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29 briefs

International Economic & Energy Weekly [redacted]

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25X1

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International Economic & Energy Weekly [redacted] 25X1

Synopsis

1 **Perspective—*OPEC: Pressures Mount*** [redacted] 25X1

OPEC's failure to adhere to a production ceiling set last October has nearly solidified market opinion that the organization cannot hold the line on prices. [redacted] 25X1

13 **Iraq: Expanding Export Capacity in a Weak Oil Market** [redacted] 25X1

Baghdad is moving ahead with plans to boost its oil export capacity, despite prospects for a continued weak oil market over the next two to three years. If Baghdad attempts to boost exports substantially once these projects are completed, oil prices will come under serious downward pressure in the absence of accommodating cuts by other exporters. [redacted] 25X1

17 **Venezuela: Implications of the Multiyear Debt Rescheduling** [redacted] 25X1

Venezuela's provisional multiyear debt agreement should improve relations with bankers and lessen financial strains over the next several years. Nevertheless, we estimate that debt servicing and import payments will exceed projected foreign exchange earnings through 1989, which Caracas probably will finance through reserve drawdowns and additional foreign borrowing. [redacted] 25X1

21 **Ethiopian Famine: No Solution in Sight** [redacted] 25X1

Widespread famine in Ethiopia could result in several hundred thousand deaths this year and, given the poor harvest prospects, conditions will almost certainly worsen in 1985. [redacted] 25X1

27 **India: Economic Problems and Policy Choices for a New Government** [redacted] 25X1

On the eve of national elections in late December, Prime Minister Rajiv Gandhi inherits a temporarily buoyant economy. Nonetheless, his Congress (I) Party, which is expected to remain in power, will face chronic economic inefficiencies and a return of international payments problems before the end of the decade. [redacted] 25X1

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33 **International Financial Situation: Political Update** 25X1

Governments of financially troubled LDCs this past month used varying strategies to defuse strikes and protests mounted by opposition forces. 25X1

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International Economic & Energy Weekly 25X1

14 December 1984

Perspective

OPEC: Pressures Mount 25X1

OPEC's failure to adhere to a production ceiling set last October has nearly solidified market opinion that the organization cannot hold the line on prices. OPEC now faces a two-pronged threat on its price structure: market fundamentals that indicate continued weak demand and ample, if not growing, supply potential; and market psychology. At the same time, mounting revenue needs continue to undermine discipline within the organization. As a result, we believe there is a growing possibility that OPEC will have to lower official oil prices either in the next few months or in the next year or so. 25X1

OPEC's commitment to the production cuts agreed to in late October and an expected surge in oil demand for winter heating needs have failed to materialize and are keeping downward pressures on spot prices. OPEC output has not been reduced significantly and, indeed, has even increased in some countries. At the same time, generally mild weather in the Northern Hemisphere has kept oil consumption down. The combination of weak market conditions and lack of OPEC discipline has now convinced most market participants that oil prices will fall and this, in turn, has further weakened demand as the major oil companies and other consumers deplete high-priced inventories in expectation of lower future prices. 25X1

OPEC members continue to be their own worst enemies in defending prices. Despite the realization that lower prices will be damaging to all producers, revenue pressures are forcing many producers to discount prices to achieve higher sales. According to industry estimates, about half of OPEC oil exports are now being sold outside the official price structure. OPEC's problems are further compounded by the fact that the current price structure does not accurately reflect the difference in market values for light and heavy crudes. The disadvantage experienced by light crude producers such as the UAE and Nigeria has forced them to offer discounts of up to $2 per barrel. OPEC has indicated that a proposal to realign the price structure of light and heavy crudes will be made at the 19 December ministerial conference. Given the advantage now held by heavy crude producers, however, we believe a solution will be difficult to achieve. 25X1

OPEC can probably muddle through the current crisis, especially if some semblance of cold weather returns to the Northern Hemisphere. While inventories can be pared further, some minimum stock levels must be maintained even with the substantial reserve of surplus productive capacity to draw on. Most of this capacity is in the Middle East, and it takes a minimum of 30 to 45 days to get that oil delivered to major consuming areas. 25X1

Over the longer term, however, OPEC prospects of maintaining the $29 benchmark are not bright. Industry forecasts indicate only slow growth in demand at best; recent evidence suggests that the conservation and substitution effects of higher oil prices have been far more substantial than expected. Even the historical relationship between economic growth and increased energy use has weakened considerably over the past several years, resulting in substantially lower energy requirements per unit of economic output. As a result, oil production will have to continue to be limited to maintain prices. Little support can be expected from non-OPEC producers in cutting production or even limiting the increase in new production over the next year or so. Internally, OPEC will continue to be faced with revenue pressures, limited flexibility for further production cutbacks by Saudi Arabia and Kuwait, and growing pressure from Iraq for higher output as its export capacity increases late next year. Unless OPEC is able to muster a cooperative effort heretofore unseen or oil supplies are again disrupted by war or revolution, the likely outcome will be a drop—perhaps a substantial one—in the price of oil. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

North Sea Gas Developments

[redacted]

British and Norwegian representatives met last week for further discussions on
the possible sale of up to 10 billion cubic meters per year of natural gas from
Norway's Sleipner field to the United Kingdom. Although the Norwegians are
seeking a resolution of the matter by yearend, it is doubtful that details can be 25X1
finalized by then. In that event, Norway may turn to the continental markets
for both Sleipner and the much larger Troll gasfield [redacted] 25X1
[redacted] Statoil has asked Oslo for approval to begin preliminary 25X1
negotiations for the sale of Troll gas, according to Embassy reporting.
Development of the Sleipner and Troll gasfields will be an important step
toward meeting West European gas demand in the 1990s and avoiding undue
reliance on Soviet gas. [redacted] 25X1

Western Participation in Soviet Pipeline Project

[redacted]

The US Embassy in Moscow reports that the USSR early next year probably
will select major contractors for a 250-kilometer coal slurry pipeline scheduled
for construction in West Siberia in 1985. US, Italian, French, West German,
and Japanese firms are bidding on the project, which could involve equipment 25X1
and technology imports valued at up to $200 million. If the pilot project proves
feasible, the Soviets eventually plan coal slurry pipelines that are 2,000 to
3,000 kilometers long. The USSR has little experience in the construction and
operation of coal slurry pipelines, and substantial Western assistance probably
will be required for the project to succeed. [redacted] 25X1

Australian Coal Exports Up

[redacted]

Coal exports—Australia's largest export earner—are headed for another
record year. Coal shipments were up 23 percent in the first nine months,
compared with year-earlier levels. Steam coal exports rose significantly as a
result of a two-thirds increase in deliveries to Japan and a nearly 75-percent
rise in shipments to Western Europe. The increases resulted in part from price 25X1
discounts as well as foreign economic recovery and stockpiling in anticipation
of labor unrest. If present trends continue, total Australian coal exports could
exceed 74 million metric tons this year—surpassing the recordbreaking 1983
level by more than 20 percent. At these volumes, Australian coal exports
possibly could equal or exceed coal exports by the United States—historically
the world's largest coal exporter. [redacted] 25X1

International Finance

Soviet-Owned Bank in Trouble

[redacted]

Unauthorized and unrecorded speculation in gold and foreign exchange futures by former officials at the Soviet-owned Wozchod Handelsbank in Switzerland may threaten the bank's financial position. The bank's principal gold dealer—a Swiss national—has since been dismissed and may face criminal charges. Former bank president Yuriy Karnaukh [redacted] has been recalled to Moscow. 25X1 This is the latest blatant example of incompetence among Soviet bankers in the West—several other Soviet-owned banks were hit by financial fiascoes over the last decade. Even if Wozchod survives, its credibility in the markets will be low for a long time. [redacted] 25X1

Global and Regional Developments

EC Renews Lome Convention

[redacted]

The EC and 65 African, Caribbean, and Pacific (ACP) countries signed a new trade and development cooperation agreement in Lome, Togo, on 8 December after nearly a year of contentious negotiations. This third Lome Convention—the Community's primary aid vehicle—will run for five years, beginning next 25X1 March and provide almost $6.4 billion in EC grants and loans. This falls nearly $1.5 billion short of what the ACP countries demanded, and in real terms provides no increase in Community aid. The agreement does not significantly alter existing EC-ACP trade preferences. At the Community's insistence, the preamble includes a symbolic reference to human rights, and the text contains a chapter aimed at promoting foreign investment and guidelines for greater EC-ACP social and cultural cooperation. [redacted] 25X1

World Food Aid Target Met

[redacted]

The Food Aid Committee of the International Wheat Council (IWC) recently announced that the 10-million-metric-ton food aid target—established by the 1974 World Food Conference—has been met for the first time. Total grain shipments to LDCs reached a record 10.5 million tons in crop year 1983/84, 25X1 and US shipments totaled 6.45 million tons, exceeding the minimum US obligation by nearly 2 million tons. Regional food aid shortages remain serious, however. While most recent food aid is being channeled to drought-stricken African nations, current pledges cover less than half of Africa's emergency food needs—estimated at 4-5 million tons for 1984/85. Much higher food aid targets probably will be sought in a renewal of the IWC Food Aid Convention, which expires in June 1986. [redacted] 25X1

National Developments

Developed Countries

Possible Italian Legislation on Foreign Investment

[redacted]

Rome's concern over recent foreign acquisitions of several leading Italian companies, including ATT's participation in Olivetti, may lead to tighter controls over foreign direct investment. The Industry Ministry is considering new legislation to require prior notification and formal authorization for capital transactions, particularly for foreign acquisitions exceeding 30 to 40 percent of a domestic firm. The government is especially concerned about the employment impact of agreements requiring Italian firms to distribute the foreign partners' products. Such legislation, however, probably would not be a major impediment to foreign direct investment. Many acquisitions, including the ATT-Olivetti tieup, have provided Italian firms with much needed capital and allowed access to the foreign partners' research and development facilities—benefits that Rome presumably would not want to jeopardize. [redacted] 25X1

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British Government Proposes Changes in Regional Aid

[redacted]

In late November, the Thatcher government proposed cuts in the regional assistance policy to industry by reducing the number of regions eligible for automatic grants and decreasing the amounts. Selective assistance would be available to an increased number of areas, including the economically depressed West Midlands. [redacted] 25X6 The government intends to eliminate grants for replacing industrial plant and equipment, a move the British Confederation of Industry says will cut incentives for modernization. The plan, strongly criticized by the Labor Party and the Trades Union Congress, is designed to save the government approximately $360 million per year by 1987-88. [redacted] 25X1

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Growth in French GDP

[redacted]

French gross domestic product (GDP) rose at a seasonally adjusted annual rate of 4 percent in the third quarter of 1984; GDP now stands 2.2 percent above what it was a year ago. Reversing the pattern of the previous two quarters, exports rose over 12 percent and imports fell more than 3.5 percent. The external sector was thus responsible for more than 90 percent of third-quarter growth. Real investment continued its four-quarter slide, despite government predictions of rapid growth this year. The government has lowered interest rates and taxes and will probably concentrate on policies to improve investment. Consumption fell slightly in the third quarter, as anticipated, but government spending continued to grow. [redacted] 25X1

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West German Business Profits Up

[redacted]

West German corporate profits and finances improved sharply last year, arresting their long-term slide. According to a Bundesbank study, aftertax profits increased over 35 percent in 1983, following a drop of nearly 6 percent in 1982. The improvement was due primarily to lower business expenses, especially for interest and personnel. Both internal and external financial resources strengthened, and the ratio of capital stock plus reserves to total assets made a modest upturn to 18.5 percent. This ratio had dropped from 30 percent in 1967 to 18.4 percent in 1982, lessening the ability of business to undertake investment and withstand business reverses. [redacted] 25X1

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West German Space Station Participation

[redacted]

West German participation in the US manned space station reportedly is now blocked only by financing problems. Research Minister Hans Riesenhuber, the project's most enthusiastic backer, is prepared to have the Ministry cover two-thirds of the projected $1 billion German contribution out of its 1985-89 budgets. The Finance Ministry, however, wants the Research Ministry to pay the entire amount. Bonn views participation as politically important but has been concerned that the cost might outweigh any substantive benefits, especially regarding technology sharing. The Cabinet probably will postpone a final decision until early next year. [redacted] 25X1

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Japanese Economic Growth Slows in Third Quarter

[redacted]

Japan's GNP expanded at an annual rate of 3 percent in the third quarter, down from 7.6 percent in the previous period. Exports were up by only 1.7 percent, while imports jumped by 7.1 percent. Private plant and equipment investment, which has been leading the domestic economy, grew by 2.3 percent. Housing and inventory investment were also up. Private consumption—over half of GNP—remained sluggish, however, growing by only 0.7 percent. Government spending, constrained by the need to fight the persistent deficit, was also weak. The Economic Planning Agency remains confident that its target of 5.3-percent growth for fiscal 1984 (which began 1 April) will be reached. The domestic economy has grown steadily despite the foreign sector's fluctuations. Some in Tokyo are concerned, however, that investment and growth will be cut back next year as stimulus from foreign demand declines. [redacted] 25X1

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[redacted]

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South African Auto Merger Threatens Jobs

Unemployment in South Africa's eastern Cape Province will rise if a merger—which will lay off an additional 2,000 automobile industry workers—takes place between Ford Motor Company of South Africa and Anglo-American's Amcar [redacted] Merger plans were prompted by declining sales in the current economic recession and would shift passenger car production to Johannesburg. Moreover, US Embassy sources report that each layoff will cost four additional jobs in related industries. Most of those to be laid off are black, and community leaders fear that greater unemployment could add to the simmering unrest in the eastern Cape, which has been hit hard by the recession and which many observers consider the most politically volatile area in South Africa. [redacted]

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Less Developed Countries

Status of Egyptian-Soviet Relations

[redacted] The USSR wants Egypt to buy more Soviet goods to reduce the almost $500 million Egyptian commercial surplus. Cairo, for its part, asked for a 10-year grace period in paying its $875 million clearing account deficit for military purchases. Gromyko said the Politburo would discuss Egypt's request, and the Egyptians agreed to pay cash for future purchases of military spare parts. If Egypt is to pay hard currency for military spare parts, its financial difficulties will sharply limit purchases. The Soviets may agree to a short grace period on Cairo's military clearing account deficit, which is supposed to be balanced at the end of each year. Egypt's total unpaid military debt to the Soviets, however—amounting to nearly $2.5 billion for purchases made in the 1960s and 1970s—will make Moscow reluctant to accept any substantial new deficits. [redacted]

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Lebanese Reconstruction Budget Approved

The Lebanese Cabinet has approved a 1984-85 reconstruction budget totaling $575 million for transportation, housing, communications, energy, water, and private industry. About 25 percent will go to ongoing projects, another 20 percent to loans to the private sector, and the rest to new commitments. Approximately the same amount, in dollar terms, was appropriated last year, but actual spending was only about 45 percent of that amount because of the fighting and a lack of revenue. The new budget calls for 70-percent foreign aid financing, and an accompanying report on the rebuilding of Lebanon puts foreign assistance requirements at $1.0-1.2 billion a year for the next eight to nine years. While Lebanon may receive the direct aid planned for the current budget if the security situation improves, $1 billion a year is completely unrealistic. [redacted]

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Sudanese Cotton Crop Bartered for Oil

Sudanese officials have told the US Embassy that Sudan is selling its entire crop of medium staple cotton to a company owned by Saudi entrepreneur Adnan Khashoggi. The cotton will be exchanged for badly needed crude oil and petroleum products. The Sudanese almost certainly are selling the cotton 25X1 at a substantial discount that could have been avoided had the cotton been sold through normal commercial channels. In the short run, the deal will alleviate the petroleum shortages that are crippling Sudan's economy. With its main exportable commodity now sold, however, Sudan faces 1985 with little prospect of foreign exchange earnings. 25X1

India-USSR Wheat Deal

In accordance with the 1985 trade protocol signed last week, India has agreed to sell the USSR 500,000 metric tons of wheat, the first major sale to the Soviets since the mid-1970s. Terms and delivery dates are not known, but Moscow 25X1 probably will pay for the wheat through a bilateral clearing account to balance New Delhi's purchases of petroleum and military equipment. With domestic supplies already overflowing, we believe New Delhi will deliver old stocks of Argentine, US, and Canadian wheat to make room for an expected record Indian harvest next spring. Moscow has indicated a desire to purchase up to 3 million tons of wheat from India, which we expect New Delhi will try to meet if the wheat harvest matches expectations. The Indian sales are likely to cut into the Soviet market for US wheat. 25X1

Pakistani Debate Over Islamic Banking

Debate over implementaion of Islamic banking continues in Pakistan, with both fundamentalists and foreign banking officials opposing government proposals to alter interest regulations. Religious scholars and fundamentalist economists, who generally back the government's efforts to "Islamize" 25X1 banking, recently rejected as "un-Islamic" plans to continue paying interest on loans to the government, state-sponsored savings plans, and government bond issues. Western bankers in Pakistan say that proposed guidelines for the distribution of profits would substantially reduce profitability and have asked for modifications, some of which have been agreed to by Islamabad. These competing objections pose a dilemma for Pakistani officials, who want the approval of Islamic authorities while retaining incentives for savings and investment. The continuing debate, along with the short time available to put the machinery into operation, probably will result in a postponement of the wholesale conversion to interest-free banking, now scheduled to begin on 1 January 1985. 25X1

Mexico Sets 1985 Economic Goals

Mexico's ambitious 1985 economic program is aimed at continuing the successful policies of President de la Madrid's first two years in office. Finance officials indicated they plan to reduce inflation, end the slide in real wages, boost economic growth 3 to 4 percent, and cut the budget deficit further. We believe achieving these goals will be very difficult. For example, we expect 25X1 inflation to significantly exceed Mexico City's target of 35 percent. This will put pressure on the budget on top of political demands to ease austerity before important elections next summer. Under these circumstances, scheduled decreases in basic food subsidies may not be fully implemented, and the government may be forced to reexamine its policy for real wages. Mexico would then overshoot its deficit target of 5.1 percent of GDP. [redacted] 25X1

Mexico Steps Up Peso Devaluation

[redacted]

Mexico's decision to step up the peso's daily slide from 13 to 17 centavos per day against the US dollar will help nonoil exports but only partially offset erosion in peso competitiveness. Meanwhile, the government is moving to ease import restrictions and tariffs to mitigate subsequent inflationary pressure. Fear of renewed speculation against the peso and the desire to distance the decision from next summer's elections probably influenced the timing of the announcement. [redacted] 25X1 25X1

Mauritian Textile Negotiations

[redacted]

A proposed visit to Washington next week by the Mauritian Ministers of Trade and Industry will focus on upcoming negotiations on US quota reductions for Mauritian textile exports. The delegation probably will stress the impact on economic development, although textile exports to the United States are a small share of total Mauritian exports. It probably will argue for preferential treatment based on Mauritian's human rights record and support for US interests in regional and international forums. According to Embassy reporting, Prime Minister Jugnauth regards the textile quota issue as a litmus test of US gratitude for his support for US policies. [redacted] 25X1

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Communist

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Good Start for Soviet Winter Grains

[redacted]

The Soviet winter grain crop, which normally accounts for about one-third of the USSR's grain output, is off to its best start in three years. Judging from data released by the USSR's Central Statistical Administration, the area sown is probably larger than that of last year. The US agricultural attache recently observed mostly "lush, even stands" in the Ukraine, North Caucasus, and Central regions. [redacted] meteorological data indicate that problems exist only in the southern Volga Valley and in the areas adjacent to the Black Sea, where dry soil conditions caused poor germination. [redacted] 25X1

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[redacted]

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[redacted] 25X1

Soviet Return to Extensive Growth Strategy

[redacted] 25X1

A Soviet economist in a recent conversation with a US Embassy Moscow official said that the surge in investment begun in 1983 is responsible for most of the Soviet economic growth over the last couple of years and reflects a return to an extensive rather than intensive growth strategy. If current trends continue, overall investment during this Five-Year Plan (1981-85) will have grown 20 percent in contrast to the planned 10 percent—much faster than in 1976-80. This is the first acknowledgment by a Soviet official that we are aware of that Moscow has abandoned attempts to significantly improve productivity while slowing the growth of investment. [redacted] 25X1

Health Services Criticized in Politburo Speech

[redacted] 25X1

In a recent speech to the Politburo, General Secretary Chernenko called for allocating additional funds to health services but funded by savings from increased efficiency. The press has criticized the medical profession for "bureaucratic redtape, vulgar negligence, and downright laziness." Health services account for less than 3 percent of GNP, and negative trends in life expectancy and mortality may explain the current criticism. The number of qualified medical school applicants is dropping, probably because of low pay, lack of prestige, and primitive working conditions, particularly in rural areas. The health sector also suffers from shortages of basic equipment and medicine and the slow construction of new facilities. [redacted] 25X1

[redacted] 25X1

Sino-Soviet Trade Agreement Signed

[redacted] 25X1

The USSR and China have signed an annual trade protocol for 1985 that calls for bilateral commerce to reach about $1.5 billion, a 36-percent increase over this year, according to Chinese news media. The growth in trade projected for next year continues a trend of expanding economic relations. In late October, a Soviet adviser, apparently the first since the early 1970s, arrived at a Chinese factory. The 1985 annual protocol was signed earlier than usual, perhaps to clear the way for Deputy Prime Minister Arkhipov to sign a five-year trade agreement during his coming visit. [redacted] 25X1

Vietnam Tapping Overseas Remittances

To ease a severe foreign exchange shortage, Hanoi recently eased the tighter controls instituted in 1983 on receipts by individual Vietnamese of foreign currency from abroad. The government increased by two-thirds the rate at which foreign currency is converted into Vietnamese dong and raised by 50 percent the quarterly sum that individuals could receive. Remittances through official channels—down 30 percent in 1983—will probably recover next year, possibly to the 1982 peak of $50 million, allowing Hanoi to resume limited payments on its $1.5 billion foreign debt to non-Communist countries. 25X1

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Iraq: Expanding Export Capacity in a Weak Oil Market [redacted] 25X1

Baghdad is moving ahead with plans to boost its oil export capacity, despite prospects for a continued weak oil market over the next two to three years. Completion of the Iraq-Saudi spurline will raise Baghdad's export capability by 500,000 barrels per day (b/d) by early 1986, and construction of a second Turkish pipeline by mid-1987 would provide Iraq the capacity to export an additional 500,000 b/d. If Baghdad attempts to boost exports substantially once these projects are completed, oil prices will come under serious downward pressure in the absence of accommodating cuts by other exporters. [redacted]

The Push Behind the Pipelines

Baghdad's efforts to increase oil exports are driven by serious economic problems. Prewar crude oil export capability of more than 3 million b/d had been cut to as low as 700,000 b/d by early war damage to its Persian Gulf export facilities and closure of the Iraq-Syria-Lebanon pipeline. As a result, crude oil exports—90 percent of the country's foreign exchange earnings—fell to about $7.8 billion in 1983 from a high of $25.3 billion in 1980. At the same time, Baghdad's revenue needs have increased substantially over the past 18 months by its acquisition of expensive weapon systems from France and the USSR. [redacted]

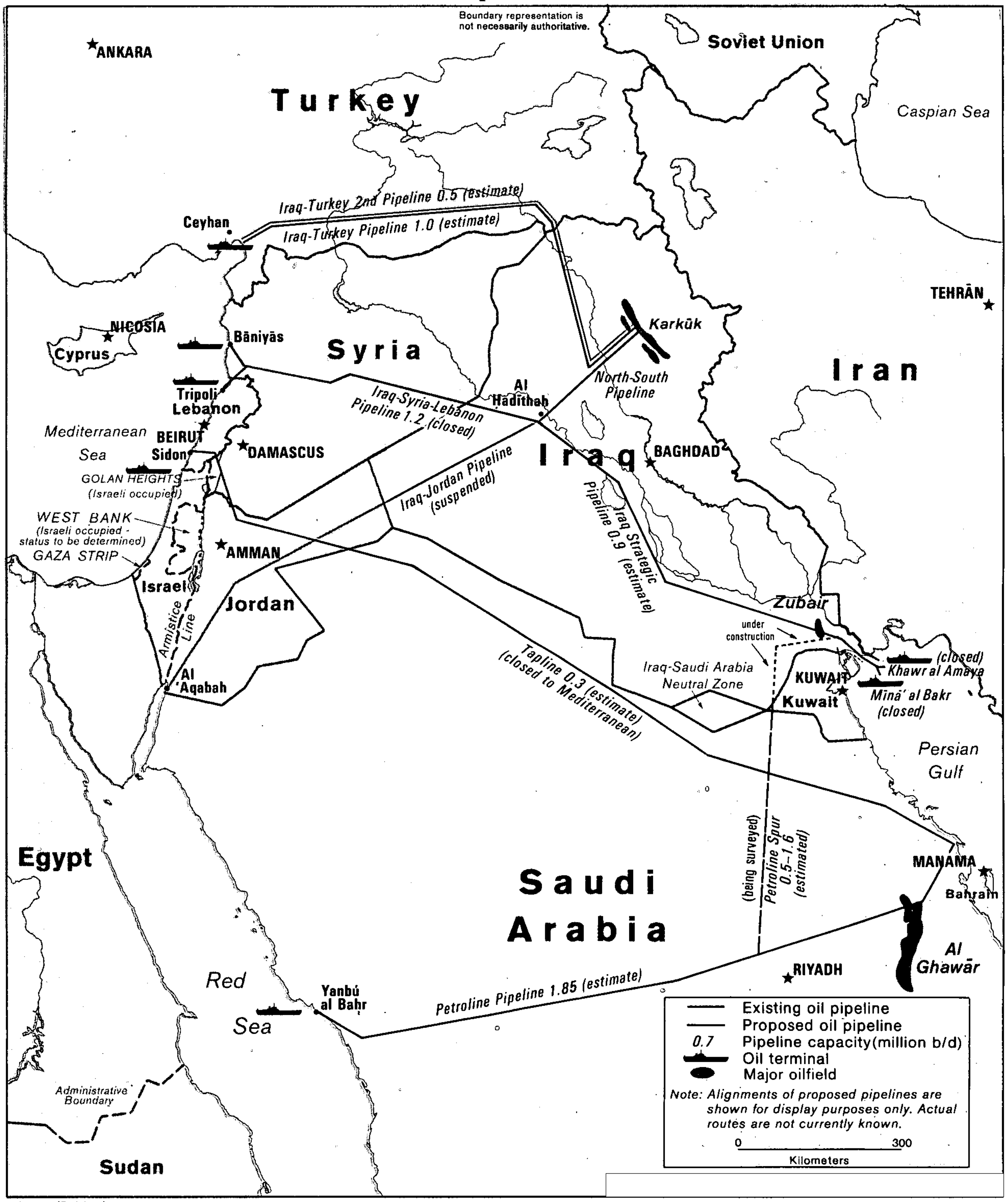
Iraq's increasingly difficult economic situation has forced a major effort to boost oil earnings. As a first step, Iraq has been able to increase production and exports by 300,000 b/d, primarily by expanding the export pipeline through Turkey—currently Iraq's sole outlet. In addition, Baghdad has secured agreements under which Iraq receives payments for about 300,000 b/d of Saudi and Kuwaiti crude delivered directly to Iraqi customers, and also has increased exports of both crude oil and residual fuel oil by truck through Turkey and Jordan. Recently, Baghdad has opened the way for still higher exports by negotiating agreements to build a spurline to Saudi Arabia's East-West pipeline and a second line through Turkey. [redacted] 25X1

New Pipeline Projects Under Way

Iraq's top-priority oil export project is a two-phased plan to tie the Zubair oilfields to the trans-Saudi Petroline and, later, to a new Red Sea port southeast of Yanbu al Bahr. In October 1984, the Italian Snamprogetti/Saipem group and the French Spie-Capag Co. won construction contracts worth $500 million for the 48-inch 500,000-b/d pipeline, according to various reliable sources. A US engineering company is serving as project manager, with the French handling pipelaying in Iraq and the Italian partners working in Saudi Arabia, according to industry press reports. Construction of the Iraqi section started in October 1984 and will be completed by June 1985 [redacted] 25X1 25X1 Meanwhile, pipeline construction in Saudi Arabia scheduled to begin this month will be delayed at least a month, apparently because land ownership claims—settlement of which could double the project's cost—are disrupting survey work, [redacted] 25X1 25X1

Baghdad has also begun preparations for construction of a parallel line to the Iraq-Turkey pipeline, using existing pump station facilities. [redacted] 25X1 Iraq's plans to build the parallel line would boost the system's capacity to 1.5 million b/d without drag-reducing chemicals.

Major Existing and Proposed Middle East Oil Pipelines



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Baghdad contracted with Snamprogetti to complete engineering studies and tender documents by January 1985. Plans call for the pipeline to be operational by mid-1987 at a cost of $600 million, according to the US Consulate at Adana. Construction bidders have been asked to provide financing proposals. [redacted]

Other Options

Some Iraqi plans to increase exports are unlikely to be successful. According to the US Interests Section in Baghdad, Iraq envisions a second phase of the Saudi spurline project to raise the pipeline's export capacity to 1.6 million b/d. Riyadh, however, has not authorized this portion of the project, and we do not expect them to do so. Meanwhile, security concerns seem to have caused Iraq to drop further consideration of the 1-million-b/d export pipeline from al Hadithah to al Aqabah, Jordan, [redacted]

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Outlook

If Iraq's pipeline projects are completed as expected—adding about 1 million b/d to export capacity—by mid-1987, we believe Baghdad will seek to export oil at levels close to its new capacity. The economic conditions that led Baghdad to expand its export capacity are unlikely to improve significantly before then. Iraqi intentions to use any new expanded oil-productive capacity were demonstrated most recently in a statement by Deputy Oil Minister al-Chalabi that the only production limitation Baghdad recognizes is the availability of export outlets. Moreover, Baghdad probably will expect continued war relief assistance from Saudi and Kuwaiti oil sales to Iraqi customers because Iraq believes it is fighting Iran on behalf of the Gulf states. [redacted]

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Given industry forecasts of little or no growth in the demand for OPEC oil, rising Iraqi output may threaten OPEC's ability to maintain oil prices. In our view, Baghdad is fearful of an oil price drop and would be willing to hold production increases somewhat below capacity to avoid a price break, but only if other cartel members accept additional cutbacks. Baghdad believes that other OPEC countries have benefited from Iraq's export difficulties and is likely to demand its fair share of OPEC production, despite the potential impact on other OPEC members. Risks of a sharp price decline will increase substantially if higher Iraqi output is not offset by other OPEC production cuts. [redacted]

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[redacted]

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Venezuela: Implications of the Multiyear Debt Rescheduling [redacted]

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Venezuela's provisional multiyear debt agreement should improve relations with bankers and lessen financial strains over the next several years. Foot-dragging by Caracas on meeting preconditions, however, will probably delay implementation of the agreement planned for next spring. Nevertheless, we estimate that debt servicing and import payments will exceed projected foreign exchange earnings through 1989, which Caracas probably will finance through reserve drawdowns and additional foreign borrowing. Moreover, Venezuela's payments position will remain vulnerable to external shocks such as lower oil prices and higher interest rates and political pressure for rapid reflation of the economy. [redacted]

Breaking the Debt Impasse

An 18-percent drop in oil earnings during 1982 and heavy capital flight drastically reduced bankers' willingness to continue lending to Venezuela. In early 1983, Caracas halted principal payments on public debt, cut spending, and adopted strict foreign exchange controls. International bankers ceased public-sector lending and cut trade credit, citing mounting overdue interest and the lack of a credible adjustment program. Although Caracas achieved a foreign payments surplus in 1983, relations with bankers deteriorated, overdue debts piled up, and Venezuela suffered a sharp recession. [redacted]

President Jaime Lusinchi pledged to resolve the debt crisis at his inauguration last February. To reestablish banker confidence, he announced an adjustment program without IMF prodding and promised to subsidize the cost of foreign exchange used to repay debt. Delinquent public-sector interest payments were settled in the spring. Moreover, Caracas maintained a moderate stance at the Cartagena meeting of Latin debtors in June. Taken together, these moves broke the financial impasse, and, in September, the bank advisory committee—representing 460 commercial banks—agreed in principle to a multiyear rescheduling of the public debt. [redacted] 25X1

The Agreement

Creditors conditionally agreed to repackage almost $21 billion of public-sector debt originally due during 1983-88 into new loans maturing over 12.5 years beginning next year. Similar to the Mexican 25X1 restructuring arrangement, the rescheduled debt will carry a reduced interest rate—1.125 percentage points above LIBOR—and bankers agreed to forego front-end fees. Because the rescheduling 25X1 pact includes no new money, bankers accepted informal IMF monitoring of the economy. [redacted]

Since reaching the agreement-in-principle, however, Caracas has impeded progress toward formally restructuring the debt. According to US Embassy and press reporting, bureaucratic foot-dragging continues to hinder clearing $1.3 billion of interest arrears on private-sector debt, one of the banks' preconditions. The frustrated bank advisory committee reportedly has refused to formally endorse the understanding, thereby preventing Caracas from selling the arrangement to each creditor bank. The Embassy indicates that the government recog- 25X1 nizes the need to make overdue payments, but we do not believe that Caracas will do so at a pace sufficient to satisfy creditors and permit implementation of the agreement before next spring. [redacted]

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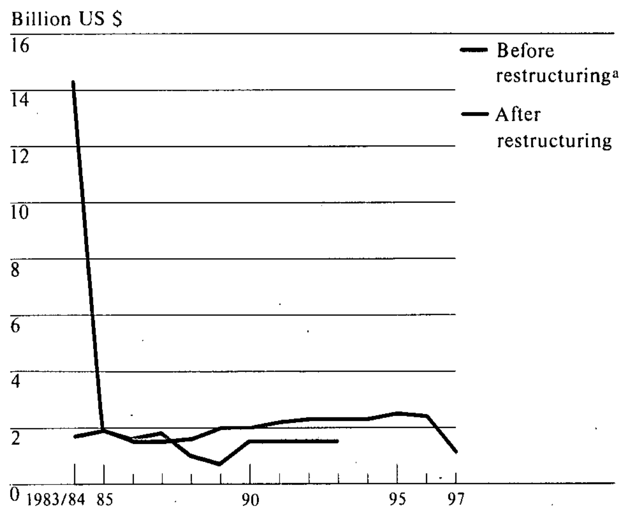
Private Debt

The public debt restructuring agreement did not affect private-sector debt, which totals an estimated $7 billion or 20 percent of Venezuela's outstanding foreign debt. Private-debt obligations could represent about one-third of Venezuela's total debt due during 1985-89 if debt is serviced through the government's preferential foreign exchange program announced last February. Under this arrangement, net private debt must be authenticated by the government and decreed to have financed only essential imports. Approved debt not guaranteed by foreign governments then must be unilaterally restructured over seven years, including a two-year grace period on principal payments. The slow-moving registration procedure is behind Caracas's failure to clear the private interest arrears that is impeding progress toward a formal restructuring agreement.

Venezuela: Total Principal Payments on Public Debt, 1983-97[a]



[a] 1990-93 are estimated.

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Benefits for Venezuela

The rescheduling will slash Caracas's immediate principal repayment obligations, and future obligations will be more evenly distributed. The US Embassy reports that Venezuela probably will amortize only $1.7 billion of public debt this year, instead of the $14.3 billion of 1983-84 debt due under the old arrangement. Caracas then will repay the rest of the public debt with relatively level annual payments through 1997. Only one-third of the public debt is now due by 1989 rather than the three-fourths scheduled originally.

The multiyear pact will also encourage sustained growth by easing external constraints. We judge the new payment schedule should bolster Venezuela's creditworthiness and gradually reopen access to international financing. In addition, the lighter interest burden will free some foreign exchange for imports to revive and reorient the economy.

Beyond this, the agreement will pay political dividends to Lusinchi. In our opinion, it will minimize the prospect of protracted debt talks each year, which typically arouse nationalistic criticism. By reducing the political visibility of the international debt issue, we believe the administration will face somewhat less domestic resistance to economic adjustment measures. 25X1

The Broader Repayment Outlook

Despite reduced obligations in the near term, Venezuela's overall payments position will remain tight during the rest of the 1980s. Through 1989, our analysis indicates the economy will generate an annual average of $4 billion for repaying creditors—the trade surplus less the net outflow of nondebt related services and capital transactions—but Venezuela will face almost a $7 billion bill for public and private debt. We expect the following in Venezuela: 25X1 25X1

- Oil revenue to grow annually by 3 percent in a weak international oil market to reach $17 billion

Venezuela: Balance of Payments, 1984-89 *Billion US $*

	1984	1985	1986	1987	1988	1989
Current account balance	3.1	0.4	1.2	1.9	1.2	0.8
Trade balance	8.2	7.7	7.2	7.7	6.9	6.2
Exports	15.7	16.0	16.3	17.7	17.9	18.3
Imports	7.5	8.3	9.1	10.0	11.0	12.1
Services and transfers balance	−5.1	−7.3	−6.0	−5.8	−5.7	−5.4
Interest payments [a]	4.1	5.3 [b]	4.0	3.8	3.7	3.4
Capital balance	−3.2	−1.8	−2.4	−2.7	−2.9	−3.3
Of which:						
Principal payments	1.7	1.9	2.5	3.0	3.1	3.5
New borrowing	0	1.3	1.5	1.8	2.1	2.3
Changes in international reserves	**−0.1**	**−1.4**	**−1.2**	**−0.8**	**−1.7**	**−2.5**
Debt outstanding	32.6	32.0	31.0	29.8	28.8	27.6
Debt service	5.8	7.2	6.5	6.8	6.8	6.9
Public	4.9	5.0	4.6	4.5	4.5	4.7
Private	0.9	2.2 [b]	1.9	2.3	2.3	2.2

[a] Assumes LIBOR remains constant at current 11.4 percent.
[b] Includes $1.3 billion of private interest arrearages from 1983-84.

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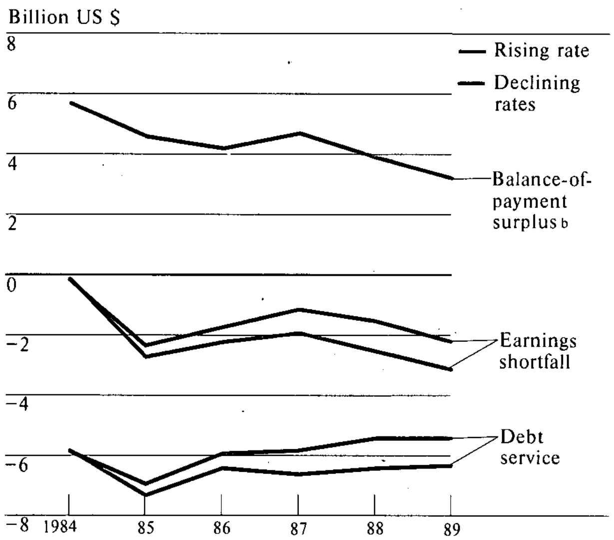
in 1989, and annual nonoil exports to average $1.3 billion.
- Imports to rebound from the depressed $6.8 billion level of 1983 to $12 billion in 1989, helping to support Lusinchi's goal of sustained growth and improved living standards.
- Capital and service net outflows unrelated to foreign debt to average more than $3 billion annually.
- Debt service payments to range from $6 billion to $7 billion, leaving a growing foreign earnings shortfall through the decade.

Adverse external shocks, moreover, would significantly undermine the benefits of the multiyear rescheduling. Although recent price declines and the OPEC production cutback have not significantly reduced Venezuelan oil income, a $2 fall in oil prices would cut export earnings by $1 billion. In addition, every percentage-point increase in annual interest rates raises debt payments by $300 million. Consequently, we estimate that a steady half-point annual rise in interest rates through the decade could leave net earnings $3 billion short of current debt obligations in 1989. 25X1

Closing the Gap

Barring a serious downturn in international economic conditions, we judge that Venezuela can probably avoid major payments difficulties through borrowing and reserve drawdowns. Government officials are already publicly discussing plans to raise $4-5 billion from multilateral and official sources. We anticipate that commercial banks will lend an additional $4 billion, on the basis of Venezuela's improved debt repayment capacity, stronger domestic economic performance, and con- 25X1

Venezuela: Debt Service Capacity Under Varying Interest Rate Scenarios, 1984-89[a]



[a] Based on debt as of December 31, 1983.
The interest rates assumed are:

	1984	1985	1986	1987	1988	1989
Rising	11.4	11.9	12.4	12.9	13.4	13.9
Declining	11.4	10.9	10.4	9.9	9.4	8.9

[b] Excluding debt service payments.

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tinuing political stability. Even so, Caracas would have to draw down reserves by about $8 billion by 1989 if it is fully to meet debt obligations and regain voluntary bank financing. 25X1

Despite our cautious optimism, we believe Lusinchi will avoid recurring liquidity crises during his administration only by balancing short-term growth and adjustment. On the one hand, he faces increasing political pressure—particularly from the labor wing of his own Democratic Action Party—for a revival of growth to reverse five years of declining per capita income. Excessive expansion, however, would quickly weaken the foreign payments position as imports soar, capital flight intensifies, and foreign financing is cut back, and it would discourage prudent adjustment to the realities of constrained oil income. Should Lusinchi fail to walk this narrow path, Caracas and its creditors would face another difficult debt rescheduling. 25X1

Implications for the United States

We judge that US commercial interests stand to benefit from Venezuela's debt agreement. Although we estimate the restructuring probably will cost US banks, which hold roughly one-third of the debt, at least $500 million in forgone interest income through 1997, the new repayment schedule has lowered the prospect of default or continued delays on servicing the $12 billion of US bank and commercial claims. Moreover, Venezuela's enhanced growth potential and eased foreign exchange situation under the arrangement will possibly result in increased US export sales and a rebound in US-sponsored investment projects. 25X1

Ethiopian Famine: No Solution in Sight

Widespread famine in Ethiopia could result in several hundred thousand deaths this year, and, given the poor harvest prospects, conditions will almost certainly worsen in 1985. Increased aid shipments have not closed the food gap, and severe transportation and security problems are seriously hampering relief efforts for hard-hit areas. We do not think the Mengistu regime is immediately threatened by the food crisis, because the government is cushioning the military and the politically important urban areas from the full impact of the famine and is widely publicizing its relief efforts.

The Picture This Year

Worsening Conditions. The country's food position at the the start of this year was, as usual, precarious, and stocks were low. Conditions deteriorated when the seasonal small rains that usually begin in February did not arrive. As a result, the midyear crop, normally between 5 and 15 percent of total grain production, failed. About 20 percent of the country's population, estimated at over 40 million, now faces food shortages—up from about 10 percent at yearend 1983.

According to government estimates, more than 80 percent of the people at risk live in the north.[1] Conditions are particularly critical in the provinces of Eritrea, Tigray, Welo, northern Shewa, and parts of Gonder, but the drought also has spread southward; Harerge in southeastern Ethiopia is especially hard hit. Pest infestations and lack of water and pasture have resulted in crop and livestock losses for both the nomadic population and the hundreds of thousands of peasants that the Ethiopian Government had placed in resettlement projects upon their return from Djibouti and Somalia. Relatively little food aid has been directed to Hararge, because donors have been concentrating their attention to the north.

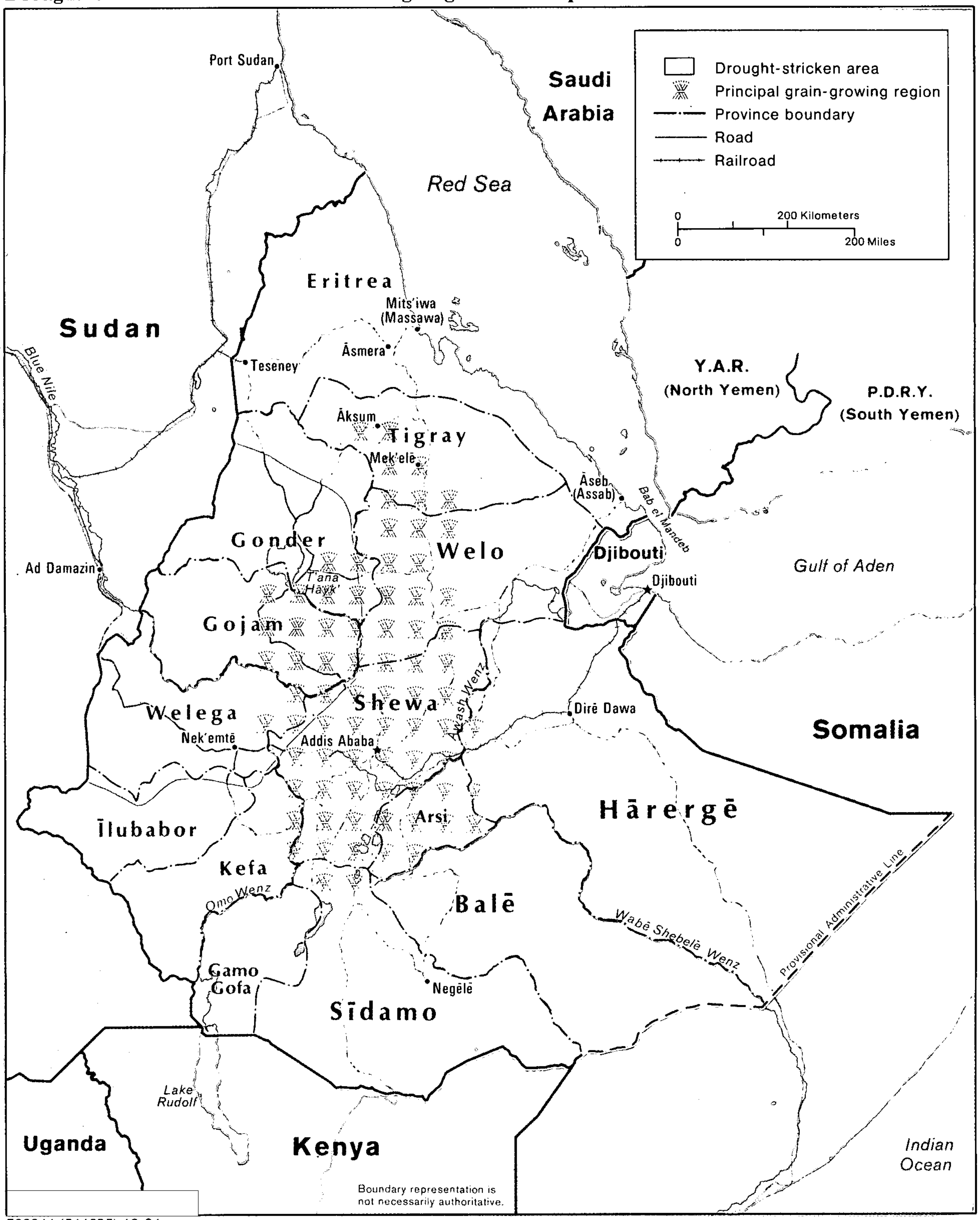
Conditions apparently are not yet as bad in southern Shewa, Bale, Gamo Gofa, and Sidamo, but are likely to worsen in coming weeks. A US Embassy drought assessment team sent to this area in October found that rainfall, crop production, and food and livestock supplies were below normal and that additional food aid soon would be needed. Some areas—particularly the highland regions of Gamo Gofa and southern Sidamo near the Kenyan border—were already in desperate shape.

Government Response. Lacking large food reserves and foreign exchange, the Ethiopian Government early this year turned to bilateral and multilateral aid to help close the country's food gap. In early 1984, the government requested roughly 450,000 metric tons of emergency aid for April through December—about half the amount it had calculated as necessary to feed drought-affected people. The government had scaled down its appeal because it recognized that it could not distribute more. For their part, donors, jaded from perennial requests for aid and denied access by the regime to production and consumption figures, were reluctant to cover even the reduced appeal.

Severe transport and security problems are plaguing relief efforts within Ethiopia. The domestic agencies responsible for disbursing food aid lack trucks in working order, spare parts, tires, mechanics, funds, and managerial expertise. An inadequate road network adds to the transportation morass. Moreover, active insurgencies in the north

[1] Estimating the numbers at risk in Ethiopia is complicated by sizable refugee movements out of the country into Sudan, Somalia, and Djibouti, and within the country by the flow of hundreds of thousands of people into towns and feeding stations in a search for food.

Drought-Stricken Area and Grain-Growing Region in Ethiopia



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morass. Moreover, active insurgencies in the north necessitate the use of large armed convoys to deliver food—and these only operate during daylight hours, according to US Embassy reporting.

To help overcome these problems, donors have begun to airlift food from Asmera, Assab, and Addis Ababa to northern distribution centers such as Mak'ele and Aksum. The impact has been limited, however, by the lack of adequate airfields and by the inherent capacity limitations of transporting bulk cargo by air. As a result, according to US Embassy estimates, less than 5 percent of incoming commodities are moved by airlift.

Deterioration in 1985

Late and sparse main rains, coupled with pest infestations, apparently have decimated the major harvest that is just beginning, and food stocks are exhausted. Reporting from Addis Ababa suggests that the harvest might be only 3.5 to 4 million tons, or about 30 to 35 percent below normal.

Estimates of the national import requirement for 1985 have run from about 1.5 to 4 million tons, or about 125,000 to 330,000 tons a month.[2] Addis Ababa used the lower figure to establish its aid request, but a substantially higher—and growing—estimate now appears more likely as the drought-affected population grows.

Mounting evidence of the increasingly severe famine during the past few months has spurred donors to pledge almost 400,000 tons of grain aid since October—roughly enough to meet the lower estimate of need for the next couple of months, but less than one-third of the grain Ethiopia requires over the coming year under that estimate. Lack of donor coordination in timing relief arrivals has resulted in both congestion and gaps in the food pipeline.

The United States, by far the largest donor, has pledged over 220,000 tons of grain since the begin-

A Lagging Agricultural Sector

A poor performance in the agricultural sector—which accounts for almost half of GDP and 90 percent of exports—has been the major factor behind Ethiopia's lackluster economic performance over the past several years. According to official statistics, real growth in agriculture averaged only 2 percent annually during the past decade, compared with 3 percent for the economy as a whole. We think the performance has been even worse.

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Smallholder farming of nationalized land has been neglected by the collectivization-minded regime—although it still represents over 95 percent of cultivated acreage and more than 90 percent of total agricultural output, according to the World Bank. Low producer prices, restrictive marketing policies, and limitations on interregional grain movements have reduced incentives to produce for the market. Scarce credit, inadequate extension services, and insufficient and expensive fertilizer and seeds have held down overall output.

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State farms—mainly used to grow corn and wheat for urban consumers and cotton and sugar for export—have proved an unsatisfactory alternative. Poor management, lack of skilled personnel, and equipment breakdowns have limited productivity, despite the ample provision of machinery and agricultural inputs. As a result, production costs are high and most state farms have been financially unsuccessful.

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Recurrent drought and lack of irrigation, and soil degradation caused by erosion, deforestation, and primitive farming techniques have limited agricultural output across the board. Moreover, poor roads and a shortage of vehicles, the inefficient government marketing system, and inadequate storage facilities have hampered food distribution throughout the country.

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ning of October, as well as medicines and other supplies and the services of two transport aircraft—worth about $116 million. Other Western donors—including the United Kingdom, France, Italy, Australia, Sweden, Norway, and the EC—also have boosted food and transport assistance. Relief aid from the Soviet Bloc, however, has been minimal and primarily transport oriented.

Even if enough aid were pledged to cover the likely shortfall, we doubt it could all be distributed. The US Embassy in Addis Ababa estimates that even if recent improvements in port management continue and automatic bagging equipment is provided, the ports of Assab, Massawa, and Djibouti will be unable to unload more than 135,000 tons of food a month—assuring that food shortfalls will continue. Moreover, the scheduled arrival of fertilizer and other imports could slow discharge.

The Ethiopian regime will continue to be reluctant to facilitate the movement of relief supplies to insurgent-controlled areas of the north, which account for a large portion of the population at risk, or to agree to a food truce with the rebels. Although Addis Ababa agreed during recent government-to-government negotiations to allow Western donors to provide food aid to all parts of the country, the Ethiopians are fearful that such assistance will strengthen the regime's enemies and further weaken its position in the north.

These distribution and security problems, when combined with the current poor harvest, almost certainly will cause famine to continue in the north and spread to other parts of the country in 1985. Deaths from starvation and related causes will accelerate beyond their already high rate.

Political Fallout

Mengistu—aware that Haile Selassie's attempt to cover up a similar crisis contributed to public support for his ouster in 1974—has taken steps in recent weeks to prevent the widespread famine from undermining his regime. The government has cushioned both the military, whose support is essential to the regime's survival, and the urban population from the full effects of the drought. 25X1 25X1

There have been no reports of food shortages in the military. Mengistu clearly gives high priority to military needs, but recurring insurgent claims that relief aid is being diverted for military uses have not been substantiated by international observers. 25X1 We believe, however, that the regime will attempt to siphon off food aid to the military if shortages develop. 25X1

The regime is also making special efforts to assure food supplies in the major cities to ward off outbreaks of discontent. The government has used scarce foreign exchange for food purchases and has requested PL480 aid to help cover food requirements in the cities. Even so, shortages have been reported and rationing has been intensified. 25X1 Moreover, Mengistu has used the military to keep the hungry from entering urban areas and has forcibly transported some of these refugees back into the drought-stricken areas. 25X1

The regime has publicized the international relief effort, especially from Bloc countries, to show it is responding to the crisis. Meanwhile, according to the US Embassy, the Ethiopians have charged that food shortages are not the result of domestic policies but of the inadequate response from donor countries to Addis Ababa's earlier warnings about 25X1 the seriousness of the drought. 25X1

The government has resurrected and expanded upon a population resettlement plan—first attempted in the late 1970s—that calls for the movement of several million people from the drought-stricken portions of Tigray, Eritrea, Welo, and 25X1 Gonder to more fertile areas in the western and southwestern parts of the country. The regime reportedly has transported some 70,000 people already, and has announced plans to bring the total to 2.5 million by the end of 1985. The government, however, has supplied the settlers with little in the way of food, equipment, or agricultural resources.

relieving population pressures in the north and opening up underutilized but potentially more productive areas of the country to farming, we believe the regime's primary goals are to cut into the base of support for northern insurgent groups and further its aim of agricultural collectivization. [redacted] 25X1

Over the Longer Term

Government unwillingness to support private agriculture, its inability to quell the insurgencies in the northern provinces, and severe soil degradation that cannot easily be reversed will continue to limit agricultural output. Stimulating higher production probably would require greatly increased credit to private farmers, sharply higher producer prices, enlarged access to agricultural inputs, improved technology, and expanded private farms. Although recent press reports indicated that the Ethiopian Government has promised to move toward a free market policy, we doubt that the ideologically driven regime—already strapped by hefty military expenses—will change its policies enough to sharply boost incentives for production. [redacted] 25X1

Ethiopia, therefore, will continue to need imported food, even in years of favorable weather, and will be vulnerable to severe food crises whenever drought recurs. Moreover, it probably will not be able to afford large commercial imports and will remain dependent on food aid, largely from Western governments, private voluntary organizations, and multilateral institutions. [redacted] 25X1

[redacted] 25X1

India: Economic Problems and Policy Choices for a New Government

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On the eve of national elections in late December, Rajiv Gandhi inherits a temporarily buoyant economy. Nonetheless, his Congress (I) Party, which is expected to remain in power, will face chronic economic inefficiencies and a return of international payments problems before the end of the decade. Economic problems will become even more severe if the new government is unable to prevent a resurgence of communal violence. For the United States, Gandhi's support for technological modernization will provide continued opportunities for US firms.

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Economic Upswing at Election Time

A miniboom is under way as the election approaches. GNP growth this year is expected to be around 4 percent following the 7.5-percent increase recorded last year. Despite drought and floods in several states, the main foodgrain harvest this year will probably be only slightly below last year's record. Industrial output is being spurred by the increase in rural income and the easing of electricity shortages. Private investment plans are booming, especially in the motor vehicle and electronics industries. Anti-Sikh riots following Indira Gandhi's assassination caused only minor economic disruptions. The government has been able to maintain shipments of surplus grain from Punjab to other parts of India, even though the terrorism that preceded the army attack on the Golden Temple in June and the restrictions on the travel that followed have curtailed trade within the Sikh majority state.

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India's international financial position is still manageable. New Delhi opted to forgo additional drawings on an Extended Fund Facility loan from the International Monetary Fund after April 1984. Reserves at the end of June were equivalent to about four to five months of merchandise imports, higher than the ratio two years ago. Increased domestic crude oil production is helping lower New Delhi's net oil import bill, and preliminary data for April-June 1984 indicate a rise in previously sluggish nonoil exports, probably due to a spurt in garment sales to the West and revival of trade with the Soviet Union. Tourist earnings will drop, perhaps by as much as $200-300 million, but the wave of communal violence has not significantly impaired India's international credit standing. Indian officials expect a decline in funds from Indians resident abroad, but disbursements from commercial borrowing will probably rise this year, and receipts of concessional aid will remain at a high level.

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Old Problems Persist

Industry is plagued by high costs and inefficiency. The growth trend, 8 percent a year before the mid-1960s, has since declined to less than 5 percent—even though investment in industry has risen dramatically from 6 to 11 percent of a growing GDP. Although power generation has risen, shortages of electricity remain one of the most severe constraints on Indian economic growth. Supply has been at least 10 to 15 percent short of demand over the past five years. According to World Bank estimates, the irregular and inadequate supply of power depresses overall GDP by one to three percentage points a year. Much manufacturing capacity is underused and obsolete. Overstaffing—the result of political patronage—and delays in obtaining government approval for business decisions handicap many public-sector corporations.

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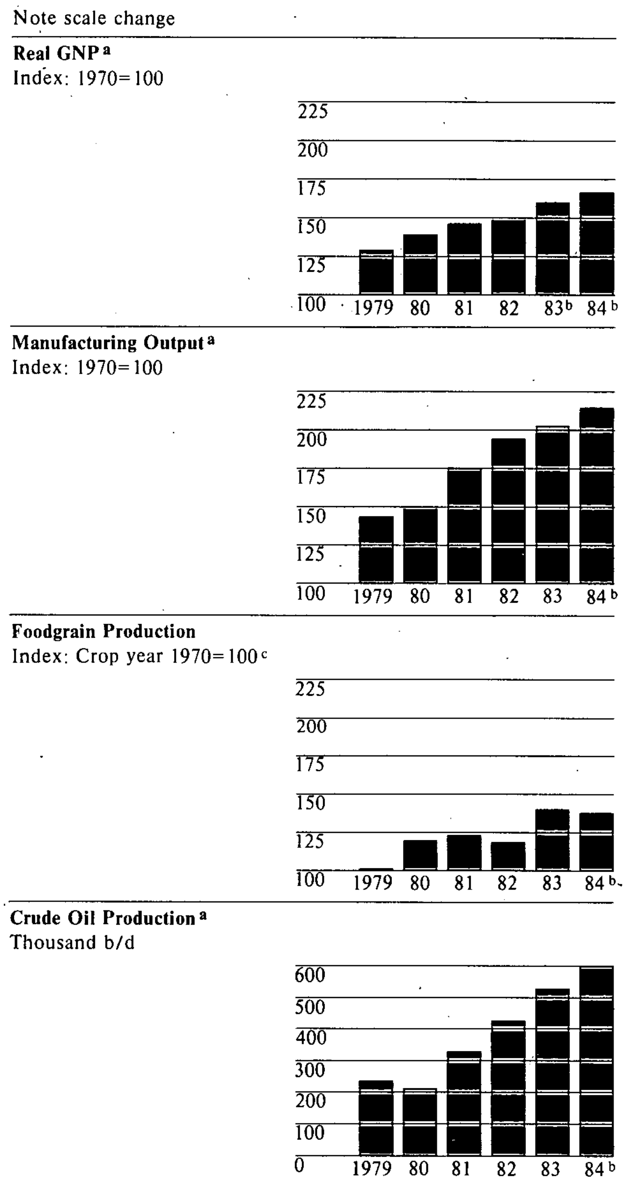
India: Economic Indicators, 1979-84



[a] Fiscal years beginning in April of the year stated.
[b] Estimated.
[c] Crop year beginning July of year stated.

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Government regulations still limit expansion of large private companies and restrict imports that could compete with domestic production. Except in a few high-technology industries, the momentum of policy efforts to ease bureaucratic controls has slackened during the past year. Business continues to benefit, however, from earlier liberalization measures that have eased shortages of imported components and raw materials, and simplified procedures for obtaining government permission to establish a factory. 25X1

Economic Strains Down the Road

Beginning in 1986, India will be hard put to finance the imports to sustain a 4- to 5-percent annual rate of GNP growth:

- Annual debt service payments, now $2 billion, will rise to $5.7 billion by the end of the decade as payments to the International Monetary Fund and commercial banks come due.
- Concessional aid disbursements are likely to fall in real terms as India's share of reduced International Development Agency funds is cut back to accommodate China and poor African countries.
- New Delhi's net oil import bill will rise sharply by the end of the decade, probably to more than $5 billion, according to the US Embassy.
- We believe that payments for military imports will rise sharply from about $500-600 million a year at present, possibly to as much as $1.5 billion by 1990. 25X1

India has no easy options for coping with the impending payments squeeze. Wary of falling into a debt trap, few Indian officials favor a major increase in commercial borrowing. Expensive petroleum exploration efforts are likely to continue in the hope that new discoveries will eventually ease the oil import bill. Guidelines for the Five-Year Plan to begin in April 1985 suggest that import-intensive projects will bear the brunt of a slowdown in government spending for new industrial development. 25X1

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India: Balance of Payments [a] *Million US $*

	1980	1981	1982	1983	1984
Trade balance	−7,690	−6,960	−6,215	−6,500	−5,000
Petroleum	−6,660	−5,570	−4,615	−3,800	−2,600
Other	−1,030	−1,390	−1,600	−2,700	−2,400
Exports [b]	8,510	8,760	9,200	9,400	10,300
Petroleum	10	240	1,200	1,200	2,000
Other	8,500	8,520	8,000	8,200	8,300
Imports [b]	16,200	15,720	15,415	15,900	15,300
Petroleum	6,670	5,810	5,815	5,000	4,600
Other	9,530	9,910	9,600	10,900	10,700
Interest payments [b]	440	490	760	880	1,000
Private transfers	2,780	2,300	1,850	1,800	1,700
Current account balance	−2,900	−3,290	−3,565	−4,200	−3,000
Principal repayments [b]	850	890	880	850	1,000
Financial gap	**3,790**	**4,180**	**4,445**	**5,050**	**3,960**
Gross concessional aid [b]	2,140	1,960	2,300	2,100	
IDA	652	786	1,108	875	
Other medium- and long-term borrowing [b]	460	600	755	1,310	
IBRD	175	420	300	470	
IMF receipts	1,710	690	1,980	1,365	210
Change in reserves	−346	−2,397	504	882	
Reserves, yearend	6,858	4,461	4,965	5,847	

[a] Estimated. Fiscal year beginning April of stated year.
[b] Excludes military.

[redacted] 25X1

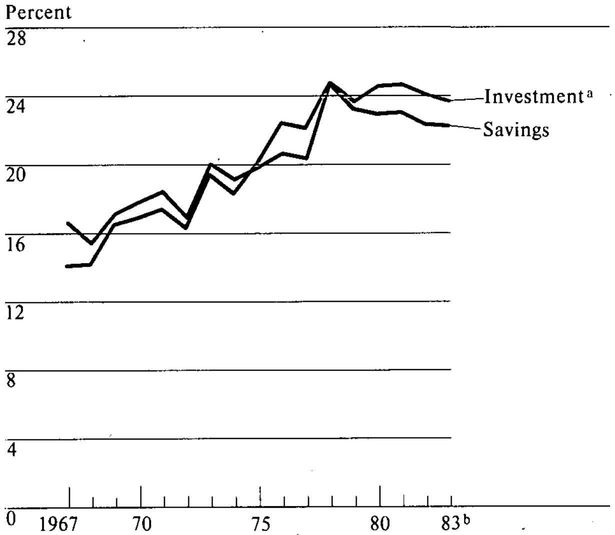
India is likely to have difficulty maintaining its investment momentum, especially for central and state government projects, many of which are already behind schedule because of budget shortages:

- There is little scope for a further increase in the domestic savings rate, which has grown rapidly since the mid-1960s.
- An even heavier tax burden on manufactured goods could jeopardize industrial growth and export prospects.
- Major opportunities for increasing government receipts fall within the jurisdiction of state governments—and would be resisted by farmers who have become increasingly active in state politics. Agricultural incomes now largely escape the tax net, and irrigation water and power are heavily subsidized.
- Windfall government profits from domestic oil sales will grow more slowly as crude production peaks. [redacted] 25X1

Policy Under a New Government

Political factors will constrain Gandhi's domestic economic policies. He can loosen government con-

India: Savings and Investment as a Share of GNP, 1967-83



[a] Gross capital formation and domestic savings as share of gross national product at current market prices. Fiscal years beginning April of the year stated.

[b] Estimated.

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Rajiv Gandhi

The Congress (I) Party is likely to remain in power after the election, in our judgment—probably with a reduced majority or even just a plurality. Gandhi's task will be complicated because he has not yet established his personal authority in his party or the nation. 25X1

Rajiv Gandhi's economic policy interests range from industrial modernization to populist measures designed to attract votes. In a December 1983 press interview, he emphasized that India must not be left behind in the technological revolution in microelectronics and computers. The Indian press reports that he promoted the opening of telecommunications and electronics manufacturing to the private sector, but also led a program forcing banks to make small loans to borrowers approved by the Congress (I). He has both sympathized with business complaints about bureaucratic delays and warned that government attempts to relax controls were often abused. His first policy address after the assassination reaffirmed India's "adherence to socialism and planning" and a major role for the public sector. He also called for greater efficiency in government and urged the private sector to absorb new technology. 25X1 25X1

trols slightly without arousing much opposition, but will probably consider controversial proposals to remove almost all restrictions on private industrial production only if the Congress (I) majority is secure and if there are no major new disruptions to trade and production from communal violence. Faced with a shortage of government funds, he will probably leave substantial investment opportunities open to the private sector, which is able to tap funds that escape the tax system.

Rajiv Gandhi's own interest in technology will help sustain the push for efficiency and modernization that is already under way. Imports of advanced technology, particularly for the electronics, telecommunications, and export industries, are likely to be exempted from efforts to lower the import bill. The new government will probably continue to encourage technical cooperation with Western businesses. We are less certain that Gandhi will be willing to take the political risk of allowing large but inefficient factories to close. 25X1

The outlook for Indian foreign trade policy is uncertain. Senior bureaucrats have not reached a consensus on policy recommendations. US officials in New Delhi anticipate hesitant steps in several directions, including a more active export promotion policy and a slight increase in commercial borrowing. The new government will probably avoid harsh new import restrictions during its first months in office. We doubt that Gandhi has the political confidence to risk the comprehensive shift away from import licensing controls toward high tariffs that has been discussed by some senior officials. 25X1 25X1

Gandhi's political skills will probably have a greater impact on India's economic prospects than will his economic policy choices. Failure to prevent a resurgence of Sikh and anti-Sikh violence would jeopardize agricultural shipments from the Punjab and probably trigger cutbacks in private investment plans and foreign bank support. He will have to seek the support of politicians who resent Indira Gandhi's centralization of political power, but regional imbalances will increase if he caves in to demands for local control of resources, such as water, electricity, and grain, that must be shared among states. [redacted]

Economic Prospects

The economy for the remainder of the decade will probably not achieve the average annual growth rate of 5 percent that Indian officials believe is essential to permit a reduction in poverty. We anticipate further agricultural gains as improved farming practices spread throughout the country, but in our judgment, there is a better than even chance that communal conflict, balance-of-payments strains, and the adjustment to a new political leadership will slow the industrial momentum provided by New Delhi's earlier economic liberalization policies and its continuing push for technology. [redacted]

Even if the Congress (I) wins a secure majority in the December election and violence is contained, we believe that the new government will eventually have to curb growth in imports and in government spending on development projects. A more favorable scenario is possible only if oil exploration efforts are successful or if the push for efficiency brings substantial progress. [redacted]

Gandhi's interest in technological modernization will sustain opportunities for US exporters—at least for the next 18 months or so—before balance-of-payments problems mount. Economic issues will continue to strain bilateral political relations, however. Even though negotiations for a memorandum of understanding on technology transfer are under way, Indian officials remain concerned that US export controls will be misused to keep Indian industry at a disadvantage. They also resent US policies that limit New Delhi's ability to borrow from multilateral lending institutions. [redacted]

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International Financial Situation: Political Update [redacted] 25X1

Governments of financially troubled LDCs this past month used varying strategies to defuse strikes and protests mounted by opposition forces. [redacted] 25X1

In **Chile**, following the imposition of a state of siege, moderate and leftist political and labor opposition groups attempted to organize a two-day national protest. Government troops, censorship of the media, and preventive arrests of leftist political figures and militant slumdwellers, however, effectively curbed demonstrations. Popular support was limited and there were minimal injuries, in contrast to previous protests. According to the US Embassy, only university students directly challenged the security forces, although terrorism continued unabated. Pinochet's actions have significantly hurt prospects for a dialogue on the transition to democracy, however, and have further polarized society. Although most Chileans probably support efforts to root out terrorists and crush violent protests, Pinochet's actions probably have increased the likelihood that more will see armed struggle against the regime as the only option. [redacted].

Bolivia's economy continued to deteriorate under hyperinflation as President Siles took several weak measures to break the accompanying political impasse that threatened his government. According to the US Embassy, Siles agreed to reconciliation talks among the major political parties hosted by the church and agreed, on 19 November, to shorten his term by one year and hold general elections next summer. In late November, the government announced a peso devaluation, increases in the controlled price of essential commodities, and steps to increase state control of the economy; but several Bolivian officials conceded privately that these measures were inadequate. [redacted]

The radical leftwing trade union confederation proceeded with a general strike for wage indexation and commodity price controls. According to press and US Embassy reports, the strike ended after the government promised to boost the minimum wage by 656 percent. Since December 1983, the minimum wage has increased by over 2,000 percent, and industrialists have threatened a nationwide "lockout" of private factories. The government also agreed to freeze the price of 10 basic foods, improve the food distribution system, increase pension benefits, and institute an emergency public works plan. In our judgment, these palliative measures will hurt government attempts at economic reform and may provide only a breather for the Siles administration. [redacted] 25X1

In **Panama**, the political fallout from a recently implemented emergency fiscal package forced President Barletta to quickly revoke the program and call for alternate legislation. Barletta proposed the austerity plan, which included a substantial new tax on services, to cover projected revenue shortfalls and qualify for a new IMF agreement. The US Embassy reports that the sudden and drastic nature of the program touched off severe public criticism, especially from business interests that felt the measures forced them to pay for the corruption and waste of the government and military. A civilian coalition called for a nationwide strike as opposition mounted in all sectors, including Barletta's own political party. Resentment spread to the military, which was stung by the criticism of its extravagance. Barletta's revocation of the plan defused these immediate political tensions, but his miscalculation probably damaged his future effectiveness. [redacted] 25X1

Thailand's Prime Minister Prem apparently has strengthened his political standing by riding out recent controversies over a devaluation and a national railway strike. The surprise 17-percent devaluation, designed to reduce the large trade deficit, triggered protests from Prem's political rival. Army Commander Athit publicly denounced the measure and challenged the government to reverse its course. The US Embassy reported, however, that Prem retained palace and military support, which forced Athit to back down. Meanwhile, labor leaders ended their attempt to politicize the railway strike, and agreed to negotiate a settlement. [redacted]

In the **Philippines**, rumors fueled the already unsettled political situation in the wake of President Marcos's prolonged isolation because of ill health. Although strikes and occasional violence over price increases, unemployment, and government mismanagement continue, the political focus—of both the ruling and opposition parties—now centers on succession. Leading ruling party and opposition political and military figures indicate they support the constitutional succession process. [redacted] The National Assembly, meanwhile, is debating legislation to clarify the succession process. [redacted]

Colombia's swelling fiscal deficit, dwindling foreign reserves, and low growth are undermining President Betancur's controversial truce with leftist guerrillas. Betancur's plan to end guerrilla violence depends, in the short term, on increased expenditures to put former insurgents on government payrolls, provide them credits, and give them land. Public skepticism about the truce and discontent over high unemployment and inflation are eroding Betancur's popularity. US Embassy officials say that recent polls show that the President's public-approval rating has slipped badly. Organized labor has begun to stage strikes and demonstrations over the government's failure to end the recession. Cash shortages are forcing Betancur to consider going to the IMF, even though such a move would further erode his power. [redacted]

Hundreds were arrested during a recent general strike in **Peru** organized by the Communist-led labor confederation. Police dispersed workers and students with tear gas and water cannons. Although the unions were protesting economic conditions, the strike was also designed to demonstrate the confederation's political strength. [redacted] 25X1

In the **Dominican Republic**, President Jorge Blanco's differing responses to protests against government economic policies underscore his willingness to allow legitimate political protests while keeping a tight lid on radical extremists. The US Embassy reports that the President allowed academic leaders to organize peaceful demonstrations calling for increases in the budget of the Autonomous University. On the other hand, riot police used tear gas against rock-throwing students, who also were protesting planned cuts in the university's budget. The opposition leftist Dominican Liberation Party, led by ex-President Bosch, also demanded an end to talks with the IMF, an increase in minimum wages, and the nationalization of the properties of a US firm on the island. [redacted]

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Tension in **Liberia** has grown over the deteriorating financial situation and Head of State Doe's preoccupation with election politicking. Government employees have not been paid for three months, and debt arrearages are mushrooming. Some local observers fear a coup unless the situation improves. [redacted]

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Next 1 Page(s) In Document Denied