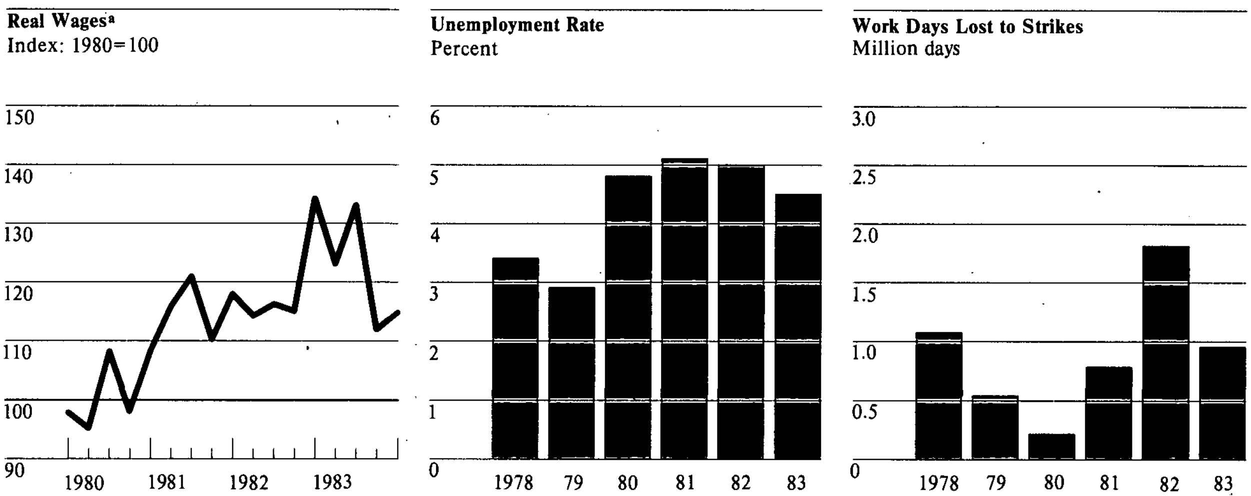
The militants sense that Histadrut has the upper hand in wage negotiations because they believe the new government will give way in the face of threatened widespread labor unrest. This perception was recently reinforced when, to dampen Israel's spiraling inflation, former Finance Minister Cohen-Orgad announced in mid-August that he would not adjust tax brackets when cost-of-living increases were paid on 1 September, but he backed down in the face of threatened strikes. The Histadrut traditionally has had a strong bargaining position, enabling it to win real wage increases averaging 6.9 percent annually since 1976. 25X1 Histadrut represents about 90 percent of the civilian labor force and has benefited from a tight labor market—the average unemployment rate since 1968 has been slightly less than 4 percent. 25X1

Signs of the Times

Histadrut's control over its member unions is being challenged. In recent years, several unions have engaged in strikes and other work actions in defiance of the Histadrut leadership, including: 25X1

- Strikes by teachers calling for implementation of a 1979 government-commissioned report that recommended salary hikes of 30 to 60 percent.
- Stoning of Histadrut headquarters in December 1981 by diamond workers because the Histadrut leadership did not support union demands for a 70-percent wage increase.

Israel: Labor-Market Indicators



[a] Quarterly data.
[b] Estimated.

[redacted] 25X1

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- Wildcat, work-to-rules action in late 1983 for higher wages by Haifa and Ashdod longshoremen, who ignored Histadrut requests that they go back to work. [redacted]

Wildcat strikes in September 1982 by workers at El Al, the national airline, caught Histadrut leaders in a no-win situation, according to reporting from the US Embassy. Histadrut leaders felt obliged to support the El Al workers, but at the same time they recognized that their demands were unreasonable. After several months of labor chaos, the government took over the airline, leaving the Histadrut with the task of negotiating the terms of layoffs and severance pay from a position of weakness. [redacted]

The Histadrut opposed the long doctors' strike in 1983 that included hunger strikes. Histadrut officials did not want the doctors to receive a pay hike in excess of the 22 percent given to other public-sector workers. In a departure from previous policy, the Histadrut called for binding arbitration. The arbitrators awarded the doctors a pay hike of 60 percent. [redacted] 25X1

In July, unions representing engineers and academics won the right to negotiate separately a new wage scale with the Finance Ministry after threatening to withdraw from the Histadrut. Traditionally, wage scales are linked so no group of workers obtains an "unfair" salary advantage over others. [redacted] 25X1

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Kessar's Dilemma

Union militants believe that Histadrut's senior leadership should more aggressively protect and even expand worker benefits. These younger leaders, particularly in government-sector unions that would be the most directly affected by an austerity 25X1 program, will resist Histadrut acquiescence to any agreement that would lead to loss of jobs or purchasing power. An additional complicating factor is that many of the militants are Sephardis, Jews of Middle East and north African origin, who resent the dominant role of Ashkenazi Jews of European ancestry in the Histadrut. Kessar, who took office in May and is himself a Sephardi, will be especially sensitive to charges that Sephardi workers are bearing the brunt of economic retrenchment. [redacted]

Histadrut leaders have not been completely insensitive to growing union militancy, but their response has been inadequate. In 1981, for example, Kessar's predecessor attempted to appease the rank and file by granting discounts to members patronizing Histadrut business enterprises. This response did little to address union militants' demands. [redacted]

The agreement allowing the academics and engineers to negotiate their own wage scales presents an additional challenge to Histadrut leaders. If these unions successfully negotiate large pay hikes, other unions whose wages are linked to the academics or engineers will demand similar increases. The Histadrut either will have to acquiesce to these demands or risk playing a substantially reduced role in wage bargaining. [redacted]

Outlook

Kessar's priorities in dealings with the government are to ensure that:

- A high level of employment is maintained.
- The burdens of austerity are shared equitably by all segments of society.
- The government carries through on all parts of the agreement. [redacted] 25X1

Reaching an agreement with Finance Minister Modai will be difficult for Kessar. Most of the economic portfolios, including finance, are in the hands of the Likud bloc, and Kessar has long suspected that Likud is out to destroy the Labor Party–dominated Histadrut. [redacted] 25X1

The risk of provoking further union alienation—particularly with the Histadrut election approaching—will constrain Kessar's room for maneuvering in negotiations with Modai and other government leaders. In response to the 16.5-percent increase in the consumer price index in August, Kesser made clear that he opposes any tampering with Israel's pervasive system of indexing wages to the country's galloping 400-percent inflation rate. This is a key structural problem at the heart of Israel's economic crisis, and without progress in this area, the government's austerity program is unlikely to succeed. 25X1
[redacted] 25X1

Unless Kessar adopts the militants' agenda as his own, the Histadrut could become a more fragmented institution over the long term. Kessar has a good reputation within the Histadrut as a trade union negotiator; indeed, many officials had been urging his predecessor to step aside in favor of Kessar for a number of years. But his popularity could quickly erode if the rank and file comes to believe he is not protecting worker interests. Nevertheless, the Histadrut survived seven years of Likud-led governments as well as colorless, inept leadership by Kessar's predecessor. Histadrut's pervasive influence throughout the Israeli economy probably will give the institution a central role to play for some time to come. [redacted] 25X1 25X1

[redacted] 25X1

USSR: Dependence on Western Equipment for Oil and Gas Development

25X1

Although the USSR has relied largely on domestic equipment in the production of crude oil and natural gas, it has turned to the West for selected high-quality and state-of-the-art equipment and technology to obtain higher operating performance and more reliable service. During the remainder of the 1980s, however, Soviet oil and gas development will depend increasingly on imports of Western equipment and know-how. Especially important will be advanced equipment for exploration, deep drilling, fluid lift, development of sour gas deposits, oil refining, and offshore operations. Any embargo of technology by the developed West would raise Soviet costs and entail delays of 18 to 36 months before alternative supplies emerge.

Impact of Western Oil and Gas Equipment

During the 1970s, the USSR purchased $5 billion of Western oil and gas equipment. The impact of these imports was important because the imported equipment was used to cover shortages or to cope with difficult technical problems.

Drilling Equipment. High-quality drill pipe, tool joints, and bits for deep drilling have been increasingly vital. Purchases of such equipment from US, Japanese, and West European firms in recent years have allowed the USSR to drill deep wells that now account for 5 to 10 percent of its oil production and roughly 20 percent of natural gas output.

In 1978 the Soviets purchased a turnkey drill-bit plant from a US firm. Soviet bits are usually one-fourth or less as efficient as Western bits of comparable design. The US-designed bits should operate for substantially longer periods at the high rotational speed of Soviet turbo-drills. We estimate that improved service life provided by the US-designed bits could permit a 5-percent increase in drilling meterage with no increase in the number of rigs. Such an increase in drilling meterage could raise oil output 70,000 to 90,000 b/d higher than if conventional Soviet-made bits were used. 25X1

Production Equipment. Approximately 1,200 high-capacity submersible pumps were purchased from US firms during the 1970s. Most of these pumps probably were installed in wells where the water cut—that is, the water content of each barrel of fluid produced—was about 50 percent. At the best fields, these pumps were being operated for three to six months before a major overhaul was required. We estimate these US pumps could have accounted for 500,000 to 1 million b/d of oil production 25X1 annually during the latter half of the 1970s. This is roughly the amount of oil exported to hard currency countries during this period. 25X1

In 1978 the Soviets undertook to expand gas-lift operations in West Siberia. A French firm contracted to install an array of Western production equipment—gas compressors, manifolds, valves, and controls—for 1,800 wells at the USSR's largest field, Samotlor. 25X1 Similar equipment was purchased for 600 wells at the USSR's second-largest field, Fedorovo. The Samotlor project is at least three years behind schedule because of construction delays. The Fedorovo project is nearing completion but is experiencing operating problems. If installed on schedule, the gas-lift equipment could have provided 200,000 to 300,000 b/d of additional oil 25X1 output beyond that otherwise expected from these fields. But, because of the delay, the window of opportunity for the most effective use of this equipment may have been missed: the water cut at Samotlor exceeded 50 percent in 1983 and is now higher than optimal for maximum oil recovery. 25X1

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Offshore Equipment and Technology. Most of the modern equipment and technology employed in Soviet offshore oil and gas exploration and production has been either purchased from the West (largely US design) or reproduced from technology supplied by Western firms. The Soviets have built five jack-up rigs copied from a Western-built unit imported in 1967. Their first semisubmersible rig was built in Finland, incorporating technology and components supplied by US firms. It was completed in 1980 and placed in operation in the Caspian Sea early in 1982. Three additional semisubmersible rigs of this type have been built at a French-equipped assembly yard at Astrakhan and are now operating in the Caspian Sea.

A joint agreement is being sought with Western firms for development of Barents Sea petroleum deposits. Large-scale development could be a multibillion-dollar undertaking involving massive infusions of Western technology and equipment.

Pipeline Construction and Equipment. As the Soviets expanded their large-diameter gas pipeline network, domestic capacity to produce suitable gas turbines was inadequate. As a result, the USSR relied on US and West European firms to supply gas turbines and spare parts for a substantial number of compressor stations. During the 1970s, the West supplied approximately 300 gas turbines with capacities from 10 to 25 megawatts (MW). These imports accounted for about 15 percent of the aggregate power installed on gas transmission pipelines of all sizes during 1971-80.

On the recently built Siberia–to–Western Europe gas export pipeline, the USSR originally contracted with Western firms to supply 120 25-MW and five 10-MW heavy-duty industrial gas turbines of US design. Because of the US embargo, however, the USSR decided to equip some of the compressor stations with Soviet turbines.

Alternative Western Suppliers

As US sales of petroleum equipment and technology to the USSR plummeted in recent years, suppliers in Western Europe, Japan, and Canada have aggressively taken up the slack. Available statistics show that Soviet contracts for Western oil and gas equipment peaked sharply in 1981, when large orders were signed for the Siberia–to–Western Europe gas pipeline. Since then the value of new orders has tumbled from $4.3 billion in 1981 to $1.3 billion in 1982 to only $825 million for 1983.

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The Role of Technology Transfer Through 1990

The USSR will encounter much more complex geologic conditions as it seeks to discover and develop deeper oil and gas deposits. The difficult operating environment will pose a challenge to the Soviet equipment manufacturing already unable to provide advanced high-quality equipment. 25X1

We believe future purchases will cluster into several broad categories: 25X1

- Deep-drilling equipment and technology.
- Fluid-lift and oil-treatment equipment.
- Offshore equipment.
- Computers and automated-control technology.
- Specialized corrosion-resistant drilling and production equipment for high-pressure, high-temperature service.
- Gas pipeline equipment. 25X1
- Secondary oil-refining equipment.
- Gas-processing equipment. 25X1

The denial of Western equipment would require the Soviets to allocate more investment to industries manufacturing oil and gas equipment and would make energy production more difficult and costly. The completion of the gas export pipeline ahead of schedule is one indication of Soviet willingness to devote resources to what Moscow considers high-priority projects. Moreover, the capabilities of not only Soviet industry but also of other potential new suppliers of oil and gas equipment such as Argentina, Mexico, Brazil, and Singapore are improving rapidly. In the event of a future US embargo of oil and gas equipment and technology to the USSR—or even a multilateral embargo by the United States and other developed Western countries—the impact is likely to be limited to 18 to 36 months before new production capacity emerges elsewhere.

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India: Defense and Development [redacted] 25X1

India has undertaken a massive modernization of its armed forces—the fourth largest in the world—without unduly straining its economy or hampering its development programs. New Delhi's reliance on less expensive Soviet weaponry and an increased use of domestically produced arms have resulted in only a slow rise in real defense spending in recent years. An increasing flow of more sophisticated and costly weapons from the Soviet Union and Western suppliers, however, is likely to aggravate India's foreign payments problems late in the 1980s. [redacted]

Security Environment

Perceived threats from traditional foes such as Pakistan and China, as well as increased superpower presence in the region, have led India to increase the size of its forces, speed up its modernization program, and expand domestic defense production. We believe that New Delhi—by far the strongest power in South Asia—envisages a greater military role for itself in the Indian Ocean. They also are increasing military ties—largely assistance and training—with various Middle Eastern, African, and Southeast Asian nations. [redacted]

Moderate Defense Expenditure

Since FY 1980 (April-March), India's defense expenditures in real terms have risen at an average annual rate of only 3 percent, reaching an estimated $6 billion in FY 1983, according to official data. Defense expenditures have averaged about 3.5 percent of GNP, and about 17 percent of central government expenditures. [redacted]

Official budget data under the "defense" heading, however, probably understate actual defense costs. For example, they do not include loans and grants to India's defense industries and research institutes, or maintenance expenses for the large paramilitary forces. [redacted] actual aggregate defense outlays could be as much as 20 percent higher than official spending estimates. [redacted] 25X1

25X1

Although the million-man Indian Army continues to receive the largest portion of the budget, an increasing share of India's defense outlays have gone to the Air Force and Navy. New Delhi has purchased large numbers of modern aircraft and naval combatants over the last 10 years to extend force capabilities in the region. The Army's share of the defense budget declined from about 73 percent in FY 1974 to an estimated 65 percent in FY 1983. [redacted] 25X1

25X1

Foreign Buying Spree

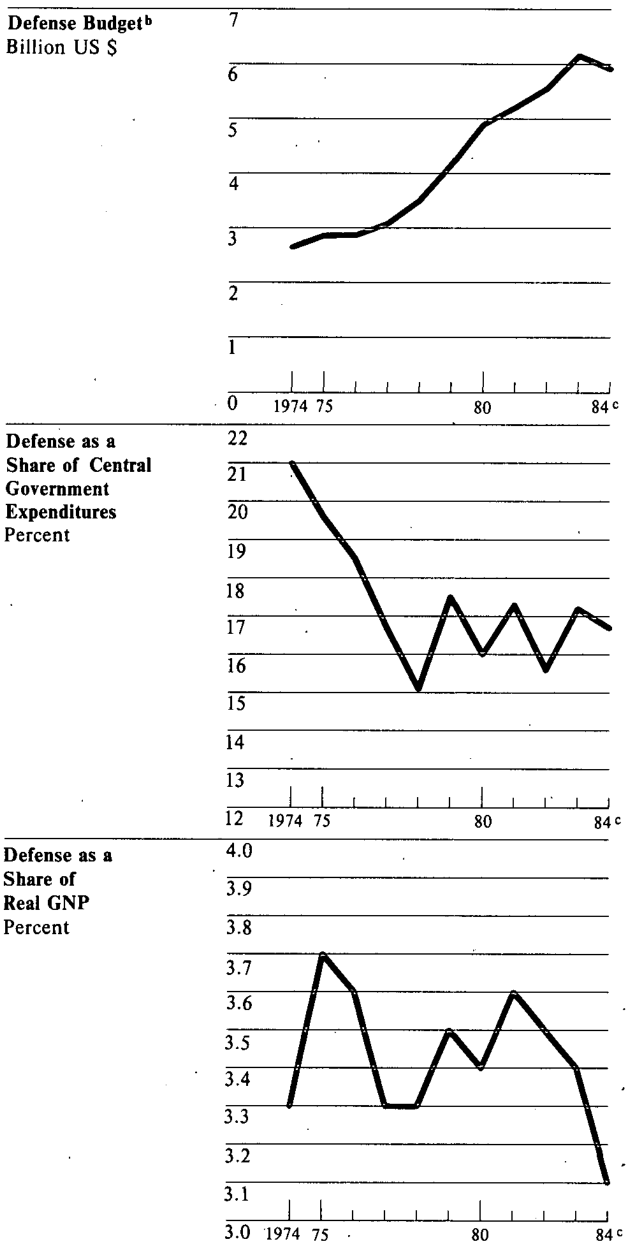
India has embarked on a major effort to procure foreign arms. Purchases largely from the Soviet Union, but also from West European suppliers, include sophisticated aircraft, missile systems, armored vehicles, naval combatants, and electronic warfare systems, [redacted] 25X1
[redacted] We estimate New Delhi's imports of weapons over the past five years have been at least $10 billion—placing India among the world's largest arms purchasers. [redacted] 25X1, 25X1

25X1

About 75 percent of the value of these weapons purchase agreements have been with Moscow. In our view, the Indians consider the Soviets a reliable supplier. They also find that Soviet weapons are cheaper—with low-cost financing—and that Soviet technology is more suitable than Western equipment to Indian production and maintenance capabilities. [redacted] 25X1

25X1

India: Defense Budget Outlays, 1974-84[a]



[a] Fiscal years beginning April of the stated year.
[b] Includes current and capital outlays.
[c] Projected.

[redacted]

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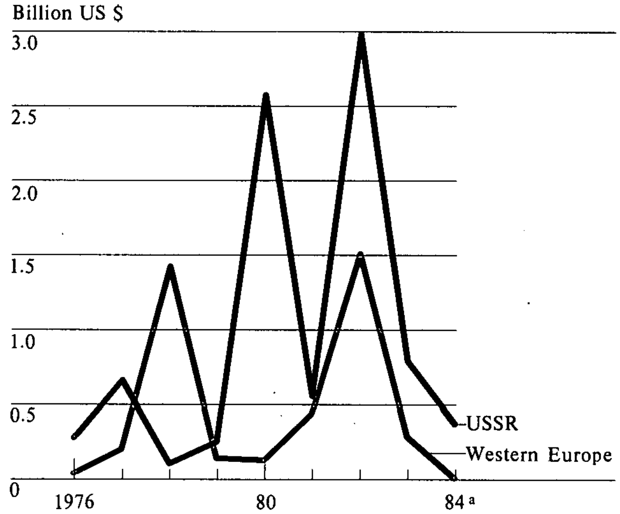
India: Major Weapons Purchase Agreements, 1976-84



[a] Through 30 June.

[redacted] 25X1

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Domestic Industry

India has developed one of the largest arms industries in the Third World. This helps to limit its dependence on imports. The domestic military-industrial complex is composed of nine large public-sector firms and 33 ordnance factories, which produced nearly $2 billion of goods and services in FY 1982 and provided employment for over 270,000 workers. Since FY 1980, real output in the nine public-sector companies has expanded three times faster than output in manufacturing—37 percent versus 12 percent—according to official data. [redacted] 25X1

India's defense industries produce equipment ranging from advanced fighter aircraft, tanks, and naval combatants to small arms. Bureaucratic redtape, poor quality control, and technological shortcomings continue to plague the arms industries,

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[redacted] and the industry relies on foreign technology and licensing arrangements. [redacted]

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Defense Burden

Despite some studies to the contrary, defense spending has not noticeably affected economic growth or development spending. Since FY 1980, combined annual state and central government spending on development activities—agriculture, industry, public health, and education—grew about 30 percent faster than defense allocations. Moreover, since FY 1980, the overall impact of military spending on development has been reduced by easy terms from Soviet suppliers. [redacted]

Defense industries produce some nondefense goods, and provide employment and training opportunities, but their contribution is small relative to the large amount of capital invested. Moreover, according to academic studies, spinoffs from Indian defense research and production are minimal because of secrecy and a lack of public- and private-sector communication. [redacted]

Public Support

The growth in defense spending and the military buildup since 1980 appear to have broad popular support. Parliamentary debates on defense spending are usually bereft of rancor. Indeed, the US Embassy reports that the opposition parties often chide the government to increase rather than reduce defense outlays. India has one of Asia's freest presses, yet journalists seldom criticize defense spending or its impact on economic development. [redacted]

We believe the military has maintained a favorable public image because it has remained apolitical and a symbol of national unity. According to the press, the public generally views the military modernization program as necessary to counter the US arming of Pakistan and the growing US-Chinese military relationship. [redacted]

Outlook

If India continues its large-scale purchase of sophisticated arms, as we believe it will, military payments could further erode New Delhi's fragile foreign payments situation in the late 1980s. Large commercial and IMF loans will also come due in the next five years. Payments for both Soviet and West European weapons could well exceed $1 billion per year by late in the decade. We believe India will try to step up exports or reduce petroleum imports from Moscow to ease the bilateral trade imbalance. [redacted] 25X1

We expect India will continue to rely on the Soviet Union for most of its arms while selectively purchasing US and Western defense technology and equipment. Most Indian defense industries have developed around Soviet technology and are not likely to adapt quickly to more sophisticated Western methods without substantial costs and production disruptions. [redacted] 25X1 25X1

If, as expected by the Indians and most Western observers, concessional economic aid diminishes over the coming years, India's development programs will require an increasing share of domestic resources. Should military spending grow beyond its traditional share of the budget, we believe defense spending could become a more contentious political issue. [redacted] 25X1 25X1

[redacted] 25X1

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Vietnam: The Empty Foreign Exchange Till

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Rapidly growing obligations on its $1.5 billion hard-currency foreign debt, combined with a dismal export performance, have produced Vietnam's worst foreign exchange shortage since the formal reunification of the country in 1976. As a result, Hanoi has virtually stopped making debt payments to non-Communist creditors and was $428 million in arrears at the end of last year. A multilateral debt rescheduling remains unlikely as long as Hanoi refuses to adopt an IMF-supported austerity program and move ahead with economic reforms. Moreover, supply limitations, low-quality products, and lack of expertise in international trade practices will make it difficult for Vietnam to expand export earnings to service even a much-reduced level of debt. Despite roughly $1 billion a year in Soviet economic assistance, we believe these external financial problems will limit the economy to only marginal growth for the remainder of the 1980s.

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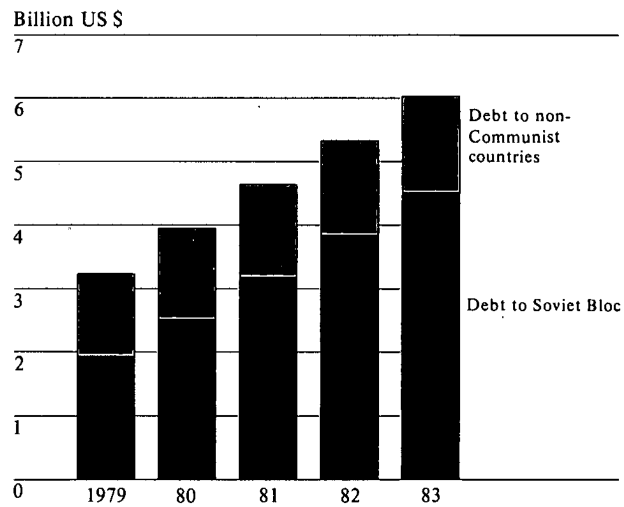
Vietnam: Growth of Foreign Debt, 1979-83[a]



[a] IMF estimates. Includes obligations to the IMF and and short-term credits.

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Growing Debt Problems

Although Vietnam at present has only limited economic contacts with non-Communist countries, its earlier economic flirtation with the West left it with a burdensome $1.5 billion hard-currency debt. Most of this debt stems from borrowings in the late 1970s to finance oil imports and to fund ambitious development projects. Roughly $1 billion is owed to official creditors, $300 million to private creditors, and about $150 million to international organizations. No US institutions are directly involved because Hanoi in 1975 repudiated most of the debts incurred by the South Vietnamese Government.

25X1

Vietnam's foreign debt obligations, moreover, have accelerated since 1980 because of rising interest rates and the expiration of grace periods on most of its borrowings. The rapid increase in debt service coincided with a 50-percent drop in official foreign exchange receipts. Western loans and grants, which peaked at nearly $500 million in 1978, fell sharply in response to Hanoi's invasion of Kampuchea in December 1978. Hard-currency export earnings have also proved disappointing. In 1983, exports to non-Communist countries totaled only $178 million, just enough to pay for two-thirds of Vietnam's imports from the West.

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The growing debt-service burden virtually exhausted Vietnam's reserves of hard currency by the end of 1981 and Hanoi largely stopped making payments on its foreign debt. Arrearages jumped to $251 million in 1982 and reached $428 million last year. Hanoi currently has less than $16 million of foreign exchange, according to IMF statistics.[2] [redacted]

Current Woes

There is little indication that the situation has improved in recent months. Vietnamese press reports indicate that export growth continues to lag this year after increasing only 10 percent last year—far less than the 60 percent called for in Hanoi's economic plan. As a result, Hanoi has probably fallen behind in its debt payments by at least another $150 million so far this year. [redacted]

More troublesome for Hanoi's foreign exchange managers is the prospect of large rice imports this year. In the north, the spring rice harvest was down about 10 percent from that of the previous year, and bad weather and insects have damaged the current crop. Although prospects for the rice crop in the south—which produces nearly 60 percent of the country's rice—are fairly good, Hanoi has already bought more than 100,000 tons of rice from Thailand and Burma, [redacted] More bad weather could force Hanoi back into the international market, preempting hard currency intended for other uses. [redacted]

Hanoi has also run afoul of the IMF, reducing its prospects for new loans. Since February, Hanoi has missed all scheduled payments on IMF loans to which it has been automatically entitled as an IMF member and by midyear was $15 million in arrears. The IMF, which considers such repayments essential to a member's good standing, is debating the country's access to further funds. Hanoi has proposed using some of Vietnam's bank accounts in the United States, blocked since 1975, to repay the IMF. The United States refuses to discuss releasing these funds, which once belonged to the South Vietnamese Government and total roughly $100 million, as long as Vietnam maintains troops in Kampuchea. [redacted] 25X1

Hanoi's Response 25X1

Maintaining that it has no intention of repudiating its debts to the West, Hanoi has sought to stretch out repayment of both principal and interest. Nonetheless, the Paris Club has refused to sponsor a multilateral debt-rescheduling package unless Vietnam implements an IMF-supported reform program. And Hanoi has had only limited success in bilateral efforts to reschedule its hard-currency debt. Tentative agreement was reached a few months ago for the refinancing of $170 million in arrears to private Japanese banks that would delay 25X1 payment until 1986-92. Hanoi is currently negotiating the rescheduling of another $400 million with Algeria, Libya, and India. If all these talks are successful—which we believe unlikely—Vietnam will be granted $290 million of debt relief in 1984 but will remain nearly $400 million in arrears. [redacted] 25X1

Moreover, Hanoi's efforts to expand its foreign exchange earnings have been only marginally successful. 25X1 The introduction of export incentives and a 70-percent devaluation in 1981 led to a 35-percent 25X1 increase in export earnings in 1982, and remittances from overseas Vietnamese jumped to about 25X1 $50 million. This success was short lived, however, as Marxist hardliners in the Politburo renewed efforts to bring the reinvigorated private sector under control last year by sharply increasing taxes on private businesses, stiffening restrictions on currency transfers from overseas, and reinstituting central control over the activities of foreign trade companies. As a result, the growth of export earnings slowed markedly in 1983 and overseas remittances fell by about 20 percent. [redacted] 25X1

[2] Vietnam's official reserves also include 735,000 ounces of gold, half of which is pledged as collateral for a $102 million loan. Hanoi maintains it is reserving the remainder of its gold stock for a future unspecified emergency. [redacted] 25X1

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Vietnam: Projected Hard Currency Debt Service Ratios and Debt Arrearages [a]

	1984	1985	1986	1987	1988	1989	1990
	Million US $						
Total debt service payments [b]	**185.9**	**216.5**	**270.7**	**292.5**	**298.3**	**290.6**	**224.0**
Principal	96.9	128.0	177.2	182.5	169.8	149.0	73.6
Interest [c]	89.0	88.5	93.5	110.0	128.5	141.6	150.4
Debt service ratio under alternative export scenarios [d]							
	Percent						
Low growth	88.0	100.0	114.0	116.0	104.0	92.0	65.0
Moderate growth	88.0	92.0	96.0	89.0	73.0	60.0	38.0
High growth	88.0	85.0	82.0	70.0	53.0	40.0	23.0
Accumulated arrearages under alternative export scenarios [b d]							
	Million US $						
Low growth	356	536	745	975	1,178	1,344	1,380
Moderate growth	356	530	735	954	1,142	1,271	1,271
High growth	356	495	639	762	809	739	228

[a] On loans taken out before 1 January 1984.
[b] Assuming bilateral rescheduling negotiations under way in mid-1984 are completed.
[c] Includes imputed interest on arrearages.
[d] Low growth = 10 percent annually; moderate growth = 20 percent annually; and high growth = 30 percent annually.

[redacted] 25X1

The Tests Ahead

The key to easing Hanoi's foreign exchange crunch in the near term is a multilateral rescheduling of hard-currency debt which—on present terms—will require payments averaging $260 million annually during 1985-87. Even with bilateral debt relief and moderately optimistic assumptions for export growth, overdue payments are likely to increase sharply as debt service approaches $300 million annually by 1987. Without a multilateral debt rescheduling, we estimate Hanoi's accumulated arrearages probably will total $1 billion by 1987. [redacted] 25X1

Prospects for a spurt in hard-currency exports are poor. A large share of Hanoi's commodity exports are committed to the USSR. [redacted] 25X1 [redacted] 70 to 80 percent of Vietnam's future exports may already be mortgaged to Moscow as part of the price of continued Soviet economic assistance. 25X1 Expansion of exports to the West is also hindered by poor port facilities, lack of marketing skills, and low-quality goods. [redacted] 25X1

Outlook

We expect Vietnam's severe foreign exchange problems to persist at least for the rest of this decade. Chances for a multilateral debt rescheduling hinge on reaching accommodation with the IMF on arrearages and economic reform. These reforms probably would include:

- Another large currency devaluation. The 1981 devaluation has been more than offset by rapid domestic price increases, especially in key export industries such as seafood.
- Slowed growth of credit and government spending, including military spending, to limit inflation.
- Sharp reductions in consumer subsidies, especially the rice subsidy to government workers. 25X1

The current leadership is unlikely to implement these reforms because—in its view—they would reverse the country's progress toward a socialist economy and also require insupportable austerity measures. Nor is Hanoi likely in the near term to take the steps necessary to stimulate exports or to attract foreign capital from non-Communist countries. Although the government probably could increase the inflow of remittances from overseas Vietnamese by assuring them that their families at home had use of the funds, even a doubling of remittances from abroad would have little impact in reducing overdue debts. 25X1

External financial problems will continue to severely hamper Hanoi's efforts to boost real growth beyond the annual average of 3 percent registered since 1979. Soviet Bloc economic aid at $1 billion annually will be insufficient to move the Vietnamese economy forward at more than a snail's pace:

- UN experts estimate that, without a sharp increase in the application of improved seeds and fertilizer, future food production may lag population growth—at 2.4 percent annually one of the highest rates in East Asia.

- Hanoi's inability to purchase petroleum supplies beyond the 36,000 b/d provided by Moscow last year will perpetuate the severe power shortages that force the industrial sector to operate at less than 50 percent of capacity and limit operation of irrigation pumps.

- Financial constraints seem certain to slow development of petroleum resources. Over the past few months, Hanoi—which is engaged in a joint oil drilling venture with the USSR in the South China Sea—has been desperately searching for drilling equipment to supplement that provided by Moscow, but has been unable to complete the financial arrangements.

- Hanoi's inability to increase imports of raw materials, machinery, and spare parts from the West slows the revival of the Western-built manufacturing sector in the south. 25X1

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