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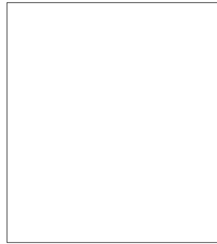

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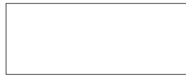

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Synopsis

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1 **Perspective—*New GATT Round?***

While a 1985 start has often been mentioned, GATT members have not yet agreed on timing, agenda, or even whether to hold a new round. GATT's annual meeting this month is not likely to provide answers to these major questions.

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11 **GATT Annual Meeting: Polarization on the Major Issues**

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The annual meeting beginning 26 November of the 90 signatories to the General Agreement on Tariffs and Trade (GATT) probably will do little to advance the goal of the United States and the other industrial countries to initiate a new round of multilateral trade negotiations.

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15 **Mexico: Impact of Lower Oil Revenues**

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Mexico's announced plan to cut its oil exports will add to the country's economic problems. Although the exact impact on oil revenue is not clear, it could be as large as 10 percent.

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19 **The Philippines: Living With a Foreign Debt Overhang**

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After a year of haggling and procrastinating, Manila has reached tentative agreement with the IMF on an economic stabilization program and completed negotiations with commercial and official creditors on a plan to restructure much of the Philippines' $25 billion foreign debt. Even with these agreements in place, however, we believe that the economic outlook for the Philippines is bleak during the rest of this decade.

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23 **Colombia: A Tottering Economy**

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President Betancur's attempts to keep campaign promises over the next few months will clash head on with a cash-flow crisis that is leading to a likely suspension of some debt service payments. To save face and secure foreign financial support, Betancur will probably adopt IMF-backed austerity measures that, although economically beneficial in the longer run, will generate higher unemployment and inflation, lower economic growth, and political and social unrest through 1985.

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27 **NICs: Accelerated Penetration of World Markets**

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The newly industrializing countries (NICs) continue to sharply increase their penetration of world markets, particularly since 1980. The NICs have almost doubled their share over the past decade, in large part because of sizable gains in the US market.

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Perspective

New GATT Round?

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Five years after the Tokyo Round trade agreements, many government and business officials in the developed countries are pushing for the new round of multilateral talks under the General Agreement on Tariffs and Trade (GATT). They hope that talks will reestablish the trade-liberalizing momentum of previous rounds, improve observance of GATT rules, promote further integration of LDCs into the GATT system, and expand GATT activities into new fields. While a 1985 start has often been mentioned, GATT members have not yet agreed on timing, agenda, or even whether to hold a new round. GATT's annual meeting this month is not likely to provide answers to these major questions.

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On the eve of this year's meeting, the international trading system faces perhaps its greatest challenges since GATT's founding in 1948:

- GATT rules and procedures—particularly concerning safeguards, agriculture, and preferential arrangements—have often proved inadequate.
- Market-sharing and trade-restraining arrangements that circumvent GATT rules have spread; prominent examples include Japanese automobile export restraints or the network of industrial country steel restrictions.
- Industrial countries have been unable or unwilling to absorb large quantities of increasingly competitive LDC manufactured exports. Nevertheless, LDC debtors demand greater access to industrial country markets so they can service their debt and support economic recovery.
- Countries with growing services sectors, such as the United States or Japan, have no adequate international forum where they can seek improved market access for their services exports (for example, banking, insurance, data processing, or construction) and investments.
- The United States needs substantial liberalization of international markets to help cope with its trade deficit, now projected to be well over $100 billion for 1984.

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Advocates of continued trade liberalization hope all of these problems—and others, such as agricultural export subsidies—can be addressed in new multilateral negotiations. While this is an ambitious goal, major trade liberalizing deals have paradoxically often been easier to achieve than smaller agreements covering narrow interests. Multilateral rounds allow for wide-ranging bargains and better focus the attention of political leaders who have the authority to approve broad compromises. The traditional alternative to multilateral efforts—settling disputes bilaterally—is slow, often results in market-sharing arrangements, and does little to deter new barriers.

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Prospects for initiating broad-based multilateral trade negotiations on the pattern of the Tokyo or Kennedy Rounds are, however, uncertain. There is much LDC resistance to reducing their own trade barriers. Latin American and South Asian GATT members, in particular, fear competing with industrial country imports and oppose greater foreign presence in local economies. Many LDCs are hostile to GATT and would rather give LDC-controlled UNCTAD the primary responsibility for developing and enforcing rules of the international trading system. 25X1

If progress toward a new round is stymied, the United States has indicated a willingness to pursue trade and services liberalization issue by issue outside GATT among interested countries. US negotiators call this alternative an "a la carte" format, as opposed to negotiations according to a fixed agenda approved by a ministerial-level GATT meeting. Many industrial and developing countries have criticized the concept, saying that it could injure GATT and the multilateral trading system. Critics, however, are probably also concerned that this format would result in trade liberalization agreements from which they would not automatically benefit, which they might be unwilling to join, and which might divert trade from them. 25X1

We believe significant trade liberalization can be achieved over the long run. The best outcome would be for Brazil, India, Argentina, and other opponents of a new trade round to recognize that their opposition could harm their own trade prospects, and to agree to comprehensive negotiations under GATT. If a multilateral approach fails, however, negotiations among smaller groups of countries will become the only alternative. Under this scenario, nations with an interest in discussing liberalization—Japan, Canada, Australia, advanced East Asian developing countries, the EC in many areas, and perhaps a few LDC debtors seeking greater access for their exports—could join the United States in negotiating trade-barrier reductions. 25X1

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Briefs

Energy

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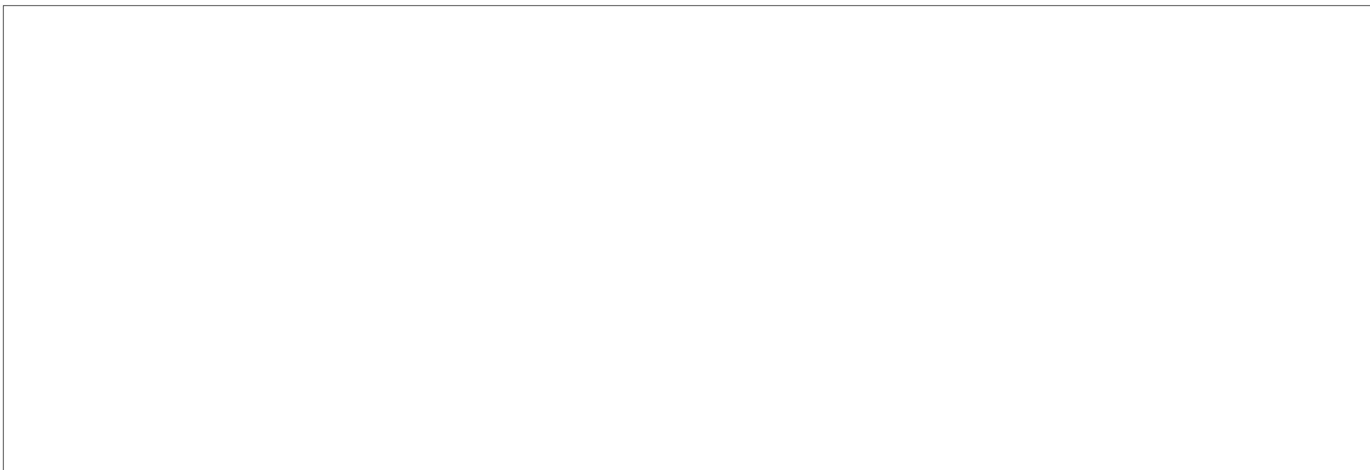

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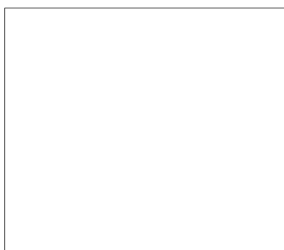
Saudis Increase Security at Major Oil Facilities



Consulate reporting [redacted] indicate that Saudi Arabia is continuing to upgrade physical security at its Ras Tanura and Abqaiq oil facilities, which handle more than half of Saudi production. Antiaircraft guns have been placed on Abqaiq's eastern approaches, and a radar system—designed for shipping control but also useful for surveillance—has been installed on the Ras Tanura and Dammam shipping channel. This radar supplements a similar system installed several years ago at Ju'aymah, Saudi Arabia's other major Gulf oil export terminal. Consulate sources report that bunkers each capable of housing 100 workers for at least a week have been built and stocked—11 at the Ras Tanura refinery, five at the Ras Tanura storage and export terminal, and seven at the main processing area at Abqaiq. [redacted] Despite this growing Saudi effort to protect its oil system from terrorists as well as the Iranian military threat, numerous additional measures to enhance security and develop effective contingency planning would be required to reduce the system's vulnerability substantially. [redacted]

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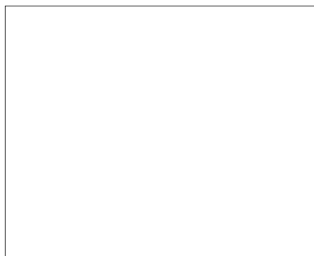
New Oil Pipelines Increase Omani Production



Replacement of severely corroded pipelines in Oman has enabled Muscat to increase oil production to 420,000 barrels per day (b/d) in recent months. [redacted] the ongoing program to install new, larger pipelines linking the southern fields with the Mina al Fahal export terminal is expected to raise capacity to 430,000 b/d by yearend and 450,000 b/d next year. Limitations

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posed by pipeline capacity constrained output in 1983 to 389,000 b/d. Until now, Oman has had little difficulty marketing its crude because of relatively attractive prices and its advantageous location outside the Persian Gulf. According to the US Embassy, recent weak market conditions have caused customers to press for lower prices. At the same time, we expect non-OPEC-member Oman will come under pressure from OPEC to reduce output or at least reduce future increases.

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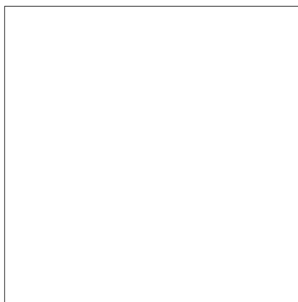
Proposals for New Pipeline Across Central America



Lack of demand has stymied efforts in Costa Rica and Guatemala for a second crude oil pipeline across the Central American isthmus. Interest in a second pipeline has been spawned by the profitability of the two-year-old Panamanian pipeline. This year, however, the pipeline has been shipping only about 600,000 barrels per day (b/d)—all Alaskan crude—compared with a capacity of 850,000 b/d and a flow of 650,000 b/d in 1982. According to the US Embassy in San Jose, Costa Rica's Ministry of Industry, Energy, and Mines is studying a $755 million proposal from the French firm SPIECAPAG for a 600,000-b/d pipeline running west to east, and a parallel 400,000-b/d line in the opposite direction. The US Embassy in Guatemala reports that a business group there is seeking support for an alternative pipeline across Guatemala. Both projects apparently are languishing, despite their potential strategic value to US and Japanese oil trade, because adequate throughput cannot be guaranteed. Further consideration of either probably will hinge on the progress of a proposed 16,000-kilometer crude pipeline from California to Texas, which could be completed by 1986.

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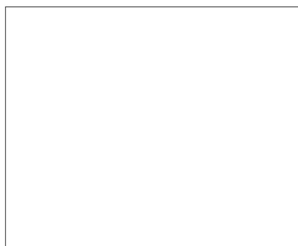
Australian Self-Sufficiency in Oil Near



Increasing domestic crude production is rapidly moving Australia toward self-sufficiency in oil. Domestic production accounted for 93 percent of Australia's total oil requirements in the first seven months of 1984—up from 72 percent for the same period in 1982. Output from domestic fields hit 543,000 barrels per day (b/d) in the first seven months of this year compared with 427,000 b/d for the same period in 1982. According to the Minister of Energy, virtual self-sufficiency is possible by the early 1990s—much sooner than had been previously projected. The Australian Petroleum Exploration Association, however, estimates that Australia must undertake at least 200 exploratory drillings per year with a success rate of between 8 and 10 percent.

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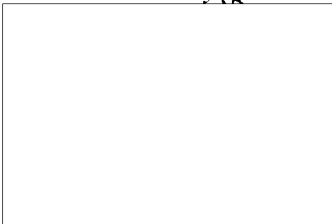
International Finance

Portugal's IMF Program About To Die Prematurely



The Embassy reports that Lisbon's standby program, originally scheduled to end in February 1985, has been effectively scrapped. The Fund suspended drawings for the last two quarters of this year after Lisbon exceeded the target on public-sector domestic credit, and has refused to renegotiate the program. It did agree to consider waiving the July limit on short-term debt to unblock previously suspended funds contingent upon the IMF's review of the program, Lisbon's 1985 budget, and price hikes. There is little hope for the waiver, however, because of Lisbon's dismal record on austerity measures for the Fund program.

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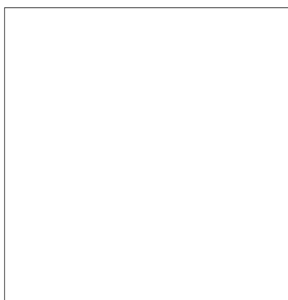
The program's collapse should not lead to liquidity problems this year. Next year, however, Lisbon's easier policies are likely to push the current account deeper in the red, and jittery bankers may cut back their exposure. With elections in the fall of 1985, the government cannot afford to submit to another IMF program. This leaves Lisbon with few options: gold-backed loans from the Bank for International Settlements to buy time, a pitch to the United States for increased aid, and an appeal to the European Community if Lisbon becomes a member in 1986. 25X1

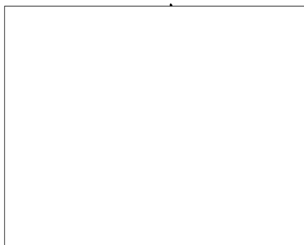
Global and Regional Developments

Libya-Belgium Nuclear Cooperation



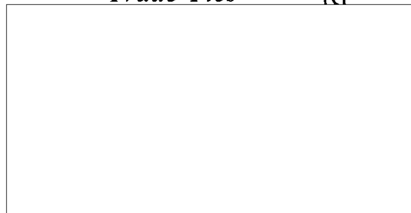
Tripoli is threatening to strengthen nuclear cooperation with Moscow if Brussels does not approve the preliminary nuclear agreement concluded last spring. Qadhafi publicly has accused the United States of conspiring to block Libya's peaceful economic progress by increasing pressure on Belgian officials reluctant to alienate Washington. Debate has raged in the Belgian Cabinet since late summer between factions favoring stronger economic ties with Libya and those who prefer to appease US and Western concerns over Qadhafi's misuse of nuclear technology. Brussels probably will delay additional nuclear cooperation as long as other West European governments do not step in to replace Belgium—the United Kingdom, France, Spain, and West Germany already have stated that they will not export nuclear technology to Libya. Nevertheless, Qadhafi probably will continue to negotiate with Brussels as part of a broader campaign to improve relations with Western Europe as well as to secure alternate sources of nuclear technology. In the interim, Tripoli can turn to the Soviets, who have supplied the equipment for Libya's small research reactor and have recently agreed to provide two 440-MW reactors for electric power generation. 25X1 25X1

Ariane Pricing Policy Wins Customers



The West European consortium, Arianespace, is winning launch contracts away from NASA because of an aggressive pricing strategy. Arianespace, for example, recently won the launch contract for the third Australian communications satellite with a bid of $20 million; the US price was $32 million for each of the first two. In contrast, we believe Arianespace charges its European customers about $40 million per satellite. Representatives of the French space agency recently said that Ariane pricing is based on five launches per year—three for European and two for other customers. If these reports are correct, the Europeans could be subsidizing about half of the cost of launches for export customers. If this practice continues, the fledgling US commercial launch industry will find it increasingly difficult to compete. 25X1 25X1

Austria and East Germany Expand Trade Ties



During Chancellor Sinowatz's visit to East Berlin last week, Austria and East Germany signed four new economic and industrial cooperation agreements, which should boost already close economic relations. Bilateral trade has mushroomed in recent years, as East Berlin has cultivated Vienna to obtain credits and diversify its Western sources of capital and foodstuffs. As a result, 25X1

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Austria has become East Germany's second-largest Western trade partner. Although East German trade with the non-Communist countries has shifted into surplus for the past two years, sizable deficits with Austria—$220 million in 1983—have continued. For Vienna, East Germany is second only to the Soviet Union among CEMA states as a market, particularly for goods from Austria's troubled state industries. Last year, total exports to East Germany soared 66 percent to $352 million, while the sale of manufactured goods increased by more than 70 percent to $313 million.

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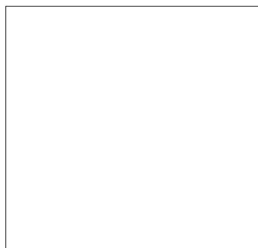
India's Tea Policies Boost World Prices



Tea prices have surged above $1.60 per pound following India's recent decision to limit 1984 exports to 215,000 metric tons—about one-fourth of global exports. Prices hit a record $1.95 per pound last January, after India ceased most tea exports because of a shortage at home. Shipments resumed in May, but for the first 10 months of 1984 world tea prices have averaged $1.58 per pound—50 percent higher than for all of 1983. Drought in Kenya, also a large tea exporter, and low stocks in importing countries have contributed to the price runup. With the rapid rise in India's domestic tea use, maintaining adequate domestic supplies at reasonable prices is likely to be an important policy goal of the new regime. Despite record tea production, the press reports that New Delhi is considering monthly quotas to limit exports to 220,000 tons for 1985.

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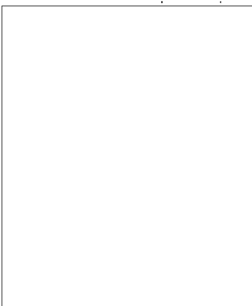
International Court of Justice Resolves US-Canada Dispute



A 12 October International Court of Justice (ICJ) decision ended a 15-year dispute between Canada and the United States. The decision delimited the boundary between the two countries in the Gulf of Maine and, more important, on the Georges Bank, one of the world's most productive fisheries and a possible offshore oilfield. Negotiations on the boundary began in 1970 but were eclipsed by the Law of the Sea talks. No further negotiations were held until both countries declared 200-mile fishing zones in 1977. Amid pressures from fishing interests on both sides in 1978, each country closed its fishing zone to the other's fishermen for a short time. With no solution in sight, the two governments agreed in 1979 to turn the matter over to the ICJ.

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The Court's decision essentially split the difference between the Canadian claim to half the Bank and the US claim to all of the Bank. It gave the United States two-thirds of the Gulf and three-fourths of the Bank. Petroleum exploration to date, which has been impeded by fishing and environmental lobbies, has not made any commercial discoveries. Aggressive prospecting on the Canadian side of the line, however, could spur renewed efforts by US companies. As expected, the decision drew grumbling from both countries' fishermen because they are now barred from some areas they historically fished.

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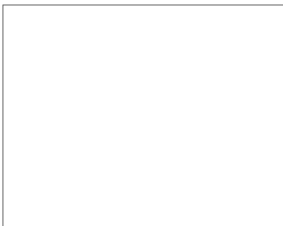
National Developments

Developed Countries

Israeli Debt Grows



Government borrowing to bolster foreign exchange reserves and to meet Foreign Military Sales obligations to the United States was the major factor in the $1.2 billion increase in foreign debt during the second quarter of this year. According to the Bank of Israel, outstanding foreign debt now totals $23.8 billion. As a result of the new borrowing, short-term debt now represents 16.8 percent of total debt compared with 13.9 percent at the end of the first quarter.

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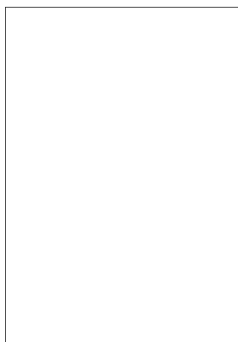
Change in Canadian Economic Policy



Finance Minister Wilson, in his first major economic statement on 8 November, stressed spending cuts and revenue increases to reduce the fiscal 1986 budget by $2.7 billion—to $26.5 billion. The cuts are broad based and affect defense, housing subsidies, unemployment compensation, and state-owned corporations. The government also announced that 1,500 civil service jobs will be eliminated in 1985. Ottawa also will allow the price of Canadian oil to rise to world levels, which will increase tax revenues, and soon will announce changes in the Foreign Investment Review Agency and the National Energy Program designed to encourage investment. Although Prime Minister Mulroney promised thousands of jobs during the campaign, the government goal of reducing the current 11.8-percent unemployment rate to 10.9 percent by end of 1985 is unlikely to be achieved. The economic program has been denounced by the opposition Liberal and New Democratic Parties but embraced by business. It is likely to be followed by stronger cuts and deficit reduction measures in next spring's budget.

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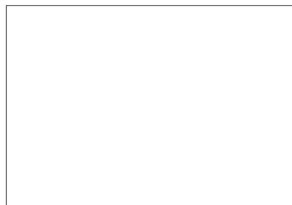
Less Developed Countries

Frustrated Mexican Attempts To Sell Public Companies



Government efforts to divest its public companies are making little headway. Only a small fraction of the public enterprises offered for sale have been placed with the private sector. Leftist unions fear that private owners would cut jobs and renegotiate generous labor contracts and have vocally opposed the sales, At the same time, private entrepreneurs have not shown much interest in buying public firms with high debt structures and weak financial positions. Moreover, businessmen and bureaucrats continue to disagree over equity positions, debt guarantees, and maintenance of union controls.

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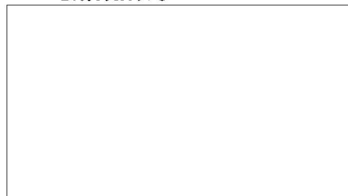
French Interest in Caribbean Basin Initiative



Political and business leaders in the French Caribbean are demonstrating considerable interest in the Caribbean Basin Initiative (CBI), according to the US Consul General in Martinique. The French Ministers of Commerce and Overseas Territories have strongly encouraged local French businessmen to participate through joint ventures with independent Caribbean islands, and at least 40 political and business leaders will attend the Caribbean Conference in

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Miami in early December. Paris officials, however, have expressed concern that the CBI will hurt Martinique's and Guadeloupe's ability to compete with their independent neighbors' fueling activities of radical independence groups—a concern they claim is shared in the Antilles. These concerns and pressure from local business interests are likely to cause France to seek an amendment to the Caribbean Basin Economic Recovery Act that would allow its Caribbean territories the same access as their independent neighbors. 25X1

Sri Lankan Economy Improves

Sri Lanka has improved its international and domestic economic performance in 1984, despite problems stemming from the communal violence against the Tamil minority last year. Tea exports, buoyed by high world prices as well as increased output, are likely to double from last year, according to US Embassy and press reports. Increases in other exports, and slower import growth—Sri Lanka is now nearly self-sufficient in rice—probably will enable Colombo to register a substantial improvement in its 1984 international payments position and forgo the need for a new IMF standby loan. With lower domestic expenditures and increased revenues from export duties, the government also hopes to further reduce both the budget deficit and inflation, which has averaged nearly 18 percent this year. On the negative side, tourism—a major foreign exchange earner—remains in the doldrums, and inefficient public-sector industries continue to burden the economy. 25X1

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Burmese Joint Venture Sets Precedent

Rangoon last month approved the first direct foreign investment outside the offshore oil industry since Ne Win took power in 1962. While the details have yet to be worked out, under the agreement with the Ministry of Heavy Industries, the West German state-owned firm Fritz Werner will provide equipment and expertise to upgrade Burma's dilapidated industrial sector. Rangoon's new partner—a longtime weapons supplier—was probably chosen on the basis of its close ties to top Burmese officials. It is too early to tell if this signals a softening in Burma's xenophobic attitudes toward foreign ownership. 25X1

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Tunisia Tightens Its Belt

The US Embassy in Tunis says that government officials are putting final touches on a stiff austerity budget for 1985. Projected spending will drop about 5 percent in real terms over the 1984 level. Price increases will be phased in for all subsidized goods including petroleum, and wage levels will remain frozen for the third year. These adjustments would boost this year's 10-percent inflation to about 14 percent in 1985. An additional $320 million in foreign borrowing will still be necessary to cover the budget deficit. Price increases on cereal products and cooking oil, those considered most likely to cause domestic unrest, will be held off until July, but civil disturbances could begin sooner as the purchasing power of the poor and unemployed is eroded. The US Embassy believes, and we agree, that how Prime Minister Mzali handles sensitive wage and price issues will be a crucial test not only of his ability to manage the budget, but of his ability to succeed ailing President Bourguiba. 25X1

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Communist

China Reorganizes Civil Aviation Sector

Beijing has announced plans to reorganize and decentralize the Civil Aviation Administration of China (CAAC). CAAC's airline operations are scheduled to break up into five companies during the first half of 1985. Beijing-based Air China initially will serve all international and many of the major domestic routes. The Shanghai-based China Eastern Airways and Guangzhou-based China Southern Airways will begin flying on major domestic routes with service on international routes scheduled for some time in the future. The Chengdu-based China Southwestern Airways and Beijing-based China Capital Helicopter Company will be limited mainly to domestic services. CAAC will continue to be responsible for air traffic control and flight coordination and will also exercise unified control over civil air services and safety. This formation of an FAA-type organization places the Chinese in a better position for negotiating a US-PRC bilateral airworthiness agreement, which they have wanted for some time. The decentralization, however, which gives each airline the right to conclude contracts for buying or leasing airplanes, could further complicate US sales of aircraft to China.

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GATT Annual Meeting: Polarization on the Major Issues

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The annual meeting beginning 26 November of the 90 signatories to the General Agreement on Tariffs and Trade (GATT) probably will do little to advance the goal of the United States and the other industrial countries to initiate a new round of multilateral trade negotiations. As was the case at the 1982 GATT Ministerial, opposition from the LDCs—led by Brazil—will be the major obstacle. The 1982 meeting approved a two-year work program that the United States and several other developed countries anticipated would develop into a new trade round, but Brazil is arguing that many work program commitments have not been observed by the industrial countries. This year the most contentious issues appear to be counterfeit goods, services, agricultural trade, and safeguards. The latter two are particularly difficult because they involve disagreements among industrial countries.

State of Play on Major Issues

Four major issues that could impede the launching of a new trade round—agricultural trade, safeguards, trade in counterfeit goods and services—will probably come up at the GATT meeting. Agriculture and safeguards are particularly troublesome because they involve disagreements among industrial countries. It will, in fact, be difficult for the industrial countries to demonstrate substantial results after two years' work on these issues. Disagreement is likely with developing countries over US efforts to establish working parties on services and counterfeit goods. Creation of working parties would be a major step in assuring that these items would be covered in a new round.

Agricultural trade rules for years have been a source of intense disagreement between the EC and other major agricultural exporters. This summer all the members of GATT's Agriculture Committee, including the EC Commission, approved a draft negotiating a framework that contained a ban, with some exceptions, on agricultural export subsidies. The EC Commission apparently was using the Agricultural Committee to try to reduce subsidization of EC agriculture, but went further than EC member states would tolerate. Consequently, in September all EC member states except the Netherlands rejected the draft, leaving the committee with nothing to present to this month's GATT annual meeting. Diplomatic reporting indicates that some European officials have shown interest in developing a broader draft that would not, as they claim the first draft did, focus on export subsidies.

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Since the end of the Tokyo Round, *safeguards* discussions among the United States, the EC, Japan, and LDCs have not resolved tough issues, such as compensation, selective application of safeguards, treatment of existing unreported ("gray area") protectionist measures, and how to deal with textiles. Diplomatic sources report that all negotiators hope to present this month's GATT meeting with a consensus on minor safeguards topics, which, however, leaves the difficult issues unresolved. A recent GATT Secretariat study requested by safeguards negotiators reasserts GATT principles of nonselective application of safeguards. By redirecting attention to this intractable issue, the Secretariat study may undermine the effort to focus on minor issues. According to diplomatic sources, some EC member states believe the Community should not make any concessions before a new trade round begins, although minor concessions before the November meeting are possible.

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The United States, Japan, the EC, Canada, Switzerland, and Sweden support a working party on

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LDC Position on a New Trade Round

According to US diplomatic sources, Brazil—the informal leader of developing countries in GATT—and other LDCs demand completion of the 1982 GATT Ministerial work program before they enter into commitments on new multilateral trade negotiations. This position is the primary obstacle to placing the GATT on track toward a new trade round. Work program commitments that Brasilia says have not been observed by industrial countries include:

- *A pledge not to initiate or maintain protectionist measures inconsistent with the GATT.*
- *Negotiating a comprehensive agreement on safeguards (measures to protect industries injured by imports).*
- *Improving GATT rules on agriculture, including market access and export subsidies.*
- *Expanding favorable treatment for developing countries.*
- *Liberalizing trade in tropical products.*
- *Examining liberalization of trade in textiles and clothing.*

While recognizing the importance of the work program, industrial countries are resisting LDC efforts to, in effect, obtain trade concessions in exchange for their participation in negotiations. Industrial countries point out that the work program cannot be separated from the new round as the LDCs are attempting to do. Indeed, if the work program were finished as LDCs demand, many new trade round goals would also be fulfilled.

In response, some LDC officials assert that the problems of the world trading system have been created by industrial countries and it is up to the industrial countries to correct them, without assistance from LDCs. Brazil argues that completing the work program would demonstrate the "good will" of the industrial countries. East Asian developing countries have been more positive toward a new round but have also expressed interest in completing the work program.

trade in counterfeit goods. Many LDCs, including Brazil, India, Argentina, Singapore, and South Korea, are opposed. US negotiators indicate that some LDCs recognize counterfeit trade as a legitimate GATT concern, but these LDCs worry that a working party might detract from other LDC objectives.

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US efforts to establish a working party on *trade in services* are supported by the EC, Japan, Canada, the Nordic countries, and Israel. At the 1982 GATT Ministerial, the United States could only obtain endorsement for independent studies by "interested" members, followed by consideration at this month's meeting of whether to proceed multilaterally. LDC opposition to a working party is led by Brazil and India. They deny GATT competence in the area, and argue that they need time to build their own services sectors before developing international rules. Many LDCs view the services issue as an attempt by the developed countries to open Third World markets for their own growing service economies. Brazil and India also reject US arguments that greater worldwide services activity would allow more rapid structural adjustment in industrial countries and more markets for LDC manufactured exports. The Chairman of the GATT Council has suggested a compromise establishing an "information group" on services, but this suggestion falls far short of US objectives.

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Outlook

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The battle over services that may develop at the GATT annual meeting could parallel a similar struggle likely sometime in 1985 over whether to go ahead with a new GATT round. On both issues industrial countries confront LDCs, and the respective leading actors—the United States and Brazil—are both firm in their positions. Indeed, we have seen no indication that the leading candidate in Brazil's January presidential elections, Tancredo Neves, would change Brazilian policy in GATT. Brazil, however, might be more approachable on these issues after the elections.

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We believe a decision on whether to hold another trade negotiating round under GATT will be delayed at least until February. According to Japanese press reports, the United States and Japan were unable to obtain developing country assent to their new round plans at a late October meeting of GATT's Consultative Group of 18 (a steering group of leading members). At GATT Director General Dunkel's suggestion, the subject was put off until after the Brazilian elections and January's turnover in EC Commission membership.

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Until the 1970s, support from the United States, the EC, and Japan constituted the critical mass needed to get anything done in GATT. Today, with the increased importance of the advanced developing countries, a consensus within GATT is no longer possible without these countries' participation. If Brazil and other leading LDCs continue to oppose a new round and can maintain general LDC support for this position, a deadlock will result. In this case, the United States could be forced to look outside the traditional multilateral GATT framework to achieve meaningful trade liberalization during this decade.

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Mexico: Impact of Lower Oil Revenues

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Mexico's announced plan to cut its oil exports will add to the country's economic problems. Although the exact impact on oil revenue is not clear, it could be as large as 10-percent. In the absence of a Mexican policy response, a 10-percent fall in oil revenues would reduce projected economic growth from 2.0 to -1.5 percent, according to our econometric model. The revenue shortfall would further constrain depressed government spending, import capacity, consumer demand, and private investment.

Rather than accept economic contraction, however, we believe Mexico City would lobby hard for more lenient IMF targets on government deficit levels. Even before the latest weakening of the oil market, we believe that Mexico City was planning to ask the Fund for spending relief. This would allow the government to boost its outlays to limit the dropoff in economic growth. In addition to higher spending, other policy responses such as reserve drawdowns, lower imports, and currency devaluations probably would be necessary to offset the economic losses caused by a sustained drop in oil revenues. Even with such policy moves, there is the risk that prolonged difficulties in the petroleum sector could result in a new debt crisis.

The Decision To Cut Exports

Mexican officials have publicly stated that effective 1 November Mexico would reduce its oil exports between 7 and 10 percent. Their statements followed OPEC's decision to reduce its production ceiling by 9 percent in an attempt to defend its $29 per barrel benchmark price.

Government concern about the potential impact of falling oil prices has led to closer cooperation with OPEC. Indeed, in strategy sessions preceding recent OPEC meetings, Mexico, a nonmember, played a prominent role. For example, Secretary of Energy, Mines, and Parastatal Industries Francisco Labastida joined Saudi Oil Minister Yamani and his Venezuelan counterpart on an unsuccessful visit to Lagos to request that Nigeria rescind its price cut.

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Mexico has a major financial stake in stabilizing the world oil market. The government, for example, is currently negotiating a $48.5 billion debt rescheduling package with more than 500 banks that is based on the assumption of steady oil revenues. Moreover, the sharper the fall in oil revenues—either due to export cutbacks or price decreases—the more difficult it will be for Mexico City to meet debt obligations, maintain growth, and adhere to IMF targets. Finally, any revenue crunch would be magnified by the continuing reduction in foreign investment that has resulted primarily from the trend toward greater state control over industry.

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The Revenue Loss

The exact impact on export revenue is not clear. Before the OPEC meeting, Mexican officials were considering a 10-percent cut in crude exports (150,000 barrels per day). Since then, they have announced a cut of 7 percent (100,000 barrels per day), but have not specified how this cut will be calculated. Before this announcement, we expected 1985 oil exports to be at their former ceiling of 1.5 million barrels per day (b/d). If a cut of 7 percent is applied to this figure and carried out, the revenue loss would also be 7 percent. Through most of 1984, however, exports have been above the ceiling. If Mexico took this higher figure as the base and applied a 7-percent cut, there would be little or no impact on revenue. The actual result probably will lie between these extremes.

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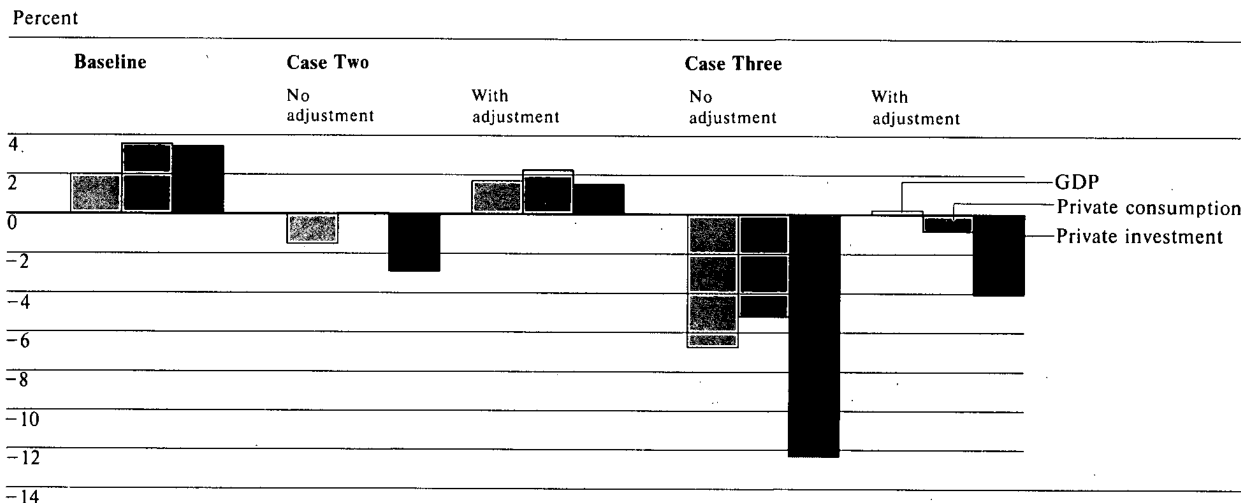
Mexico: Impact of Reduced Oil Export Volumes, 1985



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Impact on the Economy

With the Mexican economy already in difficulty, any loss of oil revenue will have a negative impact. To quantify this impact, we used our Mexican econometric model to simulate what would happen in 1985 if crude oil revenues remained constant (Baseline Case), declined by 10 percent (Case II), or fell by 25 percent (Case III). Because of the country's problems, even the baseline case assumes the IMF would allow Mexico some leniency in meeting the 1985 targets set two years ago. Specifically, this scenario posits a 5-percent increase in real government spending, no change in international reserves, and oil exports at their former ceiling of 1.5 million b/d at $27.00 per barrel. We also assume a $500 million reduction in debt service caused by an expected one-half-percentage-point drop in the London InterBank Offered Rate.

For cases II and III we did two simulations, one assuming no Mexican policy response and a second incorporating policy shifts that Mexico is likely to implement in response to the forecasted declines in economic activity.

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Baseline Case: Constant Oil Revenues. Even under this scenario, Mexico would be unable to expand its economy much next year. Reduced foreign borrowing and tight IMF financial targets will continue to hold down government consumption and investment, while financial problems and weak business confidence will keep private investment depressed.

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As things now stand, we expect Mexico City to press the IMF to loosen strictures on reflating the economy, even if oil revenues do not decline next year. After three years of falling consumption, Mexico City is under strong pressure to ease austerity and stimulate the economy. With national elections approaching next July, the government may adopt even more reflationary policies than the

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ones we posited. We have indications that Mexico City later this month will ask the Fund to boost substantially its 1985 target for the public-sector deficit, which was earlier set at only 3.5 percent of GDP. If this target is not revised upward, we estimate the economy will decline slightly.

If Mexico City boosts the increase in real government spending by several percentage points to 5 percent, our model indicates that real GDP growth is possible in 1985. We believe Mexico City would have difficulty selling reflation to the IMF without deeper import cuts and an increase in the daily depreciation of the peso against the US dollar from a 40-percent to a 50-percent annual rate. Taking all of these policy adjustments into account, our model suggests that the Mexican economy could expand by about 2 percent next year at the cost of high inflation.

Case II: Moderate Decline in Oil Revenues. A 10-percent drop in oil revenues next year (equivalent to either a price fall of about $2.70 per barrel or a 150,000-b/d sales reduction) would have a substantial impact on the economy. Assuming all other policy variables were held constant, such a drop would cause an economic contraction of 1.5 percent—3.5 percentage points below the baseline.

Only by adopting dramatic, multifaceted policies could the government offset the impact of lower oil revenues. Such a response would almost surely require additional revisions in IMF targets, including higher spending, drawdowns in international reserves, further cuts in imports, and an increase in the daily depreciation of the peso. Model results indicate, for example, that just to maintain baseline economic activity, Mexico City would have to raise spending another 3 percentage points, reduce international reserves by $1 billion, and increase the annual rate of depreciation of the peso to 60 percent. The cumulative effect of these actions would reduce imports 8 percent and boost inflation.

Case III: Oil Revenues Plummet. Our econometric analysis indicates that a 25-percent drop in oil revenues next year (equivalent to either a $6.75 per barrel price cut or a nearly 400,000-b/d sales reduction) would have a devastating effect on the Mexican economy. In the absence of offsetting policy responses, this unlikely scenario would cause GDP to decline 7 percent and would drive private consumption and investment down dramatically.

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In these circumstances, measures needed to prevent economic decline would require fundamental changes in economic policy. Mexico would virtually have to abandon its IMF-sponsored austerity program, although a substantial drawdown in reserves could temporarily delay any unilateral actions to increase debt relief. Only when the growth of government spending in the baseline case is more than doubled, international reserves reduced by $2.5 billion, and the annual depreciation of the peso increased to 80 percent, does the model simulate positive GDP growth. We estimate that these measures would cut imports by 20 percent and push inflation back toward triple-digit levels.

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Beyond 1985

Depressed oil revenues beyond next year would not only torpedo the economic adjustment program, but would also probably prevent Mexico from meeting rescheduled debt obligations. The intensifying liquidity crisis would probably drive Mexican economic decision making toward more statist policies, rather than inducing the government to lift its many restrictions on private investment. Mexico City might again blame the economic decline on the private sector and the US-led world economic structure. Such conditions also might encourage Mexico to reinvoke a moratorium on debt service. In turn, these actions would greatly increase the already strong resistance of bankers to new loans for Mexico and trigger another strong surge in capital flight.

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Lower oil revenues, disinvestment, and the cutoff of international capital could plunge the economy into a stagflation trap. Efforts to reinvigorate the economy by increasing government spending would unleash an inflationary explosion that would further

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Mexico: Impact of Reduced Oil Export Revenue [a]

	1984	1985				
	Projected	Baseline	10-Percent Decrease in Revenues		25-Percent Decrease in Revenues	
			No Policy Adjustment	With Policy Adjustment	No Policy Adjustment	With Policy Adjustment
	Percent Change From Previous Year					
GDP	1.0	2.0	−1.5	1.7	−6.8	0.2
GDP deflator	65.5	60.8	61.7	64.4	63.0	71.8
Private consumption	1.9	3.6	NEGL	2.2	−5.2	−0.8
Private investment	−4.8	3.4	−2.9	1.5	−12.3	−4.1
Real government consumption	1.0	5.0	5.0	8.0	5.0	12.0
Real government investment	2.0	5.0	5.0	8.0	5.0	12.0
	Billion US $					
Foreign exchange income	30.8	32.8	31.3	31.3	29.1	29.0
Petroleum exports	14.9	14.8	13.3	13.3	11.1	11.1
Other merchandise exports	7.8	8.8	8.8	8.9	8.8	9.0
Other [b]	8.1	9.2	9.2	9.1	9.2	8.9
Foreign exchange outlays	31.3	32.7	32.0	33.0	31.0	32.0
Debt service	17.1	17.1	17.1	17.1	17.1	17.1
Merchandise imports	9.0	10.0	9.6	9.2	9.1	8.0
Other [c]	5.2	5.6	5.3	6.7	4.9	7.0
Foreign exchange balance	−0.4	0.1	−0.7	−1.7	−2.0	−3.0
Change in reserves	2.0	0	0	−1.0	0	−2.5
Foreign borrowing requirement	**2.4**	**−0.1**	**0.7**	**0.7**	**2.0**	**0.6**
Memorandum items						
Trade balance [d]	15.3	15.3	14.1	14.6	12.5	13.8
Current account balance	4.5	5.1	4.3	4.8	3.1	4.6

[a] Assumes oil grade mixtures are constant.
[b] Includes service inflows, in-bond plants, and direct foreign investment.
[c] Includes outflows from services and capital flight.
[d] Trade balance includes exports of goods, in-bond industries, and transportation minus imports of goods.

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cut real wages and crowd out private investment. Rapid increases in the cost of living and unemployment would sharply erode living standards and prompt new highs in social tensions and illegal migration to the United States.

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The Philippines: Living With a Foreign Debt Overhang

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After a year of haggling and procrastinating, Manila has reached tentative agreement with the IMF on an economic program and completed negotiations with commercial and official creditors on a plan to restructure much of the Philippines' $25 billion foreign debt. Even with these agreements in place, however, we believe that the economic outlook for the Philippines is bleak during the rest of this decade and additional debt reschedulings will be required. Under the most favorable domestic and international economic conditions, we envisage GNP growth of no more than 4 percent annually before 1990. This will coincide with a period of rapid growth of the working-age population—3.3 percent annually—the highest in Asia.

The Rescue Package

After a year of economic decline, political unrest, and intense bargaining with its creditors, Manila is about to complete negotiations on an economic adjustment program that maps a long, difficult path to financial stability by the early 1990s. The program's key components are a $615 million IMF standby loan, an $8.5 billion financing package from commercial creditors consisting of new loans, rescheduled debt payments, and revolving trade credits, and $2.4 billion in new loans and rescheduled debt payments from official creditors.

The program is based on the IMF's calculations that Manila faces a $3.8 billion financing gap through 1985. Of this amount, Manila's commercial creditors are to supply $925 million in new loans and $775 million by rolling over arrears. The commercial agreement will be formally approved in early 1985, but loan disbursements will be backloaded—that is, $525 million will not be released until late next year—and they will be tied to continued compliance with IMF performance criteria. This agreement also substantially reduces Manila's amortization payments by postponing over $2.1 billion in payments due during 1984 and 1985. Furthermore, the package permits the foreign banks to extend rescheduling into 1986 at their option—which would postpone another $1.2 billion in amortization payments on commercial debt.

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The IMF-supported program is designed to improve the foreign payments position, reduce inflation, restore trade financing, and redress some of the economy's underlying structural weaknesses. If Manila continues the "prior policy actions" already in place—including the peso float, new taxes, and tight monetary policies—the standby loan will be approved by the Fund's Executive Board in mid-December. An agreement to reschedule debt owed to official creditors could follow shortly thereafter at the Paris Club.

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The Declining Economy

The foreign exchange crisis, economic austerity policies, and eroding confidence in President Marcos's political leadership have taken a heavy toll on the economy. On the basis of reports to the government's creditors, we believe that real GNP will decline this year by at least 5 percent, compared with a 1.4-percent increase in 1983. Our analysis suggests that public and private investment outlays have dropped by a third, while government consumption has fallen 14 percent. Furthermore, on the heels of successive devaluations and rapid money supply growth in early 1984, inflation is running at a 60-percent annual rate after averaging no more than 15 percent annually over the last three years.

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Anatomy of a Foreign Debt Crisis

Manila's foreign debt has increased tenfold since 1970, exceeding $24 billion in 1983. A decadelong spending spree was made possible by an abundance of government guarantees to private Filipino borrowers linked to the Marcos administration and by Manila's continued support for an overvalued peso—which artificially cheapened imports. Although foreign borrowing financed GNP growth rates averaging 6 percent annually since the early 1970s, it also resulted in a proliferation of uneconomic investments by the private and public sectors.

The cost of the borrowing binge mounted rapidly in the early 1980s. The Central Bank's growing dependence on short-term borrowing—at high interest rates—to finance the trade deficit pushed debt service payments up to $2.9 billion in 1983, absorbing over 35 percent of export earnings from goods and services and placing an unsustainable strain on foreign exchange reserves. Out of money and credit, on 17 October 1983, Manila declared a moratorium on principal repayments to foreign creditors, froze foreign exchange transactions, and asked the IMF and foreign bankers to organize debt rescheduling.

Progress toward a financial rescue package was slowed by Manila's foot-dragging. President Marcos squandered several opportunities for speedy approval of an IMF standby loan because of his preoccupation with containing political opposition in the wake of Benigno Aquino's assassination in August 1983. According to US Embassy reporting, Marcos's reluctance early this year to implement economic policies sought by the Fund further soured relations with the IMF and commercial bankers—relations already strained by Manila's penchant for procrastinating on promised reforms and falsifying macroeconomic data.

Real wages have declined by 25 percent over the past year, and basic commodities are widely reported in short supply. This sharp reduction in government spending is curtailing programs benefiting rural areas and is increasing discontent among civil servants and the military, according to US Embassy reporting. Moreover, unemployment this year has grown by 400,000 in Manila alone, according to estimates by Philippine economists.

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Another casualty of the economic decline has been the country's financial system. Since midyear, many Philippine banks have been pushed to the brink of collapse by a flood of recession-induced business failures and tight monetary policies. Over a dozen bank runs and closures, including the near failure of the nation's largest savings bank, are eroding public confidence in the country's financial system.

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One of the few bright spots is the country's external trade position, which registered its first improvement since 1977. We project that the current account deficit will shrink by $1.2 billion this year, largely due to a 23-percent decline in imports—particularly capital goods. Furthermore, the nearly 65-percent depreciation of the peso since October 1983 promises to boost exporters' profits and encourage export-oriented production in the years ahead.

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Near-Term Outlook

Using an econometric model to highlight the economy's response to the debt crisis, austerity measures, and different external economic conditions, we believe that over the next year Marcos will be faced with choosing between the policy prescriptions of his creditors—chiefly the IMF—or charting a course that seems more politically expedient in the short term.

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Philippines: Balance of Payments *Million US $*

	1979	1980	1981	1982	1983	1984 [a]
Current account	−1,497	−1,904	−2,061	−3,200	−2,757	−1,542
Merchandise trade balance	−1,541	−1,939	−2,224	−2,646	−2,482	−487
Exports	4,601	5,788	5,722	5,021	5,005	5,300
Of which:						
Coconut products	965	759	756	590	622	753
Sugar	238	474	609	440	321	315
Lumber	484	433	383	293	323	325
Copper	330	679	544	313	242	335
Nontraditional manufactures	1,520	2,108	2,609	2,380	2,354	2,662
Imports	6,142	7,727	−7,946	7,667	7,487	5,787
Oil	1,385	2,248	−2,458	2,105	2,132	1,831
Services	−311	−399	−309	−1,040	−747	−1,305
Interest payments	−626	−975	−1,374	−1,990	−1,929	−2,380
Transfers	355	434	472	486	472	250
Capital account	894	1,532	1,329	1,562	633	−744
Direct investment (net)	20	−102	175	17	112	−20
Medium- and long-term loans (net)	1,151	1,032	1,332	1,548	1,392	−364
Short-term loans (net)	−558	196	−213	−56	−836	−500
Other	281	406	35	53	−35	140
Overall balance	**−603**	**−372**	**−732**	**−1,638**	**−2,124**	**−2,286**
Cumulative arrears on interest and principal payments—including debt payments covered by the moratorium.					1,600	2,700

[a] Projections.

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Assuming favorable external economic conditions and a relatively stable domestic political environment, we expect real GNP to decline 2 percent next year and to grow by no more than 2 percent in 1986. Our analysis suggests austerity measures requested by the IMF will reduce the current account deficit to $1.1 billion next year and trim the public-sector deficit to 1 percent of GNP. In addition, our baseline assessment suggests that tight monetary policies and wage restraint will trim inflation to 20 percent in 1985 and 14 percent in 1986. Manila will need to extend commercial and official debt rescheduling agreements into 1986 and 1987, however, to deal with amortization payments, which total $2 billion annually.

The political costs of austerity, we believe, will be substantial, and Manila's strained relations with its creditors—and its recent record of tough negotiations with the IMF—suggest that Marcos could be tempted into a confrontation with the Fund over economic policy. Continued domestic unrest could prompt Marcos to grant tax, wage, or price relief—moves that might jeopardize the hard-won financial rescue package and intensify the 1985 downturn.

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If Manila falls out of compliance with IMF targets and disbursements are suspended—as they were in 1983—the Philippines would need to balance its

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external accounts rapidly, since small amounts of new external financing and precariously low foreign exchange reserves would be insufficient to support a large trade deficit. To cut the trade deficit, Manila would probably impose additional budget cuts, higher interest rates, and quantitative restrictions on imports. It would also request another moratorium on external debt payments.

Under this noncompliance scenario, we believe real GNP would fall by over 7 percent in 1985—5 percentage points worse than the decline projected with the IMF program in place. Furthermore, inflation would leap to about 45 percent as domestic spending concentrates on the few available imported and domestic goods. For their part, commercial and official creditors would probably not remain passive during another debt moratorium. Banks probably would selectively refuse to renew trade credits, and some official creditors would be required to suspend further assistance, thus forcing Marcos back into negotiations with the IMF.

Looking to 1990

Manila's foreign debt burden probably will continue to constrain economic growth through 1990, depressing living standards and further aggravating already high unemployment levels. Even with sound economic policies, favorable world economic conditions, and some restoration of business confidence, by the late 1980s our simulations suggest that annual GNP growth rates will not exceed 4 percent. This period of slow economic expansion will coincide with growth in the working-age population of 3.3 percent annually—Asia's highest.

Financing even these modest growth rates will require about $1.4 billion in new net foreign lending each year between 1987 and 1990. Outstanding foreign debt would rise to roughly $33 billion, and we project that debt service payments will absorb nearly 36 percent of export earnings in 1989. The Philippines, however, will face net outflows of foreign exchanges after 1985 as its annual interest payments on foreign debt exceed net capital inflows by $2 billion. Nonetheless, if Manila remains in compliance with the IMF and shows good faith in initiating economic reforms, we believe that these financing levels can be secured.

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In any case, the Philippines' road back to financial stability will continue to be long, difficult, and easily derailed by external factors. The Philippine economic recovery is quite sensitive to changes in world trade, international interest rates, and oil prices:

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- If GNP growth in the Philippines' major trading partners falls 2 percentage points below our best case scenario, we project that by 1989 Philippine GNP per capita would be 10 percent below the best case level, while the debt service ratio would climb from 36 percent to 43 percent.
- Similar results occur if international interest rates are 3 percentage points higher than in our best case scenario.
- If a new oil shock drives oil prices up by 50 percent, 1989 GNP per capita would be 20 percent lower than in our best case and financing requirements between 1986 and 1989 would be $10 billion higher.

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Colombia: A Tottering Economy

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President Betancur is facing his most difficult test since he entered office in August 1982. His attempts to keep campaign promises over the next few months will clash head on with a cash-flow crisis that is leading to a likely suspension of some debt service payments. To save face and secure foreign financial support, he will probably adopt IMF-backed austerity measures that, although economically beneficial in the longer run, will generate higher unemployment and inflation, lower economic growth, and political and social unrest through 1985.

Domestic Doldrums

The administration has failed to engineer significant economic improvements. Although Betancur pursued expansionary policies to accommodate political pressure groups, the economy grew by only 1 percent last year—the worst performance since 1950—and unemployment continued to rise. Increased public spending, new subsidies, and eased access to credit for farmers and other groups kept inflation close to 20 percent.

Economic growth this year is still depressed, according to the US Embassy. Industry revived this spring, but agriculture, commerce, and construction activity remain slack. Unemployment reached a record 14 percent in June, despite the administration's effort to create employment. Accelerated monthly devaluations and import restraints helped push prices up at an annual rate of 21 percent during the first six months of the year, well above the government goal of 14 percent.

Financial problems persist despite some reforms. The public deficit that tripled to record levels in 1983—$1.6 billion, according to government figures—is still growing despite new taxes. The government has exhausted available domestic credit resources to bridge the growing fiscal gap and to come up with matching funds for development loans needed to relieve the external accounts. Leading Colombian firms, moreover, notified the government in February that they will no longer service their foreign debt. They maintain that the acceleration of monthly devaluations and their cash-flow problems make further payments impossible. The financial system also is reeling from private-sector borrowers' lack of liquidity, widespread domestic corruption, and insider loans made by the banks.

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Bogota's continuing economic problems are causing some social restiveness and eroding Betancur's popularity. According to US Embassy officials, the latest polls show that the President lost about half of his nearly 70-percent public approval rating between August 1983 and August 1984, largely because of delays in settling the insurgency and declines in living standards. Colombians have been reacting negatively not only to falling living standards, but also to a highly resented new value-added tax. Organized labor, turned restive and frustrated by the persistent recession, has ended its two-year honeymoon with Betancur: teachers struck for two months in April and busdrivers demonstrated in August, when the government vetoed fare hikes.

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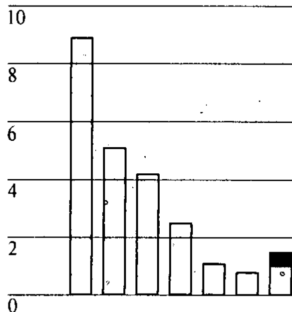
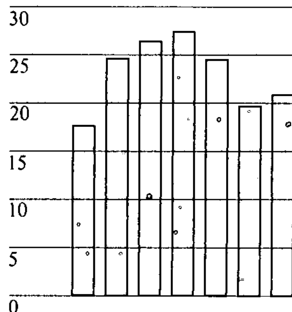
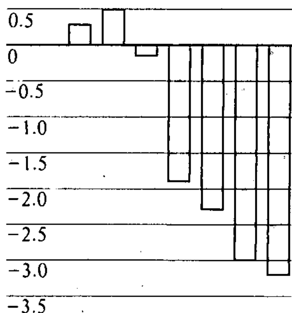
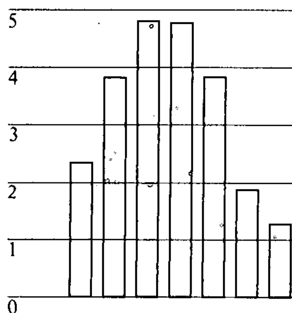
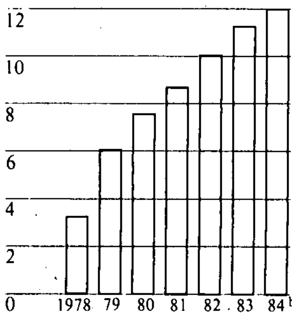
Colombia: Selected Economic Indicators, 1978-84

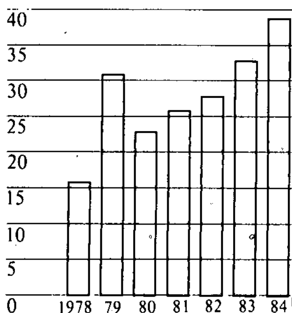












[a] End of year; excludes gold.
[b] Estimated.

Colombia's Debt Profile

Colombia so far has managed to service its $12 billion foreign debt without refinancing. Over half of the $8 billion government debt is owed to international agencies like the World Bank and the Inter-American Development Bank at lower interest rates and longer terms than that owed to commercial banks. The government estimates total private foreign debt at $4 billion, including some $1.2 billion in short-term obligations. While Colombia's overall external debt is smaller in relation to the size of its economy than that of many other developing countries, the debt has been rising sharply, and the debt service ratio more than doubled between 1978 and 1983.

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Colombia: Balance of Payments

Million US $

	1980	1981	1982	1983 [a]	1984 [b]
Current account balance	**−159**	**−1,895**	**−2,292**	**−3,000**	**−3,200**
Trade balance	−238	−1,544	−1,946	−1,805	−1,700
Exports, f.o.b.	4,062	3,219	3,230	2,875	2,900
Coffee	2,375	1,459	1,577	1,465	1,500
Imports, f.o.b.	4,300	4,763	5,176	4,680 [c]	4,600 [c]
Net services and transfers	79	−351	−346	−1,195	−1,500
Capital account balance	**1,200**	**1,800**	**2,000**	**700**	**−100**
Of which:					
Direct investment	121	228	337	56	131
Long-term loans	100	600	700	300	
Short-term capital and errors and omissions	200	100	200	−600	−700

[a] Estimate.
[b] Projection.
[c] Reflects tightening of nonessential imports and accelerated monthly devaluation pace.

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Coping With Pressures

The next few weeks will be critical for an administration that has few options. The burgeoning fiscal deficit threatens the slim foreign reserves cushion, which at the present pace of decline would be exhausted by mid-1985. We doubt Bogota would favor further import restrictions, because they would be incompatible with plans for economic growth. To avert a foreign exchange crisis, bankers are urging Colombia to undertake an IMF stabilization program.

The cash shortage is forcing the Betancur administration to weigh the economic consequences of failing to make debt payments against the political ramifications of a large devaluation and measures to reduce the fiscal deficit. In our view, Betancur probably will continue publicly to pretend that his policies are working, but will privately undertake a "shadow" IMF-backed austerity program.

In any case, we believe he will have difficulty obtaining sufficient political backing for unpopular adjustments. As the economic situation deteriorates further:

- Various import-dependent interest groups will demand relief.
- Influential coffee growers will press for higher domestic support prices to offset increasing production costs.
- Labor will call for wage hikes and more public spending to maintain buying power and ease unemployment.
- Business critics will insist Betancur hold down labor costs and devalue the currency.

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The President will have to contend with both political resistance and inadequate financial resources in his efforts to implement the reforms he pledged in a nationwide truce with the guerrillas.

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Economic Impact of Narcotics and Other Contraband on the Colombian Economy

Trends in financial flows associated with drug production, as reported by the US Embassy in Bogota, do not support the belief, common both inside and outside Colombia, that "black money" continues to be a source of strength for the Colombian economy. The US Embassy reports that earnings from cocaine and marijuana have declined sharply since 1982 as a percent of GDP and have actually had a contractionary effect on the money supply because other exports have not risen enough to compensate for falling drug earnings. Thus, drug income does not serve as a countercyclical economic force for Colombia, but appears to move in the same direction as the economy as a whole, worsening the problems of the legitimate economy and impeding government efforts to deal with its financial difficulties.

The government has promised to reintegrate the guerrillas into the civilian population by putting them on the government payroll for a year at the minimum wage, granting them credits to establish small businesses, and, in some cases, giving them land. These offers have provoked complaints from many corners of society and stiff congressional opposition. Peace on these terms would entail high short-run costs but, in our view, bestow significant benefits over the longer term.

Outlook

Most forecasts of the pace of recovery in the developed countries indicate that Colombian exports are unlikely to post the strong rebound needed to reduce the persistent current account deficit. According to US Embassy estimates, sales of coal from the El Cerrejon project, scheduled to start next February, will provide only modest relief. Major infrastructure investments needed to exploit substantial oil reserves in the interior will also delay any near-term help from the energy sector. We believe international bankers will resist financing a large payments deficit and providing the loans for new development projects without an IMF stabilization program in place.

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Such a strategy will probably lead to further near-term economic decline. While austerity measures are essential over the longer term, in the short run they will produce higher unemployment, inflation, and lower real wages and economic growth. Thus, we expect economic stagnation to continue in 1985, with growth at a 2-percent pace.

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We believe Betancur will avoid much of the political fallout for these conditions. He has blamed former Finance Minister Edgar Gutierrez for the domestic economic troubles and external factors—such as low commodity prices, protectionism by Colombia's principal trading partners, and foreign bankers' reluctance to lend—for the cash-flow crisis. If the opposition Liberals, who control Congress, reject the President's proposals for tax increases or fail to give the administration emergency authority to restructure the public sector, Betancur will have an additional scapegoat.

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NICs: Accelerated Penetration of World Markets

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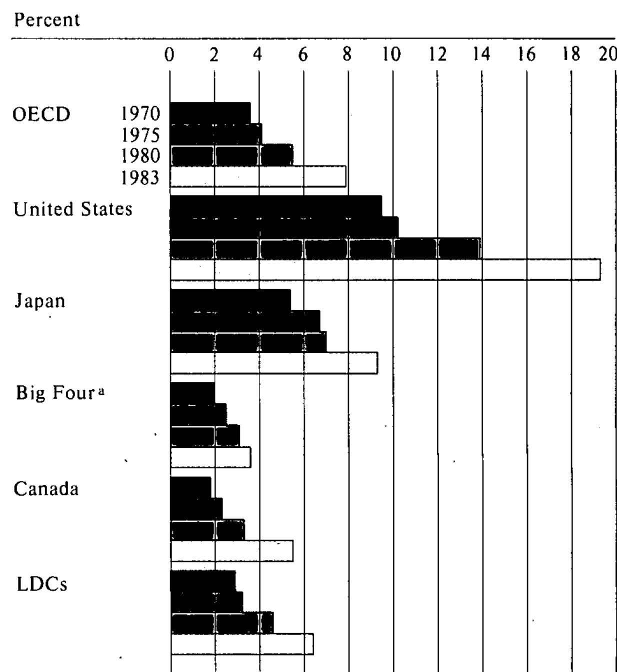
The newly industrializing countries (NICs)[1] have sharply increased their penetration of world markets, particularly since 1980. In the OECD import market, the NICs have almost doubled their share over the past decade, in large part because of sizable gains in the US market. In the LDCs, where overall imports dipped between 1980 and 1983, purchases from the NICs continued to rise sharply. The upward trend in the NIC share of world trade is likely to continue at least in the near term because of the growing competitiveness of these countries in many product lines. In response, we can expect growing protectionist pressures against the NICs, particularly in the industrial countries.

The Acceleration

The NICs have been gradually increasing their share of both industrial and developing country markets since 1970. The pace at which they have been penetrating world markets, however, has accelerated since 1980. This is particularly evident in the case of the OECD market. Last year the NICs accounted for nearly 8 percent of OECD imports, compared with 5.5 percent in 1980. First-half 1984 trade data for the Big Seven show an even further penetration, with imports from the NICs accounting for 9.5 percent of total Big Seven foreign purchases, compared with 9.2 percent for all of 1983.

Most of the recent gain in the NICs' share of the OECD import market has stemmed from sharp increases in exports to the rebounding US economy. NIC sales rose 46 percent between 1980 and 1983, boosting the NICs' share of the US market from 14 percent of US imports to over 19 percent. First-half 1984 trade statistics for the United States show

Newly Industrialized Countries: Share of World Imports



[a] West Germany, France, the United Kingdom, and Italy.

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continued growth in purchases from the NICs, reflecting the continued rise in US import demand. Increased NIC exports to the United States consisted mainly of manufactures such as chemicals, textiles, electrical machinery, and consumer electronics. US imports from the six NICs were up nearly 31 percent in the first half from a year earlier and accounted for about one-fifth of total US foreign purchases.

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[1] The newly industrializing countries are Brazil, Hong Kong, Mexico, Singapore, South Korea, and Taiwan.

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NIC penetration of other OECD markets has been less dramatic because of weaker trade links and trade barriers in Western Europe, particularly for steel and textiles. Last year NIC sales to the Big Four European nations accounted for only 3.6 percent of their imports—barely higher than the share in 1980. Among the major West European nations, the NICs have been most successful in penetrating the UK market, where they accounted for 5 percent of foreign purchases in 1983. In France and Italy, on the other hand, the NIC share was just 3 percent. NIC sales to Japan last year amounted to $11.7 billion or just over 9 percent of total Japanese imports, up from 7 percent in 1980.

Although LDC imports overall fell by 3.8 percent between 1980 and 1983, purchases from the NICs rose 35 percent. As a result, the NICs' share of the LDC import market climbed from 4.6 percent in 1980 to 6.4 percent in 1983. Major items imported by the LDCs include petroleum products, some foodstuffs, and manufactures such as textiles, steel, and consumer electronics. First-half 1984 figures show a continuing upward trend in NIC exports to the LDCs, with NIC sales to these countries up an estimated 14 percent over the same period last year.

OECD: Imports From the NICs *Billion US $*

	1970	1975	1980	1983
Total	**8.3**	**24.9**	**75.6**	**95.2**
United States	4.1	10.8	35.6	52.0
Japan	1.0	3.9	9.9	11.7
Western Europe	2.7	8.5	25.3	25.1
West Germany	0.7	2.5	6.5	5.7
France	0.2	0.7	3.1	3.1
United Kingdom	0.6	1.6	4.6	4.7
Italy	0.3	0.7	2.3	2.3
Other	0.9	3.0	8.8	9.3
Canada	0.3	0.9	2.2	3.8
Other	0.2	0.8	2.6	2.6

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Underlying Factors

In recent years, the NICs have become more competitive in many lines of manufacturing ranging from textiles and shoes to steel products and electronics. The rapid growth of export-oriented electronics industries in most of these countries has been a major factor in boosting their sales to the industrial West. Many NICs have targeted certain industries for expansion and have made great efforts to attract foreign investment to develop these industries. South Korea, for example, has entered joint ventures with US firms to acquire the technology to produce more advanced semiconductors. The NICs have also been marketing their products more aggressively in both industrial and developing countries. Mexico and Brazil, for instance, have been promoting their exports through currency devaluation and various fiscal incentives to increase foreign exchange earnings with which to service their debts.

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Prospects

The upward trend in NIC penetration of world import markets will probably continue in the near term. With many LDCs still unable to increase foreign purchases substantially because of their financial problems, the NICs are likely to focus their sales drives on the more open industrial country markets. Further penetration of OECD markets will probably lead to new protectionist measures against the NICs. The West Europeans, for instance, have expressed concern over increased NIC competitiveness in declining industries such as steel and textiles and may try to further limit NIC access to their markets. While the Japanese are, in general, less concerned, they are worried about the competitiveness of their steel industry, particularly in third country markets.

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