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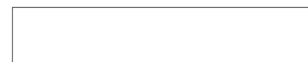

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24 briefs

International Economic & Energy Weekly

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15 February 1985

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Synopsis

1 **Perspective—*The Oil Market Outlook: Another Difficult Year for OPEC***

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The oil market outlook in 1985 indicates that downward pressure on oil prices will continue, and another price reduction is likely, possibly as early as this spring.

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13 **OECD: Dealing With an Oil Price Drop**

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Most OECD governments would pass on to consumers the benefits of further declines in oil prices—boosting GNP growth and lowering inflation. Although some governments would consider taxing away an oil price decline to ease budget deficits, they probably would wait to see the size and permanence of a price cut before acting.

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17 **USSR: Problems Exporting Oil and Gas**

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The Soviets have substantially reduced oil and gas exports to some West and East European customers. The USSR should be able to meet its gas export commitments, but the the same may not be true for oil.

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21 **Nicaragua: Economic Vulnerabilities**

25X1

Bleak export prospects promise a worsening of Nicaragua's serious economic and financial problems. To step up military spending, the Sandinistas are reducing subsidies to local consumers and producers and further stalling international creditors.

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31 **Mexico: Dim Prospects for Foreign Investment**

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Tough regulations and poor prospects for economic performance are discouraging foreign investment in Mexico. As long as the government is unwilling to create a favorable investment climate, Mexico will not attract enough new overseas funds to offset the slump in domestic investment or limited access to international credits.

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15 February 1985

Perspective

The Oil Market Outlook: Another Difficult Year for OPEC

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The oil market outlook in 1985 indicates that downward pressure on oil prices will continue and another price reduction is likely, possibly as early as this spring. Non-Communist oil consumption is expected to increase only marginally this year. At the same time, non-OPEC oil production will again increase—albeit at a decreasing rate. As a result, demand for OPEC oil probably will at best hold relatively flat this year.

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The recent OPEC agreement on prices is generally viewed as too little too late. The move reduced the average OPEC oil price by less than 50 cents per barrel, not enough to dampen increases in non-OPEC oil capacity or to spur demand. Lower revenues will encourage some OPEC members to cheat on their production quotas at the earliest possible moment. Put simply, the perception that the organization has lost control of the oil market remains widespread.

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We believe OPEC members realize that a moderate reduction in oil prices is unlikely to increase demand in the short-to-medium term and that cohesiveness is necessary. Nevertheless, the motivation for some members to overproduce is substantial:

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- Most important, Saudi ability to absorb further reductions in oil output is limited

In our judgment, Riyadh currently is unwilling to take the lead on any substantial reduction in oil prices. Rather, we believe the Saudis are hopeful that the recent price agreement and institution of a mechanism to monitor production and prices will allow further cuts to be avoided.

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OPEC's efforts to gain the cooperation of non-OPEC producers, such as Mexico, Egypt, Malaysia, and Brunei, have proved largely unsuccessful. Indeed, Cairo and Mexico City apparently believe that OPEC members must accept the role of residual supplier. Although North Sea producers have maintained production at capacity, London deferred setting its "official" oil price for two months because of concern that a reduction would lead to a general round of price cuts—and a further fall in the value of the pound. As a result of recent increases in spot prices, however, London is proposing to reinstate its last official oil price of $28.65 per barrel for January and February—a move that avoids undercutting current Nigerian prices.

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The market outlook for 1985 and the next few years indicates that OPEC faces formidable challenges, even if the organization manages to avoid another cut this year. OPEC has not formulated an effective strategy to:

- Equitably prorate its market share among members in a market where reduced stock usage exaggerates seasonal shifts in demand and pressures on Saudi Arabia, OPEC's swing supplier.
- Deal with the uncertainty on production levels and revenue streams that has resulted from the movement away from term contracts.
- Control prices on the growing volume of product exports.
- Accommodate Nigeria's need—and pressure from other members—for a higher output level while also meeting likely Iraqi demands for a quota increase, perhaps later this year.

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Briefs

Energy

Western Europe's Crude Oil Costs Rising

Despite a drop of $6 per barrel in world oil prices since March 1983, the dollar's appreciation against West European currencies has more than offset lower prices, because crude oil costs are denominated in dollars. The continued strength of the US dollar has contributed to a further delay in the long-anticipated recovery in oil demand in Western Europe. Data indicate European oil consumption rose only by 1 percent in the first three quarters of 1984, as compared with a 5-percent increase in the United States. Increased cost, however, is one of several factors that continue to slow the recovery of oil demand in Western Europe. Japan with its healthy economic recovery has seen oil demand increase by 6 percent in the first three quarters of 1984 despite the strength of the US dollar.

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Local Currency Crude Oil Cost Per Barrel

	February 1983	30 January 1985	Percent Change February 1983/ 30 January 1985
US dollars (Saudi benchmark)	34	28	−17.6
Japan (*yen*)	8,032.2	7,125.2	−11.3
France (*franc*)	234	270.8	15.7
West Germany (*DM*)	82.5	88.7	7.5
Italy (*lira*)	47,532	54,586	14.8
United Kingdom (*L*)	22.2	24.8	11.7
Netherlands (*guilder*)	91.0	100.3	10.2
Spain (*peseta*)	4,411.8	4,905.6	11.2
Greece (*drachma*)	2,840.6	3,620.4	27.5
West European (average)			14.1

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UK-Norwegian Natural Gas Deal Rejected

The United Kingdom rejected a proposal to buy 10-12 billion cubic meters of gas per year from Norway's Sleipner field. UK Energy Secretary Walker said that new estimates of domestic gas resources show the United Kingdom can supply its needs without Sleipner. London rejected the $30 billion contract because of concern about the balance-of-payments effect and the loss of tax revenues resulting from importing gas rather than producing domestically.

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Oslo has decided to shelve development of Sleipner for the present and try to negotiate with other West European countries for sales of gas from the larger Troll field. Oslo is going ahead with planned discussions this year on development of Troll gas, but the collapse of the Sleipner project will cool some of its enthusiasm. Moreover, the high cost of Troll gas will make it difficult to sell. Failure to develop and market Troll gas would increase the likelihood of significantly greater European reliance on Soviet gas.

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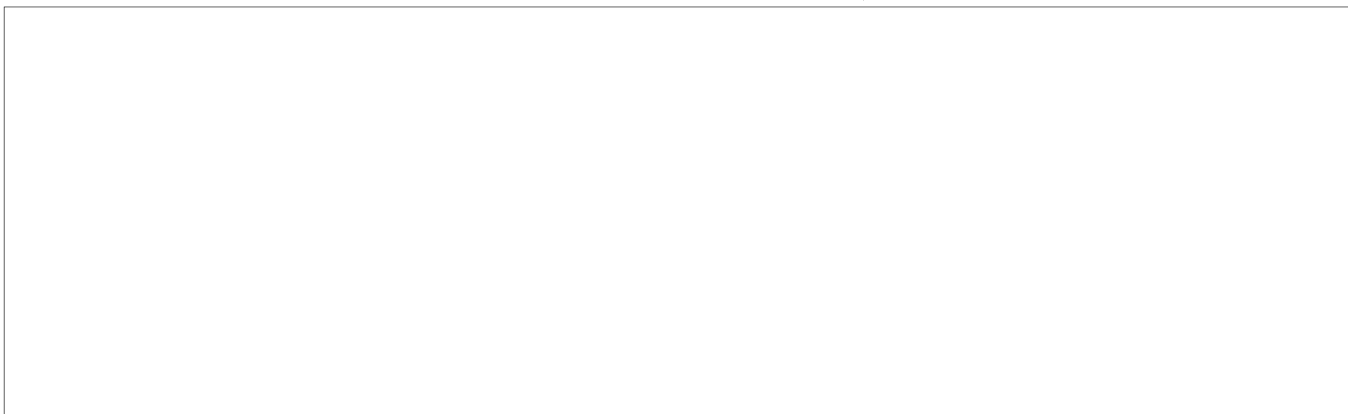

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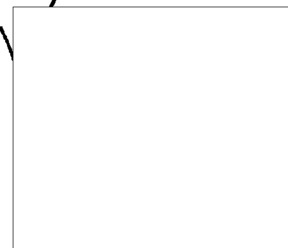
Bidding for South Korean Nuclear Plants



Seoul is expected to solicit tenders for nuclear power plants 11 and 12 in the second half of 1985, but the bidding—originally scheduled for 1982—could be scuttled by opposition from energy planners who favor coal. Coal proponents are being bolstered by an unreleased government study that gives coal a cost edge over nuclear fuel and reported "coal lobby" backing. US Embassy officials report US, Canadian, and West European firms have begun strenuous prebid lobbying for the contracts in which technology transfer and domestic content as well as cost will weigh heavily in Seoul's decision. The two 900-megawatt units are scheduled for completion in 1996. Bids on units 13 and 14 will be delayed until 1988 because of concerns about South Korea's $43 billion foreign debt, according to press reports.

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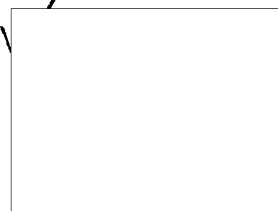
International Finance

Mexico Pledges More Belt-Tightening



New austerity measures announced last week appear designed to gain IMF approval for Mexico's 1985 economic program. The government disclosed it will cut 1985 public spending by $465 million, sell or close 236 state companies, and freeze hiring. In addition, Mexico City plans to rely more on tariffs and reduce use of licensing. The IMF, which has been negotiating with the administration since November, is currently in Mexico City reviewing the revised 1985 economic plan. In January the IMF rejected Mexico's package for this year and asked for tougher steps on the budget and inflation. Although

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we believe these latest concessions will be sufficient for the IMF, we do not expect Mexico to fully implement them. Almost all of the 1985 budget will probably be spent before the July elections, and the government will attempt to keep its pledge to maintain real wages and employment. Moreover, unions are likely to fight closures of large state-owned factories.

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Portugal Seeks Jumbo Loan

Lisbon is asking international bankers to participate in a $500 million credit facility to help finance Portugal's current account deficit, which is expected to reach $1 billion for 1985. An arrangement worked out between Lisbon and the lead managers of the loan sets up a mixed facility: one-half of the total credit will be a traditional syndicated loan for eight years at five-eighths percentage point over LIBOR; the other half will be a revolving credit at three-eighths percentage point over LIBOR. The deal probably requires participation in the short-term facility if banks want to subscribe to the conventional syndicated loan. Press reports indicate the Portuguese chose this route to attract financing for the cheaper revolving standby facility. The heavy oversubscription of last month's credit for the state-owned electricity company and the dramatic improvement in Portugal's current account deficit during the last two years suggest that Lisbon probably will not encounter difficulties obtaining sufficient commitments.

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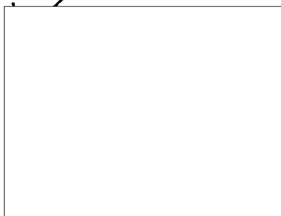
Turkish Loan Difficulties



Turkey's attempt to arrange a new and innovative $500 million credit continues to face difficulty. The credit requires the lead banks to underwrite the successive issuance of short-term notes on the Euromarket over a seven-year period. As of early February the syndication manager had lined up only some $450 million. Problems began surfacing late last year when several banks decided against participating. These bankers pressured the Turkish Central Bank to abandon the so-called hybrid scheme in favor of a traditional bank syndication because Turkey's credit rating is far below that of others, such as Sweden, that have successfully used this type of facility. Turkey's Central Bank Governor, however, has predicted optimistically that the credit will be completed by the end of February. Failure to finalize the deal could damage Turkey's reputation in the international financial community.

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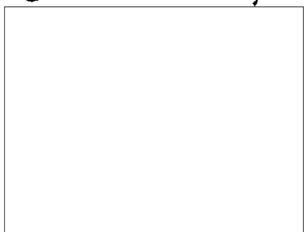
Global and Regional Developments

Debtor LDCs Improve Reserve Positions



Foreign exchange reserves of the top 20 LDC debtors rose 20 percent from yearend 1983 levels, reaching almost $69 billion by the end of third quarter 1984. The most impressive gains were registered by Brazil and Mexico—the two largest LDC debtors. Argentine reserves grew to almost $2 billion but were still below the 1982 level. Substantial declines were registered by the

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Top 20 Debtor LDCs: Foreign Exchange Reserves [a]

	Billion US $				Reserve-to-Import Ratio (*months*)
	1981	1982	1983	1984 [b]	
Total	**68.26**	**52.63**	**57.16**	**68.64**	
Brazil	6.60	3.93	4.35	9.23	7
Mexico	4.07	0.83	3.91	7.01	9.5
Argentina	3.27	2.51	1.17	1.90	5.5
South Korea	2.68	2.81	2.35	2.56	1
Venezuela	8.16	6.58	7.64	8.69	12
Indonesia	5.01	3.14	3.72	4.75	4
Egypt	0.72	0.70	0.77	0.77	1
Philippines	2.20	1.72	0.79	0.26	[c]
India	4.70	4.31	4.94	5.87	4.5
Chile	3.21	1.81	2.04	2.23	8
Malaysia	4.10	3.77	3.78	4.05	3.5
Algeria	3.70	2.42	1.88	1.75	2
Nigeria	3.90	1.61	0.99	0.99	1.5
Peru	1.20	1.35	1.36	1.51	7.5
Thailand	1.73	1.54	1.61	1.61	2
Colombia	4.80	3.86	1.90	0.77	2
Morocco	0.23	0.22	0.11	0.10	[c]
Pakistan	0.72	0.97	1.97	1.05	2
Taiwan	7.24	8.53	11.86	13.52 [d]	8
Sudan	0.02	0.02	0.02	0.02	[c]

[a] Total reserves minus gold; end of period.
[b] Third quarter.
[c] Less than one-half month.
[d] May 1984.

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Philippines, Colombia, and Pakistan. The net increase was due largely to improved sales in recovering developed-country markets. Most of the debtors have held imports close to 1983 levels. For the group, reserve holdings equal over four months of imports—a one-half month gain since 1983.

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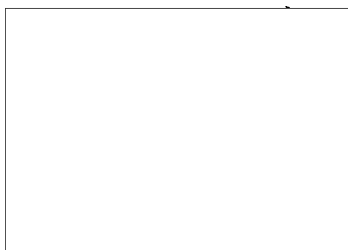
Tighter COCOM Controls



COCOM countries at their recent high-level meeting adopted several measures to tighten strategic export controls. For the first time, they agreed to some restrictions on sales of COCOM-controlled products to Cuba, although member countries still will have wide discretion on enforcement. The delegates agreed to work more closely with other countries to prevent diversion of COCOM items through their territories. They failed to resolve licensing questions involving China and formed an ad hoc subcommittee to study the problem. Exports to China now account for over 80 percent of COCOM cases—up from only 1 percent five years ago. The meeting was less acrimonious than the last one, reflecting the growing consensus that more effective multilateral control is necessary. Many COCOM countries probably already impose restraints on sales to Cuba, although not in coordination with other COCOM members.

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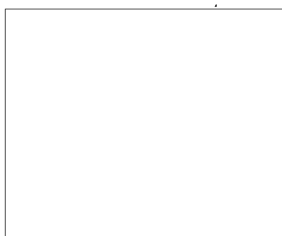
No Agreement Expected at Cocoa Meeting



The cocoa producing and consuming countries meeting in Geneva next week are not likely to agree on a replacement for the International Cocoa Agreement (ICCA) that expires in September. Consumers are proposing a midpoint of $1 a pound within an as yet unagreed-upon target range, and producers want a $1.10 to 1.55 range. A less contentious issue will be export restrictions to supplement the existing buffer-stock mechanism. Although most producers favor export quotas, they might agree to some form of the EC's proposal to withdraw cocoa from the market when prices fall to near the ICCA minimum. Cocoa prices are several cents below the current $1.10 per pound ICCA minimum, and many producers believe an effective new pact will be necessary to prevent further price declines. Even though consumption has outpaced production in the last two seasons, most observers expect the production surpluses this year will put more downward pressure on prices.

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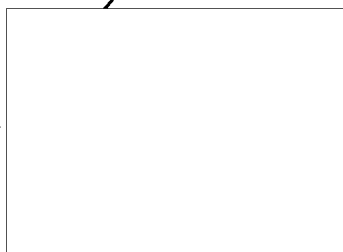
Saudi-Turkish Military Cooperation



Riyadh is negotiating with Ankara for training of Saudi officers at Turkish military schools, the maintenance of Saudi aircraft at Turkish airbases, the sale of a wide range of spare parts for the Saudi Army, and the possible purchase of Turkish-built missile attack boats. Saudi Arabia is seeking to expand ties to Turkey as part of its efforts to strengthen the informal coalition of moderate Islamic nations, to offset the potential of a powerful postwar Iraq, and to counter Soviet and radical influence in the region. The negotiations also reflect Saudi efforts to secure new sources of spare parts and to become less dependent on US contractors and Pakistanis for aircraft maintenance. In return, Riyadh is holding out the prospect of substantial financial aid and

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other economic benefits; the US Embassy believes Turkey may already have as much as $4 billion in commercial contracts with the Saudis. For its part, Ankara has been trying to expand arms sales in the Middle East, particularly Saudi Arabia, to bolster its arms industry.

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National Developments

Developed Countries

Spanish Exports Surge

A sharp increase in Spanish exports last year dramatically improved the current account balance and allowed Madrid to meet its GDP growth target. Madrid estimates real exports rose 20 percent in 1984, versus 7 percent in 1983. Export earnings rose about $4 billion, helping swing the current account from a deficit of $2.5 billion in 1983 to a surplus of $2 billion—the government target was a $500 million deficit. Export performance was also almost entirely responsible for raising real GDP growth to 2.5 percent, continuing the recovery begun in 1983. We believe the export boom stemmed mainly from a gain in competitiveness after the 1982 devaluation, slumping domestic demand, and a pickup of growth in major trading partners. Spanish officials expect a slight erosion of price competitiveness coupled with strengthening domestic demand to slow real export growth to 4 to 5 percent this year. Another large current account surplus is anticipated, giving Madrid enough leeway to ease monetary policy and encourage investment growth.

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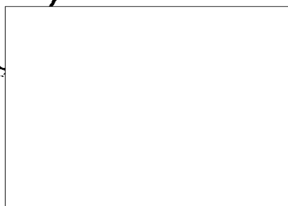
Japanese Workweek Proposals



At a January international trade union symposium in Japan, representatives from various industrialized nations expressed concern that Japan's long working hours constitute a "hidden export subsidy." Domei, a major Japanese labor confederation, sponsored the meeting as part of its efforts to reduce the workweek from 48 to 40 hours and to make other changes in the country's Labor Standards Law. A Ministry of Labor advisory council report last year recommended only a 45-hour workweek. The union hopes international pressure will force a favorable response from the government. Domei's proposed changes, however, fail to tackle the more difficult issue of wage increases, which could boost import demand and thus ease trade friction. Japanese wage gains have not come close to those in other industrialized nations.

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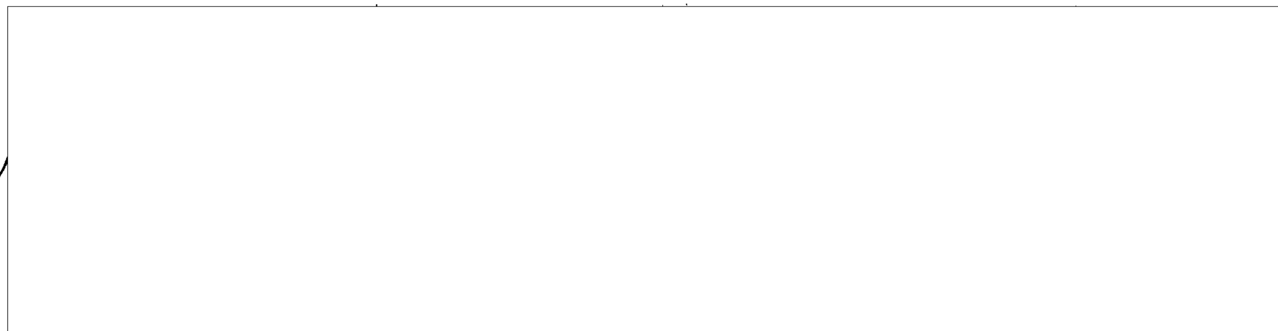

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Less Developed Countries

Bolivian General Strike Threat

La Paz has devalued the peso by 80 percent and raised food, fuel, and transportation prices by an average of 400 percent. To blunt the effects of these measures, workers have received a 330-percent pay hike. The country's largest labor confederation has denounced the adjustments and is considering calling an indefinite general strike. Labor leaders almost certainly will call for the general strike in hopes of forcing President Siles to scale back austerity measures. A strike would heighten military concern and provide radicals in the labor movement with new opportunities for provoking violence. The economic gains are likely to prove ephemeral, as financial concessions and repeated wage increases continue to fuel the country's hyperinflation.

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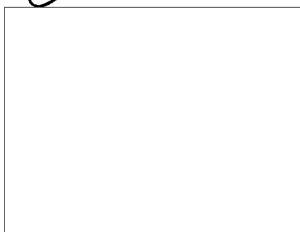
New Jamaican Economic Reverses



The worldwide alumina glut and Jamaica's high production costs are prompting Alcoa to suspend its bauxite and alumina operations in Jamaica for at least one year, according to the US Embassy. The closure comes on the heels of Prime Minister Seaga's announcement that tourism—the second-largest foreign exchange earner—has fallen sharply since the steep hike in petroleum prices last month triggered three days of public protests. The shutdown will cost Jamaica about $60 million in export revenues this year. This loss and a possible $80-100 million drop in tourist receipts in 1985 will compound the country's financial difficulties and may cause the collapse of its $165 million IMF package. Alcoa's closure will cost 900 jobs, and unemployment already is approaching 30 percent. Increasing economic hardships are likely to cause Seaga's party to lose local elections to be called by June, but they probably will not make him yield to opposition calls for an early general election.

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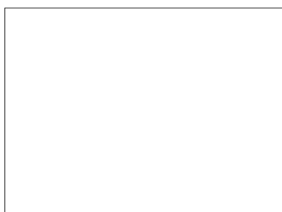
Conflicts Over the Lebanese Economy



Lebanon's rapidly deteriorating economy is becoming a new focus of antigovernment actions that will add to the country's climate of violence.

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Meanwhile, "Islamic Jihad"—probably the radical Shia Hizballah—has claimed it bombed several Beirut banks two weeks ago to protest against those profiting from the fall of the Lebanese pound. The rapid fall of the pound in the last two months has caused prices to rise 30 to 40 percent—as much as the increase for all of 1984. Militias continue to siphon off customs duties, the government's major source of revenue. The government has aggravated the situation by appointing governors of the central bank who have no financial experience.

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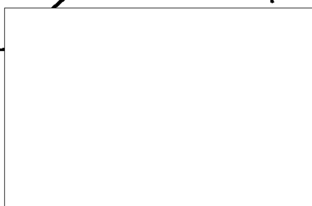
Ethiopian Austerity Measures



Ethiopia this week announced the imposition of a national drought-relief tax, equaling one month's pay for all workers. Chairman Mengistu on Saturday announced plans to cut imports—primarily of automobiles, luxury goods, and textiles—and to impose petroleum rationing. In addition, Mengistu declared that all Ethiopians will be called on to serve tours at relief shelters and

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resettlement camps. Government policies largely had protected the urban population from the famine's effects, but the new austerity measures and developing food shortages in the cities now will affect it adversely. Mengistu is unlikely to extend these measures, particularly the tax and fuel rationing, to the military, his primary power base.

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Papua New Guinea Closes Gold Mine

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The four-year-old, $1 billion Ok Tedi gold and copper project in western Papua New Guinea will close 28 February by government order. The government was providing 20 percent of the project's cost in order to gain the transport facilities and hydroelectric system associated with the copper-mining phase. For several months, the mining consortium of US, Australian, and West German firms had been denying charges that, because of falling copper prices, it planned to abandon the project after stripping it of better-than-expected gold ores. Workers who have threatened to destroy the mine if it is closed have been pacified by the consortium's promises to renegotiate, but the government has yet to show signs of relenting. Port Moresby—generally friendly to foreign capital—undoubtedly intends the shutdown as a strong warning that investors will be expected to live up to original contract provisions.

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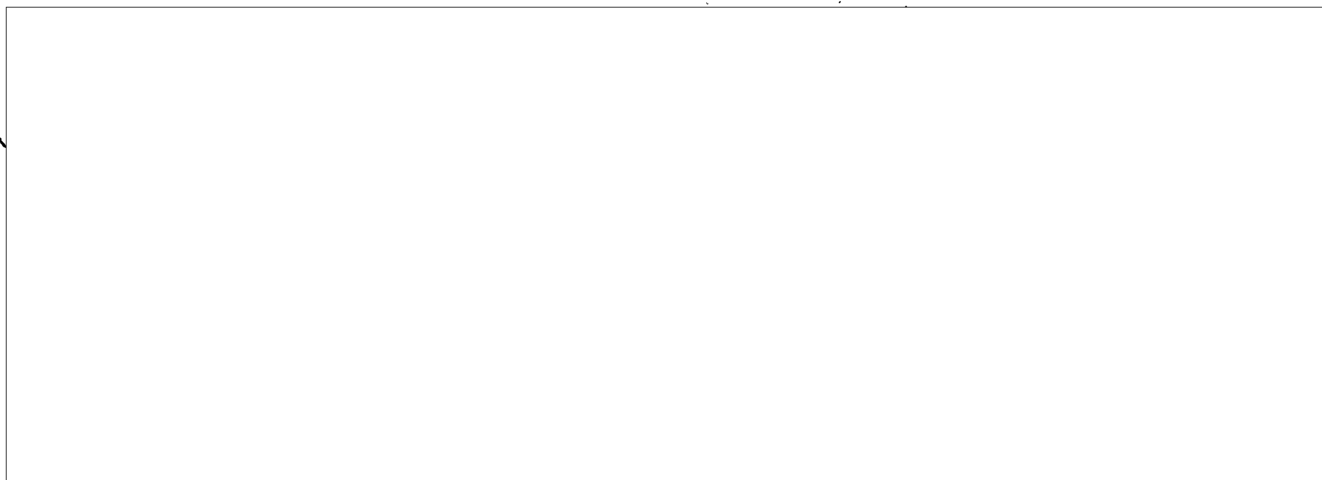
Communist



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Personnel Changes at China's S&T Commission

China's State Science and Technology Commission (SSTC) Minister, Song Jian—who will lead the Chinese delegation to the United States for the April meetings on US-China S&T cooperation—has appointed four new vice ministers, according to Embassy reporting. All are younger, well-educated men, with diverse backgrounds in industry as well as academic research. The new appointments should strengthen SSTC ties to important segments of the research and development community, and facilitate reforms designed to make research more responsive to industry needs. Beijing has been working on reform of the S&T system for several years. Song Jian's appointments indicate

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that the minister, who took over the SSTC only last September, is moving aggressively to surround himself with reform-minded personnel. A major policy statement outlining changes in the management and funding of scientific research is expected at the end of February.

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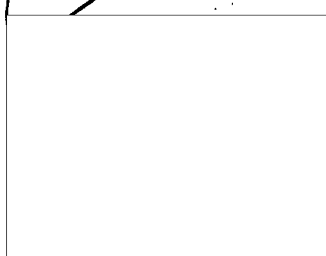
Vietnam's 1985 Economic Targets



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According to the Vietnamese press, Hanoi's ambitious 1985 economic plan calls for increases of 6.5 percent in GNP, 10 percent in foodgrain production, 11 percent in export earnings, and substantial boosts in the production of electricity, coal, fertilizer, and cement. Hanoi also plans to relocate 180,000 workers—nearly double last year's figure—to the new economic zones. The goals for electric power, fertilizer, and labor redistribution may be attainable. Unless the weather is unusually favorable, however, Vietnam is almost certain to fall far short of the key targets in foodgrain production and exports. The foodgrain target of 19 million metric tons is especially surprising because 1984 output fell nearly 1 million tons short of the planned 18 million tons. According to diplomatic reporting, another such miss may threaten the position of the State Planning Commission Chairman, Vo Van Kiet, one of the few pragmatists in the party hierarchy.

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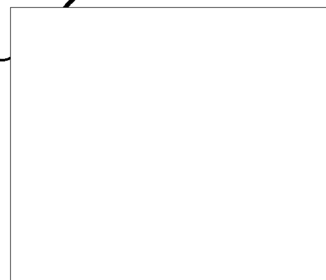
Record Rice Crop in Laos



Favorable weather and expanded acreage led to a 1.3-million-metric-ton harvest last year, according to a recent estimate by the FAO representative in Vientiane, roughly matching domestic needs. This figure exceeds the 1983 crop by 200,000 tons. Earlier projections by the FAO of a poor harvest had spurred an appeal for international food aid at midyear, resulting in contributions of roughly 20,000 tons of rice. The United States provided 5,000 tons. Despite the record crop, distribution problems may still cause localized shortages over the next few months, according to the US Embassy in Vientiane.

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OECD: Dealing With an Oil Price Drop

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Most OECD governments would pass on to consumers the benefits of further declines in oil prices—boosting GNP growth and lowering inflation—but they would not take advantage of lower inflation to stimulate their economies. Japan and Italy, however, probably would offset at least part of a substantial price drop with new taxes to trim their budget deficits and hold down oil consumption.

Economic Impact

We have estimated the impact of a $2 and a $5 drop in the price of oil on OECD economies using our Linked Policy Impact Model (LPIM).[1] A $5 drop in the price of oil maintained throughout 1985 and 1986 would boost OECD GNP growth by an additional 0.7 percentage point this year and 0.5 percentage point in 1986. This effect would occur in three different ways:

- The net effect of the drop in the OECD oil import bill and the decline in sales to oil-exporting countries would boost OECD GNP growth by about 0.3 percentage point in 1985.
- OECD inflation rates would be 1 percentage point lower in 1985 than they otherwise would be; the lower price level would add slightly more than 0.2 percentage point to OECD GNP growth in 1985.
- Slower inflation would help cut interest rates by about 0.5 percentage point, on average, boosting investment, and thus increasing OECD GNP growth by slightly less than 0.2 percentage point in 1985.

Under this scenario, increased US import demand would benefit the other OECD countries, particularly Canada. Despite a decline in exports to its important OPEC market, Japan would register the largest current account improvement of any industrial economy. Among the Big Four West European countries, a $5 drop in oil prices probably would spur the recovery enough to keep unemployment from worsening in 1985-86.

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A $2 oil price drop obviously produces smaller benefits. In this case, GNP growth in the OECD would accelerate 0.3 percentage point in 1985 and 0.2 percentage point in 1986. The increase in growth, however, would barely affect unemployment. Inflation would ease 0.4 percentage point in 1985 and 0.2 percentage point in 1986 from the rates that would exist without any oil price decline.

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The Policy Response

Because the increased strength of the dollar largely has offset the decline in the price of oil since early 1983 for OECD economies other than the United States, most governments would now welcome the opportunity to pass on to consumers any decline in the price of oil. Although some governments would consider taxing away an oil price decline to ease budget deficits, they probably would wait to see the size and permanence of a price cut before acting. Although depreciation of the dollar would magnify a drop in oil prices, the gains would be reversed if the dollar strengthened again. Because of continuing problems with inflation and budget deficits, we believe that few, if any, OECD governments would

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[1] A $2 scenario assumes an economic impact too small to require a policy response, although we believe that a $5 decline—a possibility frequently mentioned by oil market analysts—is the threshold at which governments would begin to make policy changes.

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OECD: Impact of a $5 Drop in Oil Prices [a]

Change from baseline

	1985	1986
OECD		
GNP growth rate (*percentage point*)	0.7	0.5
Inflation (*percentage point*)	−1.0	−0.5
Unemployment rate (*percentage point*)	−0.2	−0.3
Current account (*billion US $*)	15.8	2.2
United States		
GNP growth rate (*percentage point*)	0.8	0.7
Inflation (*percentage point*)	−1.1	−0.5
Unemployment rate (*percentage point*)	−0.2	−0.5
Current account (*billion US $*)	5.4	−2.2
Japan		
GNP growth rate (*percentage point*)	0.7	0.3
Inflation (*percentage point*)	−0.7	NEGL
Unemployment rate (*percentage point*)	−0.1	−0.2
Current account (*billion US $*)	7.9	8.2
West Germany		
GNP growth rate (*percentage point*)	0.6	0.5
Inflation (*percentage point*)	−1.0	−0.5
Unemployment rate (*percentage point*)	−0.3	0.5
Current account (*billion US $*)	0.1	−1.3
France		
GNP growth rate (*percentage point*)	0.9	0.4
Inflation (*percentage point*)	−0.9	−0.2
Unemployment rate (*percentage point*)	−0.3	−0.6
Current account (*billion US $*)	1.0	0.2
United Kingdom		
GNP growth rate (*percentage point*)	0.2	0.3
Inflation (*percentage point*)	−0.5	−0.5
Unemployment rate (*percentage point*)	−0.1	−0.2
Current account (*billion US $*)	−0.7	−1.1
Italy		
GNP growth rate (*percentage point*)	1.0	0.5
Inflation (*percentage point*)	−0.8	−0.9
Unemployment rate (*percentage point*)	−0.2	−0.2
Current account (*billion US $*)	2.0	1.0
Canada		
GNP growth rate (*percentage point*)	0.7	0.8
Inflation (*percentage point*)	−0.7	−0.4
Unemployment rate (*percentage point*)	−0.1	−0.4
Current account (*billion US $*)	0.5	0.8
Smaller OECD countries		
GNP growth rate (*percentage point*)	0.7	0.6
Inflation (*percentage point*)	−1.2	−0.5
Unemployment rate (*percentage point*)	−0.2	−0.4
Current account (*billion US $*)	−0.4	−3.3

[a] In the baseline, we assume an oil price of $29 per barrel in both 1985 and 1986 and that nominal government spending and money supply targets would not change. For the scenario, we assume that the $5 price drop occurs at the beginning of 1985 and that the price of oil remains unchanged through 1986. Exchange rates stay constant.

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respond to lower oil prices by adopting more expansionary policies, despite their desire to reduce unemployment.

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The *Japanese* Government is one of the few that would consider action to keep retail oil prices from falling. According to the US Embassy, Tokyo thinks the current softness in oil prices will last only a few years, and producers will regain control of the oil market by the late 1980s. Consequently, if the market continues to weaken this year, Tokyo probably would raise oil taxes to maintain current

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retail prices and to avoid an increase in oil dependence. Moreover, this would help Prime Minister Nakasone reduce the government budget deficit—still an important goal for the government.

Although our results indicate that the *United Kingdom* would benefit from declines in oil prices, the near-term effects of reduced government oil revenues as well as additional downward pressure on the pound would be unwelcome. Ultimately, London probably would have to let the pound decline, no matter how politically unpopular it would be to see sterling continue to slide. In this case, the British probably would again ask the other major governments for temporary help in supporting the pound—a positive response is unlikely. On the brighter side, higher unemployment in the coal and petroleum industries would eventually be more than offset by job gains in the rest of the economy, particularly in the nonoil export sector where the cheaper pound would make goods and services more attractive.

Britain's alternative strategy of defending the pound by hiking interest rates would be costlier for the Thatcher government, economically and politically. London already has raised the commercial base lending rate by 4.5 percentage points to 14 percent—almost 10 points above the inflation rate. Another hike in interest rates would further cut growth and employment prospects for the economy. Moreover, when the economic damage from the current hikes becomes apparent, we believe Thatcher will have to lower interest rates and hope that the pound will only ease downward. In any case, a further drop in the oil price would make it more difficult to implement the proposed income tax cuts for the fiscal year beginning on 1 April.

In *Italy,* the government of Prime Minister Craxi almost certainly would try to impose new taxes on petroleum products to offset partially the drop in oil prices. With a budget deficit equal to more than 13 percent of GNP, Rome would be helped by a new source of revenue that would not reduce after-tax income. Infighting among the coalition members, however, would make passage difficult. Nationwide elections are scheduled for May, and the coalition partners—the Christian Democrats, in particular—are calling for stimulative measures.

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The *Canadian* Government would pass on any decline in world oil prices to consumers. Ottawa also might phase out domestic oil price controls faster than planned. Nonetheless, an oil price decline would make reducing the sizable deficit more difficult because lower oil prices would reduce tax revenues from Canada's petroleum sector. Moreover, a large fall in oil prices probably would hamper Ottawa's plans to cut federal payments to the provinces. The oil-producing provinces, in particular, would press for maintaining the payments to offset their own losses in energy revenues.

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Both *West Germany* and *France* are likely to allow domestic oil prices to decline as the market price of oil goes down. Better performance on growth and inflation would do more to revive French Socialist Party prospects in next year's National Assembly elections than a smaller budget deficit paid for by an increase in oil taxes.

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Almost *all other OECD governments* would let domestic oil prices go down in line with a world oil price decline. Lower revenues from natural gas, would make reduction of the budget deficit almost impossible for the *Netherlands.* Those with major deficit problems—*Greece, Portugal,* and *Iceland*—probably would consider raising oil taxes.

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USSR: Problems Exporting Oil and Gas

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The Soviets have substantially reduced oil and gas exports to some West and East European customers, largely because an unusually harsh winter in the USSR has caused spot shortages of domestic energy. Later this year, the USSR should again be able to meet its gas export commitments. The same may not be true for oil, however. The currently depressed level of oil output and sharply reduced stocks will make it difficult for the USSR to meet its domestic and East European oil commitments while sustaining hard currency exports. Although reactions have been muted, this supply crunch could be causing concerns among some customers about the USSR's reliability as an energy supplier during the winter.

Recent Energy Export Difficulties

In recent weeks, the Soviets notified several West European customers that the USSR will not export any crude oil or oil products to them during the month of February. According to West European press services and industry spokesmen, the Soviets told some customers that the stoppage was caused by a "national emergency." press sources indicate a scarcity of Soviet oil sold on the spot market since early January.

In addition to the suspension in oil exports, the USSR this winter has reduced substantially natural gas deliveries to several West and East European customers. Soviet gas deliveries to Austria, for example, were reduced by 40 percent last month. Cutbacks of similar proportions affected customers in at least two other countries. Moreover, the cutbacks appear to have lasted far longer than normal during periods of peak demand in the USSR.

Underlying Causes

The cutbacks have been caused or aggravated by several factors:

- This year's winter weather has been unusually severe.
- Soviet oil production has fallen in recent months.
- There is little room for increased domestic consumption once oil and gas commitments to Eastern Europe and hard currency customers are filled.

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Normally, harsh winter weather at Soviet ports and oil and gas fields makes it difficult for Moscow to meet its energy export commitments without some interruptions in supply. Poor planning, transportation problems, inadequate storage capacity, and substantial seasonal increases in domestic demand are mostly to blame. The USSR attempts to fully commit its oil and gas supplies, so imbalances between supply and demand or impediments to distribution—such as those caused by this winter's harsh weather—almost always cause shortages for some end users, domestic or foreign. In the case of oil, the shortages appear to be getting worse each year.

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Buyers' Concerns

So far, the impact of the recent export cutoffs on affected countries has been marginal. Alternative supplies of both oil and gas are still plentiful, even though the market has firmed somewhat recently.

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How Soviet cancellations in energy deliveries during periods of harsh weather and peak domestic demand are affecting the USSR's reputation as a

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reliable energy supplier is unclear. Some West European business concerns have complained in recent months about dependence on the USSR for energy supplies. Reactions in West European capitals to the recent delays have been limited.

Because of the soft oil market, West European dependence on Soviet oil is not a crucial issue. Nevertheless, Moscow is the largest single supplier of fuel oil to Western Europe, and some OECD countries buy a large portion of their oil needs from the USSR. Finland and Iceland, for example, receive 95 percent and 70 percent of their oil needs, respectively, from the USSR. Six other West European nations buy at least 15 percent of their total oil imports from the USSR.

In contrast to Western Europe, the Communist countries are probably more concerned about the Soviet cutoff. All of Moscow's East European allies, except for Romania, depend on the USSR for at least three-fourths of their oil supplies. Most of these countries also reexport some Soviet oil to earn hard currency. In Asia, the USSR is almost the sole source of oil for the economies of Vietnam, Mongolia, Cambodia, and Afghanistan. In Latin America, Cuba depends on Moscow for all of its oil imports, and Nicaragua depends on the Soviets for over half of its oil.

Moscow has promised its East European allies that it will not reduce oil exports to them through 1990 as long as they meet their export and other obligations to Moscow on time. We have some doubt, however, that the USSR will live up to this commitment.

Implications for Hard Currency Earnings

The suspensions of oil and gas deliveries will reduce first-quarter hard currency earnings, but the outlook for the year as a whole is less certain. In recent years, Soviet shortfalls during the first quarter have been offset by greater deliveries later in the year. In the past three years, the USSR managed to export record amounts to OECD countries by the end of

Dependence on Soviet Oil, 1983

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	Imports of Soviet Oil (*thousands b/d*)	Share of Total Oil Imports (*percent*)	Share of Total Oil Consumption (*percent*)
OECD [a]			
Austria	30	18	15
Belgium	114	16	28
Finland	253	95	122
Greece	53	16	23
Iceland	7	70	70
Netherlands	271	18	47
Sweden	72	15	18
Switzerland	46	18	19
Other			
Nicaragua [b]	7	55	55
Afghanistan [c]	9	95	95
Communist [a]			
CEMA			
Bulgaria	269	88	94
Czechoslovakia	342	94	101
East Germany	342	77	95
Hungary	159	75	80
Poland	300	86	91
Romania	4	1	1
Cuba	190	100	90
Mongolia	19	100	100
Vietnam [c]	33	85-90	85-90
Other			
Yugoslavia	112	54	39
North Korea	15	30	30
Laos [c]	1	20-25	20-25
Cambodia [c]	3	95-100	95-100

[a] Other countries belonging to these organizations buy less than 15 percent of their oil imports from the USSR.
[b] These data are for 1984.
[c] Information on energy use in these countries is scarce. These are rough estimates.

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the year. Most of the increases in 1982 were at the expense of deliveries to Eastern Europe. In 1983 and 1984, however, the reexports of OPEC oil accounted for much of the rebound. The USSR receives oil from OPEC nations mostly in return for arms deliveries. Soviet imports of OPEC oil have increased from about 80,000 b/d in 1981 to about 220,000 b/d in 1983. By third quarter 1984, these imports had increased again, to roughly 250,000 to 270,000 b/d.

Earnings from sales of oil and gas provide the USSR with almost 60 percent of its total hard currency receipts from merchandise exports (including arms sales). Oil sales make up about 50 percent—earning about $15.6 billion in 1983 and probably more than $15 billion again last year. This year, however, the USSR will have to overcome some unfavorable trends if it is to maintain the value of its oil exports to the West without disrupting deliveries to its socialist partners:

- Exports are off to a very slow start during the first quarter.
- Oil prices may continue to slide somewhat in 1985.
- Soviet oil production could well decline again this year in the wake of the roughly 65,000-b/d drop in 1984.

Soviet reexports of OPEC oil will help sustain earnings from oil sales, but they do not represent a net improvement to the USSR's overall hard currency position. Resale of this oil represents an extra step required of the Soviets to translate its arms deliveries into hard currency.

Gas sales earned the USSR about $3.3 billion in 1983, and probably close to the same amount last year. Contract deliveries to Western Europe are scheduled to increase slightly in 1985. The Soviets should have no trouble meeting these commitments, given their considerable success in increasing gas output in recent years. These sales should earn them about $3.3-3.5 billion this year.

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Nicaragua: Economic Vulnerabilities

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Bleak export prospects promise a worsening of Nicaragua's serious economic and financial problems. Managua is virtually broke, has already spent the revenues from this year's presold agricultural exports, and is likely to fail to make numerous promised deliveries. To maintain government imports and step up military spending, the Sandinistas are reducing subsidies to local consumers and producers and further stalling international creditors. As a result, we expect the economic situation to deteriorate as consumer good shortages worsen and more producers face bankruptcy.

The Sandinistas fear they may be faced with economic sanctions and already have begun to diversify trade and to try to secure more financial support. Although US sanctions probably would result in foreign exchange losses of about $25 million—which Managua could withstand—the indirect costs probably would be substantial. Even if there are no sanctions, increased Communist support would be needed to bolster the troubled economy.

Dismal Economic Situation

Exports are in serious trouble. Earnings from coffee and cotton—Nicaragua's largest exports—are likely to be as much as 50 percent below the Sandinista's target this year. Insurgents have hit government plantations hard, and coffee beans and cotton on private plots are rotting because of inadequate government prices and critical labor shortages. Private growers report that chronic fertilizer and pesticide shortages and equipment problems are also hampering agricultural output.

At the same time, government mismanagement and harassment of the private sector has gutted business confidence, led to steep business losses, and derailed productive investment. According to the US Embassy and press reports, punitive exchange and price policies are driving businessmen to black markets and smuggling to avoid bankruptcy.

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Huge budget deficits and growing shortages have sent consumer price inflation soaring toward triple-digit levels. The public deficit jumped from 21 percent of GDP in 1983 to 25 percent in 1984. At the same time, inflation more than doubled to 60 percent in 1984. Unemployment, currently estimated at 30 percent, is rising.

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Public services have deteriorated, and, according to the US Embassy, government-provided water, electricity, and telephones function only sporadically. Various sources report severe shortages of such basics as milk, rice, beans, toilet paper, soap, and light bulbs.

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Government Initiatives

Recent measures to ration foreign exchange and cut the budget deficit will put further economic and financial pressure on consumers and businessmen:

- On 4 February Managua more than doubled prices on many consumer goods in an attempt to get staples back into official channels. The 50-percent wage hike given at the same time—the first adjustment in two years—will only partially restore purchasing power.

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- On 8 February Managua announced a new series of exchange rates, effectively devaluing the cordoba by half. Revised rates will further undercut

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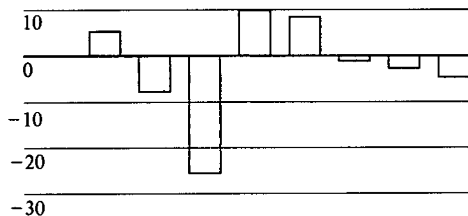
Nicaragua: Economic Indicators

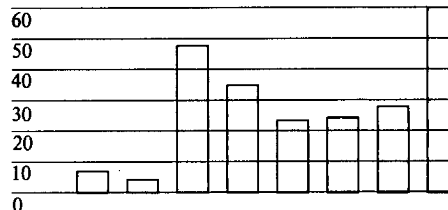
Real GDP Growth

Percent



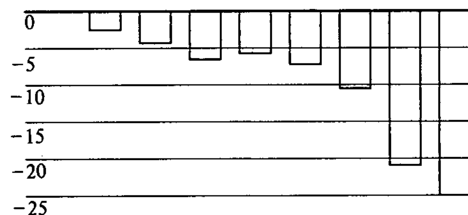
Consumer Price Inflation

Percent



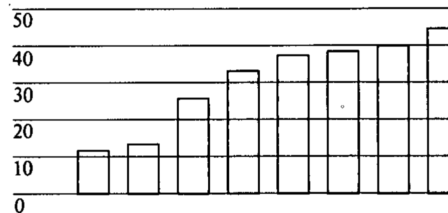
Central Government Budget Deficit as a Share of GDP

Percent



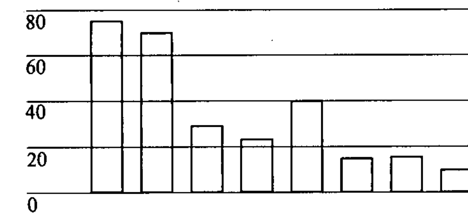
Public Sector Production as a Share of GDP

Percent



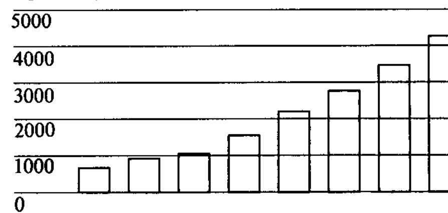
Share of Bank Credit Provided Private Sector

Percent

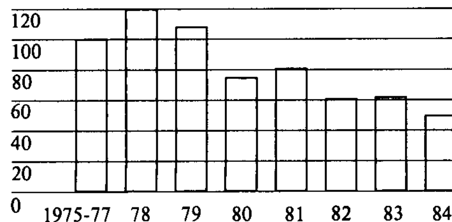


External Public Debt (yearend, medium- and long-term)

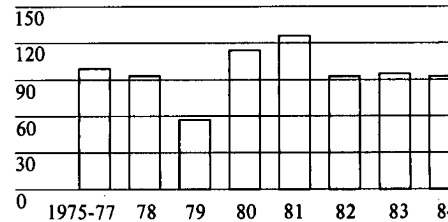
Million US $



Index of Exports Volume



Index of Nonmilitary Imports Volume



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private-sector access to imported consumer and producer goods. Under the system, exchange rates will range from 20 cordobas to the dollar for essential imports to 50 cordobas to the dollar for most nongovernment purchases.

- To finance increased defense spending, Managua has also announced a freeze on government employment and education spending, and a reduction in consumer subsidies, government investment, and social programs.

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Stalling Creditors

Managua is promising some debt payments in order to keep Western credit lines open, but arrearages continue to mount. Unless overdue IMF obligations are settled, Nicaragua will probably be declared ineligible to make further drawings. Commercial bankers have recently agreed to give Nicaragua more time to work out arrangements for token payments on interest now two years past due.

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International Economic Leverage

Managua recognizes its economic vulnerabilities and has made an effort to diversify its markets and search for additional financial support. Its concerns probably have been heightened by the insurgents' calls for US trade sanctions on Managua. Sanctions by the United States alone, however—we doubt broad support from other Western nations—probably would lead to foreign exchange losses equal to less than 1 percent of GDP. Trade with the United States has already fallen sharply from prerevolution levels. Nicaragua's US sugar quota has been lifted; the United States has never imported much Nicaraguan cotton; and coffee sales have been shifted to Western Europe and CEMA countries.

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Nicaraguan Exports to United States *Million US $*

Commodity	1975-77 (annual average)	1984 [a]
Total	**140**	**57**
Bananas	5	24
Shrimp	20	10
Meat	33	9
Coffee	21	5
Sugar	39	4
Tobacco	6	3
Other	16	1

[a] Twelve-month data.

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We estimate Nicaragua would need a 10-percent increase in Communist financial support to compensate for export losses from unilateral trade sanctions. The Soviets, however, already have demonstrated their willingness to assist the Sandinistas further by offering increased oil financing. Nicaragua also probably would be able partially to evade US sanctions through third party front operations by relying on Cuban experience.

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The impact of unilateral US sanctions on imports probably would be harder for Managua to overcome. The $112 million in critical intermediate goods, spare parts, and machinery imported from the United States in 1984 would be difficult to replace in the medium term. A unilateral cutoff would, at least temporarily, add to consumer shortages and idle US-made equipment.

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Nicaragua: The Foreign Financial Gap

Million US $ (except where noted)

	1975-77	1982	1983	1984
Trade balance	−86	−418	−485	−685
Exports, f.o.b.	518	406	428	365
Imports, f.o.b.	604	824	913	1,050
Military	0	100	135	250
Other	0	724	778	800
Net Services	−62	−273	−283	−280
Interest obligations	43	217	200	200
Other	−19	−56	−83	−80
Net transfer	13	86	150	200
Military grants	0	34	64	100
Other	0	52	86	100
Current account balance	**−135**	**−605**	**−618**	**−765**
Debt principal due	35	150	155	160
Financial gap	**170**	**755**	**773**	**925**
Medium- and long-term capital inflows	163	645	826	850
Commercial bank loans	74	NEGL	NEGL	NEGL
Rescheduled debt and arrears	NEGL	184	205	260
Interest	0	93	104	140
Principal	0	91	101	120
Official loans	89	461	621	590
Bilateral	42	425	553	560
Military	0	66	71	100
Other	0	359	482	460
Multilateral	47	36	68	30
Net short-term capital (includes errors and omissions)	−9	11	−72	55
Drawdown in reserves	16	99	19	20
Other financial items				
External debt (yearend, medium- and long-term)	703	2,800	3,500	4,300
Commercial bank debt	368	964	1,030	1,120
Net international reserves [a]	31	−431	−450	−470
Debt service ratio [b]				
Obligations due (*percent*)	15.1	90.4	82.9	986
Obligations paid (*percent*)	15.1	45.1	35.0	27.4

[a] Foreign exchange reserves minus short-term liabilities.
[b] Debt interest and principal as percent of merchandise exports.

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Beyond the Simple Economics

The indirect costs of sanctions—further strains on an already shallow managerial pool—probably would be substantial. Sandinista managers would have to assess the impact of export and import cutbacks, locate alternative markets, set new sales terms and shipping arrangements, coordinate delivery dates, and line up new financing and import priorities. Moreover, sanctions would intensify the Sandinistas' siege mentality and probably would cause the regime to shift resources to defense to counter a perceived US invasion threat.

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Even if there are no sanctions, the Sandinistas will need increased Communist support to shore up the economy. It is uncertain, however, whether Soviet support would ever be sufficient to assure the steady growth of the Nicaraguan economy.

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Mexico: Dim Prospects for Foreign Investment

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Tough regulations and poor prospects for economic performance are discouraging foreign investment in Mexico. Although the de la Madrid administration claims to be seeking foreign capital and technology to spur growth, Mexico City recently imposed new regulations on industries with heavy foreign participation in order to ensure that less efficient local producers would not be driven out of business. As long as the government is unwilling to create a favorable investment climate, Mexico will not attract enough new overseas funds to offset the slump in domestic investment or limited access to international credits.

Changing Atmosphere

Traditionally, Mexico has viewed foreign investment as a "necessary evil." Government control reached new highs in the early 1970s with legislation that limited foreign ownership to 49 percent, established a formal review commission to screen all applications, restricted patent protection, and sought to reduce dependence on foreign technology. Other regulations in the late 1970s imposed local content requirements in an effort to increase technology transfer, local employment, and net foreign exchange earnings.

Investors were still attracted by Mexico's large and growing domestic market, relatively cheap labor, lack of exchange controls, ease in finding capable Mexican partners, and proximity to US and Latin American markets. During 1976-82 the stock of direct foreign investment more than doubled to $10.8 billion, accounting for an estimated 4 percent of total investment. Nonetheless, foreign businesses played an increasingly important role; by 1981 almost 60 percent of total overseas sales of manufactured goods were produced by Mexican affiliates of foreign firms.

Impact of the Financial Crisis

Foreign investment has plunged as a result of Mexico's rapidly deteriorating economic situation. Only some $700 million in foreign investments entered Mexico in 1982 compared with $2.4 billion in 1981. During the first six months of last year, only $29 million was invested by foreigners, primarily in assembly operations where the domestic value added is extremely low. The surprise bank nationalization in 1982 raised concerns among both foreign and domestic investors that the government planned to greatly expand its control over the economy. At the same time, the imposition of exchange controls and sharp devaluations greatly added to the operating problems and stimulated capital flight. In 1983 the government-imposed austerity program caused a deep cut in consumer demand that slashed industry operations to only about 50 to 60 percent of capacity.

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Foreign investors with large equity stakes sought to boost exports to compensate for the drop in domestic sales and the increase in financial restrictions. The sharp peso devaluations had made Mexican products competitive abroad. Moreover, many foreign subsidiaries were forced by exchange controls to depend on their parent companies financially

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manufactured goods exports jumped almost 30 percent in 1983, giving Mexico a $600 million trade surplus in manufactures.

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De la Madrid Sends Negative Signals

In early 1983 following President de la Madrid's inauguration, the administration articulated the

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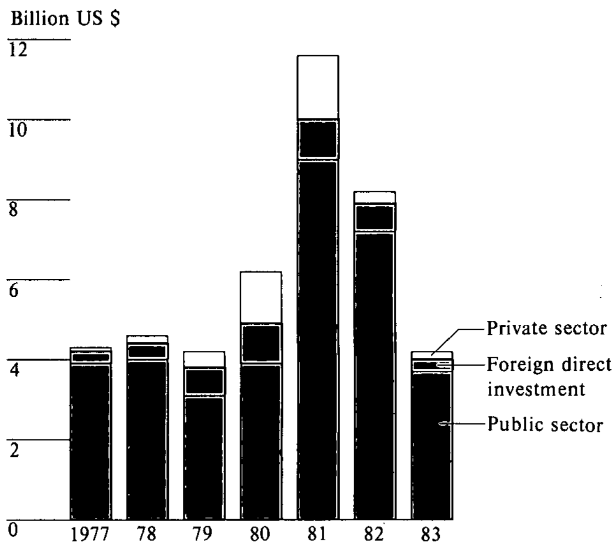
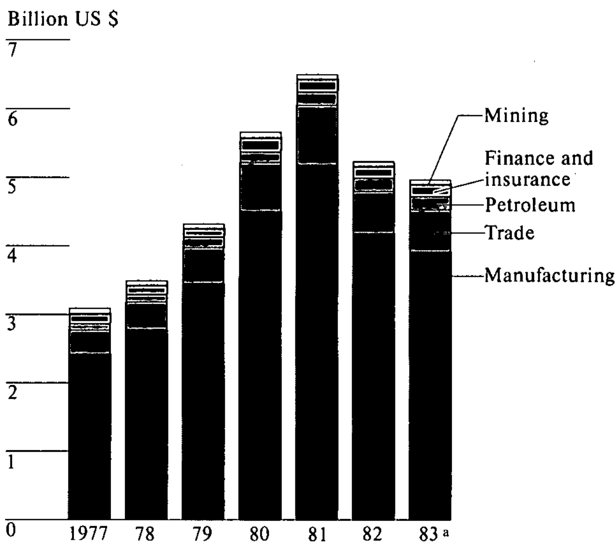
Mexico: Foreign Investment Factors, 1977-83

Note scale change

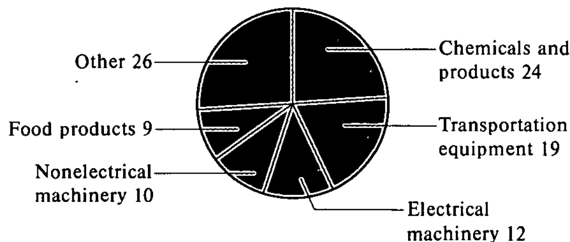
Comparison of Net Long-Term Capital Flows



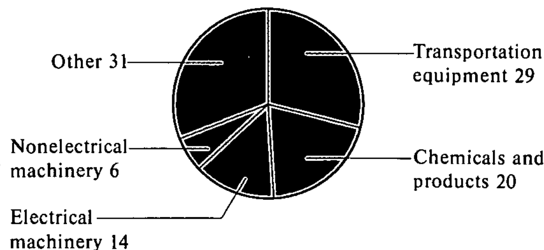
US Foreign Direct Investment in Mexico by Industrial Sector



Foreign Direct Investment in Mexican Manufacturing Sector, By Industry, 1980



Manufactured Exports of Mexican Companies With Foreign Participation, By Industry, 1980



[a] Estimated.

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need for new foreign investment, but, as the economic crisis became less acute, traditional political sensitivities to foreign investment again surfaced. De la Madrid appeared increasingly skeptical of foreign investor motives and sensitive to pressures from highly protected local producers. He began siding with advocates of more regulation, such as Foreign Minister Sepulveda and Minister of Planning and Budget Salinas de Gortari, against proponents of liberalized foreign investment, such as Under Secretary for Foreign Investment and Technology Transfer Adolfo Hegewisch and Finance Minister Silva Herzog. Controls were tightened on the auto and pharmaceutical industries—two sectors with extensive foreign participation—and are being considered for electronics and food processing. Moreover, several close observers have noted that de la Madrid's drift away from a favorable foreign investment view has made bureaucrats reluctant to be associated with any politically sensitive investment project.

De la Madrid promised in February 1984 that Mexico would interpret the 1973 Investment Code more flexibly and allow up to 100-percent foreign ownership in such priority sectors as computers, communications, and oilfield and petrochemical equipment. Majority foreign equity participation, however, continued to be discouraged. Foot-dragging on foreign investment applications continued, and, even when firms offered export promotion, new technology, or expanded employment, few exceptions were granted. Last month the government refused IBM's request for 100-percent control of its planned operation—which would have generated about $20 million in net foreign exchange earnings annually—after nearly a year of negotiations. The rejection was backed by a broad coalition of local producers, the political left and at least two economic cabinet ministers.

Prospects for New Foreign Investment

Without presidential support for a better investment climate, new foreign investment in Mexico is unlikely to rise significantly over the next several years. Many companies say they will not invest until Mexico demonstrates greater flexibility in interpreting the new decrees and guidelines. Those already there probably will concentrate on reinvesting earnings as they retool for export promotion, work to use excess capacity, or in some cases merge with local companies to take advantage of government incentives designed to boost local industries. For example, several US automakers, which already have multibillion-dollar investments in Mexico, are expanding their exports of parts and some vehicles to the United States. The $500 million Ford plant in the state of Sonora has received the most publicity.

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We expect the largest of the already established firms to use their bargaining power as large employers to cut mutually beneficial deals with the government. By selectively bending implementing regulations, Mexico hopes to gain foreign exchange, improve competitiveness, and generate new jobs.

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Many potential new investors, however, have told the US Embassy and financial press that they remain skittish about investing in Mexico because they fear that the rules will change when the economy improves. Many firms also are intimidated by controlled prices, recent loss of peso competitiveness, poor access to peso credit, export and local content requirements, protection of technology, and the government's general attitude toward the private sector, according to the US Embassy. Prospects for continued slow economic recovery will dampen any return of interest in Mexico's domestic market. Few expect a resurgence in consumer demand that will reduce excess capacity. Moreover, business sources also claim that growing state domination of the economy has begun to outweigh many of the economic advantages associated with investment in Mexico in the past. Nevertheless, firms that expect to be able to make special arrangements with the government—particularly those in high-priority areas—probably will advance investment proposals.

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Tightening Control

New industry guidelines, issued in late 1983, covered the largely foreign-owned automobile assembly operations. The regulations severely restricted the types and models of vehicles that foreign investors could produce, banned eight-cylinder engines, tightened local content requirements, and forced investors to boost the positive trade balance between exported final products and imported components. It also made DINA, a parastatal producer of heavy trucks and buses, the sole manufacturer of medium-duty trucks. As a result of the regulations, many manufacturers had to extensively retool production and forfeit their most profitable lines.

In February 1984 new restrictions were announced for retail pharmaceutical production, 80 percent of which is produced by foreign-owned firms. The decree requires uniform generic packaging and labeling, a move multinational labs claim will erode their patent protection, according to the US Embassy. Moreover, the decree increases restrictions on local sourcing, product registration, and pricing. The Embassy also reports that these measures have already cut into the profitability and production of specialized medicines. Almost 50 multinational labs, both American and European, are challenging the constitutionality of this decree. Some have threatened to leave Mexico if a compromise with the government is not reached.

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The government also has proposed an electronics-sector plan that, if implemented, would increase local content to 80 percent within five years and force local assembly of circuit boards and other components. Foreign-owned firms dominate all but the microcomputer end of this market. Several of these firms have indicated that local assembly of intricate components probably would cause a significant decrease in the efficiency of production.

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A sectoral reorganization similar to those above is also rumored to be under study for the food-processing industry. The food industry has substantial foreign participation and has long been the target of government and leftist criticism for allegedly diluting the traditional Mexican diet with high-cost, low-nutrition "junk foods."

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Implications

As long as the government is unwilling to create an investment climate that is favorable for foreign enterprises, the economy will remain dependent on oil market trends and foreign bankers' largess. Mexico cannot expect to offset limited access to international borrowing or continued capital flight with large inflows of foreign investment funds. As a result, capital needed to retool and to start up new export industries will be limited. Moreover, Mexico will have poor access to new technology, experienced entrepreneurship, and marketing techniques necessary to increase competitiveness with other export-oriented countries.

The apparent unwillingness of the de la Madrid administration to adopt a more liberal and consistent foreign investment policy is likely to continue aggravating investment and trade relations with the United States. Recent US attempts to cajole the Mexicans into softening restrictions on foreign pharmaceutical companies by threatening to hold up approval of the agreement on export subsidies have produced few results. Meanwhile, other US businesses, fearing Mexico's retaliation, are pressing Washington to ease up and allow them to make their own arrangements with the de la Madrid administration.

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