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**International
Economic & Energy
Weekly** [Redacted box]

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5 April 1985

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**International
Economic & Energy
Weekly** [Redacted]

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**International
Economic & Energy
Weekly** [Redacted]

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Synopsis

1	Perspective—<i>The OPEC Challenge in Product Exports</i> [Redacted]	25X1
	In our view, expanded product exports from OPEC pose little threat to the energy security of oil-importing countries in the near term. [Redacted]	25X1
3	Summit Issues: Japan Begins To Deliver on Market Opening [Redacted]	25X1
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7	Summit Issues: Structural Adjustment in the Big Six [Redacted]	25X1
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11	Summit Issues: Western Europe Copes With the Dollar [Redacted]	25X1
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**International
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Perspective***The OPEC Challenge in Product Exports*** []

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Several OECD countries—as a result of a shift in refining capacity from major consuming countries to oil exporters—have expressed concern about the energy-security implications of growing product exports from OPEC and the organization's increased ownership of refineries and distribution networks in developed countries. The weak oil market and growing competition from OPEC suppliers have forced the closure of some 8 million b/d in non-Communist refining capacity since 1980. By 1990 we believe an additional 7 million b/d of capacity could be mothballed as a result of continued weak oil demand and planned expansion in OPEC refining capacity. Meanwhile, OPEC product exports could double. []

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In our view, expanded product exports from OPEC pose little threat to the energy security of oil-importing countries in the near term. OPEC's main threat to energy security remains its ability to control the production of oil. We expect non-Communist refining capacity outside OPEC to remain sufficiently flexible to meet demand requirements through 1990:

- As long as a country is dependent on imports, it is largely irrelevant whether the oil is in the form of crude or product. If refinery closures impair a country's ability to process domestic production and stocks, however, product imports would increase and heighten vulnerability to a disruption.
- OPEC ownership of refineries and distribution networks in developed countries poses little threat because these facilities could be commandeered in a crisis and some oil exporters might have a vested interest in their continued operation. []

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Rising product exports, however, could affect prices. Because prices for product exports are not controlled by OPEC, members will be tempted to discount prices in a weak market. Such action would undermine the official price structure for crude oil and could result in a collapse in oil prices.

Although a price decline would present consuming countries with potential economic gains, sharply reduced revenues would have potentially destabilizing effects on several oil producers that could lead to a disruption in oil supplies. []

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The impact of rising OPEC refining capacity and product exports on non-OPEC refiners will depend in large part on trade policies adopted by importing countries to protect their refining industries. Pressures for restrictions on oil product imports are mounting in several developed countries, and some

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refiners claim that OPEC's access to low-cost crude supplies will lead to unfair competition. In our judgment, additional OPEC product exports can be readily absorbed if distributed among the various consuming areas. Japan, however, has restrictions on imports that could force more products into other regions, perhaps encouraging some West European nations to enforce or strengthen existing restrictions. If Western Europe and Japan opt for protectionist measures, pressure on the US refining industry will intensify. We believe policies to restrict OPEC products would ultimately be ineffective because of OPEC's ability to control crude oil production and thus limit crude availability.

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Summit Issues: Structural Adjustment in the Big Six

Since last year's London Summit, Big Six governments have implemented a variety of measures aimed at promoting structural adjustment in their economies. Several countries have moved to free up their capital markets, reduce government ownership of industry, and contain the power of national labor unions. Serious labor market rigidities remain, however, and continue to retard the restructuring process. Moreover, Big Six governments are maintaining large subsidy programs for noncompetitive, traditional industries. Prospects for industrial restructuring should improve over the next few years, but governments will remain essentially conservative in their approach.

Recent Developments

Capital markets outside the United States and the United Kingdom remain inefficient and highly regulated. Governments have been especially reluctant to expose their financial systems to international competition. Japan has moved over the last year to relax the rules on foreign and domestic lending. Paris is easing a wide variety of credit controls to encourage more efficient capital allocation. West Germany has promised a far-reaching liberalization of its capital markets, although details have yet to be published. In addition, Paris and Bonn have ended withholding taxes on nonresident lenders to counter a similar US move.

Privatization, the transfer of government enterprises to the private sector, is the announced goal of several governments. Only the United Kingdom, however, has followed through. Bonn's privatization scheme has been postponed and scaled down, and Italy's plans to sell some state-owned firms is off to a slow start. Although Tokyo has privatized the national telecommunications monopoly, the move has been denounced by potential foreign

competitors who fear that new government regulations will still deny them access to Japan's telecommunications market.

Labor mobility is not a problem in Japan, but West European labor markets are highly inflexible because of union power, high employer taxes, barriers to firing, and generous unemployment benefits. The Governments of France, Italy, and the United Kingdom have compelled their powerful unions to accept large-scale layoffs over the past year. These victories, although encouraging, have yet to be consolidated by new legislation that would allow firms to more easily adapt their work forces to changing market conditions. Wage bills in most Big Six countries are bloated by high social security taxes, and governments have been reluctant to encourage new jobs by reducing such charges.

Industrial subsidies, which most Big Six governments view as their chief tools to promote industrial restructuring, continue to be concentrated on declining industries. Despite almost a decade of adjustment, Western Europe's problem sectors—steel, shipbuilding, and textiles—remain dependent on subsidization. Japan has long employed subsidies and special tax breaks to target the development of high-value-added industries. West European countries, however, are increasingly looking toward subsidies to promote high-tech industries. Italy has been providing low-cost loans for purchases of advanced capital goods. West Germany introduced last year special tax writeoffs for research and development investment. Joint European projects, such as the EC's information technology research program—ESPRIT—or the

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Country Programs

Japan does not suffer the economic difficulties facing other Big Six governments, and therefore Tokyo sees no need to alter its restructuring strategies. Economic growth last year was just under 6 percent, inflation is under control, and unemployment is only 2.7 percent. MITI's industrial policy has two goals: to promote "winners" by encouraging investment in high-tech growth areas and to ease the transfer of resources from depressed industries. MITI has employed subsidies and tax breaks to speed the application and diffusion of technology in the microelectronics, robotics, high-speed computing, and artificial intelligence industries. At the same time, MITI has sponsored capacity-reduction cartels for depressed industries such as aluminum. Such cartels are controversial because of their alleged impact in curbing imports—a charge Tokyo flatly denies. [redacted]

West Germany is offering increasing financial assistance to promote the startup of new business and to stimulate private research and development. Tax revisions in 1984 give relief to small- and medium-sized firms and provide tax breaks for R&D investment. Bonn also is increasing grants for technical research. Nonetheless, the Kohl government subsidizes declining industries at an even higher level than its predecessor. [redacted]

France continues to retreat from the interventionist policies that characterized the first year of the Mitterrand government. The Socialists have made progress, at least on paper, toward a more free market oriented economy. They are reducing credit controls and are trying to create a venture capital market. Paris has eased bureaucratic requirements for starting a business. Foreign investors are now generally welcome—notification and authorization requirements have been liberalized. In the past year, foreign firms, especially Japanese, have been allowed to buy out troubled businesses that in the past would have become wards of the state. Moreover, the Socialists have largely eliminated de facto wage indexation. Progress has been less impressive in other areas. Labor and management have failed to negotiate more flexible work rules. Employers still cannot adjust their work forces easily because labor contracts and government laws restrict the use of temporary and part-time workers. [redacted]

The United Kingdom is counting on tight fiscal and monetary policies and free market principles to generate industrial restructuring and sustainable growth. Low inflation, deficit reduction, and investment-stimulating tax cuts are key to Prime Minister Thatcher's strategy. The new budget introduced tax reforms to lower the cost of hiring new employees and promised an expansion of youth training programs in partnership with the private sector. To reduce the power of British labor unions, Thatcher last summer pushed through legislation mandating the regular election of union officials. Tories are also faithfully executing their extensive privatization program. Sales of government-owned companies have totaled over \$8 billion, and London has opened several public service sectors such as telecommunications to private competition. [redacted]

Italy's record on restructuring is mixed and no overall industrial policy has been developed. The government acted last year to curb the wage indexation system, although that measure could be repealed if a Communist-sponsored referendum goes against the government. Rome has given financial support to extensive company efforts to lay off redundant workers. Also, the government has enacted controversial legislation to limit tax evasion. Prime Minister Craxi has not acted, however, to fundamentally reform the country's wasteful welfare system, and progress in curbing government indebtedness appears to be due more to funding shifts than to actual budgetary improvements. [redacted]

Canada lacks a national industrial policy and a specific restructuring program. Although the new government has pledged to reduce the impediments to restructuring, Prime Minister Mulroney has yet to articulate a specific agenda or to approach the powerful provincial governments on the process. Mulroney has abandoned the Trudeau government's autarkic investment policies, and is reducing barriers to foreign capital. The new energy program is intended to spark private-sector investment by reducing the government's take of energy revenues. [redacted]

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Dutch-West German program to develop a 1-megabit microchip—are becoming more frequent. The most notable examples of European cooperation—Ariane and Airbus—have become competitive, but at heavy taxpayer cost.

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Outlook

Prospects for industrial restructuring outside the United States over the next few years seem somewhat brighter than in the recent past. Technological innovation should increase as large Japanese and West European corporations improve their profit and liquidity positions and devote more resources to research and development. We expect to see more joint ventures among US, European, and Japanese high-tech firms. The major economies appear to have arrested the chronic growth of their welfare systems, but we do not expect that the attitudes, social arrangements, or legal frameworks that inhibit innovation in Western Europe will change easily. Some governments face tough elections over the next few years, and they will be cautious on reform. Moreover, governments will be loath to tamper with social nets and worker rights while unemployment remains high.

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**Summit Issues: Western Europe
Copes With the Dollar**

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West European concern that the strong dollar is holding back the region's economic recovery is ill founded. The 100-percent real appreciation of the dollar against the European Currency Unit (ECU)² between 1980 and 1984 has given West European producers an edge in international markets. According to our econometric model, real GNP in the four major West European countries was higher each year than it would have been if the dollar had held steady. The rising dollar also helped stabilize the European Monetary System (EMS) by holding down the West German mark against the other EMS currencies. On the negative side, the strong dollar generated pressure on domestic prices, but all the major West European countries still managed to lower their inflation rates during the period.

Impact of the Strong Dollar

We believe the appreciation of the dollar during 1980-84 helped the West European economies. The main positive impact came in the foreign sector where total real exports of goods and services last year were higher than in the baseline scenario—most of the increase in exports was in sales to the United States. Imports from the world, on the other hand, were lower. Our results also indicate that the strong dollar has boosted West European investment and private consumption. Our model indicates, however, that the price level in the Big Four was higher than it otherwise would have been.

¹ This article is excerpted from a forthcoming DI intelligence assessment.

² The European Monetary System (EMS) is a joint float of eight EC currencies; the United Kingdom and Greece have not joined the float. At the heart of the EMS is the European Currency Unit (ECU), an accounting unit made up of a basket of the 10 EC currencies. Each country in the float is required to intervene to stabilize the value of its currency against the ECU—in effect, against the weighted average of the other currencies.

***Methodology for Estimating the Impact
of the Dollar's Strength***

We used our Linked Policy Impact Model (LPIM) to isolate the effect of the strong dollar from other factors that influence trade patterns, such as the US economic recovery. To estimate the impact, we first ran a baseline simulation for the 1980-84 period incorporating the exchange rate changes that actually occurred. We then ran a second simulation holding real exchange rates constant—that is, the nominal exchange rates were allowed to vary just enough to offset inflation differentials. More specifically, because we wanted to isolate the dollar's impact on each of the Big Four West European countries individually, we held the real dollar exchange rate constant against the Big Four on a weighted average basis, while allowing real exchange rates within the Big Four to vary as they actually did in the real world. The differences between the results generated by the two simulations measure the impact of the dollar's real exchange rate appreciation.

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These results probably overstate the positive impact of the dollar because net capital flows from Western Europe to the United States are not explicitly captured in our model. We believe, however, that the negative effect of these capital outflows is relatively small. For example, if capital movements were the sole cause of the 3-percentage-point rise in real West European interest rates, the model indicates that less than half of the dollar's positive impact on GNP is eliminated.

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**Big Four: Impact of the
1980-84 Real Appreciation
of the US Dollar***Percent change from baseline*

	1981	1982	1983	1984
Big Four				
GNP	0.3	1.2	2.1	3.9
Private consumption	-0.8	-0.5	0.4	1.9
Investment	0.1	1.5	2.1	3.6
Exports	0.6	0.5	0.6	2.6
Imports	-2.1	-3.7	-4.5	-4.0
Price level (GNP deflator)	0.9	3.7	7.0	11.0
West Germany				
GNP	0.4	1.3	2.6	4.8
Private consumption	-0.3	0.2	2.0	5.0
Investment	0.9	2.4	3.9	6.1
Exports	0.3	0	0	1.8
Imports	-1.2	-2.3	-2.4	-0.4
Price level (GNP deflator)	0.8	3.9	7.4	11.9
France				
GNP	0.3	1.7	2.4	4.4
Private consumption	-0.4	-0.3	0.1	1.0
Investment	0.9	3.2	5.5	4.5
Exports	1.2	1.0	0.8	2.7
Imports	-3.2	-3.0	-3.4	-3.8
Price level (GNP deflator)	0.3	1.3	3.0	4.9
United Kingdom				
GNP	0.7	1.7	2.6	3.4
Private consumption	-1.2	-0.2	0.3	0.5
Investment	0.9	3.2	5.5	4.5
Exports	1.2	1.0	0.8	2.7
Imports	-3.2	-3.0	-3.4	-3.8
Price level (GNP deflator)	0.7	2.9	5.3	7.5
Italy				
GNP	-0.5	-0.6	-0.3	1.3
Private consumption	-1.8	-3.0	-3.1	-2.2
Investment	-0.7	-2.1	-2.8	-1.1
Exports	0.7	0.9	1.3	3.5
Imports	-2.6	-6.2	-7.6	-7.5
Price level (GNP deflator)	2.2	8.1	15.1	23.5

West European Reactions

For much of the 1980-83 period, West European leaders complained that the strong dollar was putting upward pressure on interest rates, holding back economic growth, and boosting inflation. Paris even attributed the failure of the original Mitterrand economic program to the dollar's rise. []

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Between mid-1983 and late 1984, West European criticism of the dollar abated. The West Europeans clearly became more aware of the boost that the strong dollar was giving to their exports and their economic growth rates. In its mid-1984 economic review, for example, the West German Institute for Economic Research attributed the West German recovery mainly to an export boom powered by US economic growth and the strength of the dollar. Western Europe recorded a \$5 billion trade surplus with the United States last year, compared with a \$30 billion deficit in 1980. []

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Realization that the strong dollar has contributed to EMS stability probably also has played a major role in dampening West European criticism. The EMS has now gone two years without experiencing one of the bitter realignment struggles that previously had occurred, on average, every nine months. Despite West Germany's lower inflation rate and stronger current account balance, the West German mark has not experienced much upward pressure against the French franc or the Italian lira. As a reserve currency, the mark is often held as a substitute for the dollar. When the dollar started rising, people sold their marks for dollars faster than they sold French francs or Italian lire, holding the mark down within the EMS. []

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Another reason the West Europeans became less concerned about the strength of the dollar was their apparent decision to "decouple" their economic policies from changes in the dollar. Although US and West European real interest rates are both

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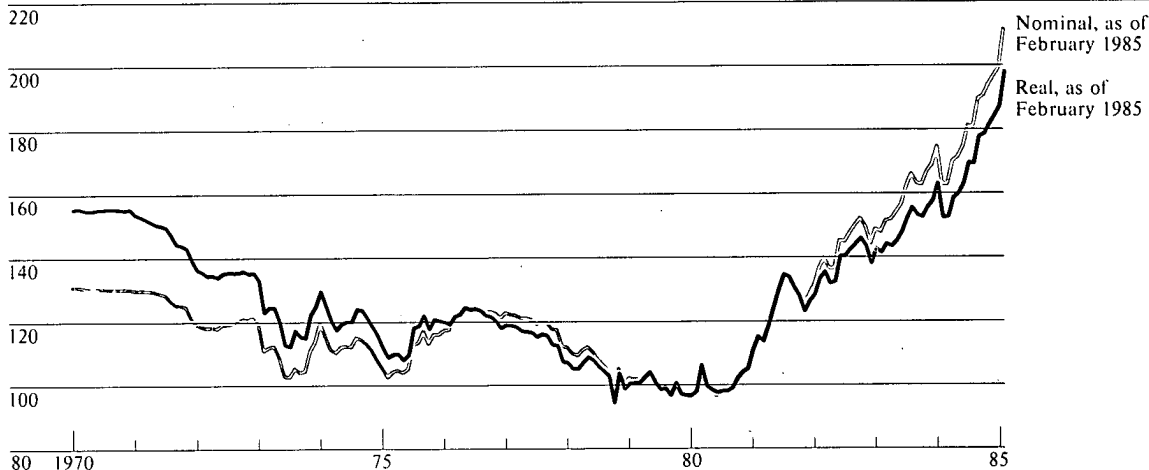
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Dollar/ECU Exchange Rates, Real and Nominal, 1970-85

Index: 1980=100



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higher than they were in the 1970s, changes in their respective levels are much less closely correlated than they were then. [redacted]

In the past few months, however, West European concern over the strong dollar has picked up again. We believe this stems in part from political sensitivities. In the United Kingdom, for example, Prime Minister Thatcher has said that the value of a nation's currency reflects its basic strength and that the pound should remain above parity with the dollar. Nonetheless, the major reason for the increased concern probably is the widespread feeling that the higher the dollar goes, the further it could fall later—the exchange rate development the West Europeans fear most. [redacted]

Impact of Future Dollar Movements

The West Europeans probably would be worse off if the dollar declines than they would be if the dollar stabilizes or appreciates further. A drop in

the dollar would worsen West European trade competitiveness, reduce GNP growth, and aggravate the unemployment problem. In addition, a depreciating dollar would create pressure for a realignment of EMS parities, already overdue because of the inflation differentials within the EMS. With the dollar falling, more capital probably would flow into West Germany than into other EC countries, adding to the pressure. In this situation, an EMS realignment would be unavoidable; in the past such realignments invariably have turned into crises for the EC. [redacted]

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Argentina: Coming Labor Confrontation

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Falling real wages and rising unemployment threaten to bring labor into greater conflict with the Argentine Government. Inflation, which has soared from 340 percent to 800 percent under President Alfonsin, is stretching labor's patience to the limit. We foresee major wildcat strikes over wages in the months ahead. This will complicate Argentina's negotiations with the IMF that could lead to a resurgence of cash problems by midyear. Although Alfonsin is likely to obtain a new Fund program, once campaigning for the November parliamentary elections begins, we see little chance that he will attain revised IMF targets.

Wage Policy Under Alfonsin

Alfonsin, during the election campaign and early in his term, promised Argentine workers real wage increases that he perceived as necessary to maintain labor support. Instead, the wage formulas used by the government were juggled so often that labor doubted official claims that wages were staying ahead of inflation:

- When Alfonsin took office in December 1983, he publicly vowed to increase real wages by 6 to 8 percent during 1984, a pledge that proved a major stumblingblock in negotiations with the IMF. By September Buenos Aires began quietly backing away and announced that wages would be held to 14-percent nominal increases each month.
- Wage supplements were paid in October, November, January, and March in an effort to prevent a decline in real wages.
- In March the government recommended that wage increases be set at 90 percent of the previous month's inflation.

Argentina: Wage and Price Levels

Index: September 1984 = 100

	Wages	Consumer Prices
1984		
October	126	119
November	140	137
December	142	164
1985		
January	172	205
February	196	248
March ^a	246	300

^a Estimated.

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Although the shifts in wage policy caused a plague of strikes last year, most were minor. In September the General Confederation of Workers (CGT)—which represents most of the unions and 30 percent of the labor force—staged a general strike with mixed results. The strike lasted only one day, and worker participation was spotty except in Buenos Aires. According to the US Embassy, the lethargic response probably reflected worker satisfaction over relatively generous wage increases, despite a doubling of the inflation rate to nearly 700 percent last December over year-earlier levels. In addition, Alfonsin's popularity among union members was still strong. Moreover, Alfonsin had co-opted the union leadership into the wage-setting process through a social pact with business and the government.

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The Growing Wage Gap

Wage policy has had an uneven impact. Alfonsin is able to dictate the wage increases for civil servants, but public corporations and private-sector firms have used the announced changes only as guidelines. As a result, estimates show that civil servants' real wages were down about 25 percent in December 1984 compared with December 1983, while public-sector industrial workers' wages fell about 6 percent and those in private industry rose 11 percent. Through strikes and union pressure, private-sector employees obtained salary adjustments on top of the wage settlements. Their ability to extract above-target pay increases waned toward the end of the year, however, as the economy dipped and layoffs increased. [redacted]

This year, all workers are being affected by the slippage in real wages. Since December real wages have fallen 5 percent accompanied by an increasing number of strikes, according to the press. Some 25,000 auto workers staged a two-day strike in early March, and in mid-March the 300,000-member metalworkers union called a strike alert claiming that their real wages had fallen 60 percent since September. New strikes by teachers and gas workers have also been called in reaction to late March price hikes. [redacted]

Labor Opposition and Inflation

Labor opposition is beginning to coalesce in the face of the continuing inflationary spiral—the current rate is 800 percent. The CGT rejected the government wage recommendation for March, but apparently still does not feel strong enough to attempt another general strike. Saul Ubaldini, the senior CGT secretary general, recently told the Argentine press that a national strike would be avoided as long as the wage negotiations with government and business continued. We estimate workers would need a 40-percent wage increase in April to restore purchasing power. [redacted]

We judge that labor may still be willing to go along with restraint through April, [redacted]

[redacted] Unless the govern-

The Union—Peronist Connection

The lack of serious labor threat to the Alfonsin government thus far probably reflects the fracturing of the Peronist party—the party most closely aligned with labor—and the schisms within the union movement. Although the CGT has the potential to exert considerable power, it remains an amalgam of competing groups. These factions were nominally reunified last March when Alfonsin tried to ram new union election laws through Congress, but the alliance has been frayed by the widening split in the Peronist party. Old-line union bosses recently took steps to effect a reconciliation, and the two Peronist wings have opened a dialogue. The prospects for reestablishing cohesion are not good, but, if Alfonsin continues to hold wage increases below inflation, this could galvanize the unions and Peronists into concerted action. [redacted]

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ment shows signs of controlling inflation, labor will become more combative. [redacted]

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[redacted] A prominent Peronist politician predicts that, by June, Argentina will be suffering from a wave of wildcat strikes because of government failure to halt the inflationary spiral. [redacted]

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Implications

We see little chance that Alfonsin will be able to attain new IMF budget and inflation targets currently under negotiation—especially as the November parliamentary elections approach. Alfonsin probably will be unable to resist labor demands for higher wages, although he again may try to spread any catchup increases over several months. In addition, several government ministries and the military are seeking public spending increases in the coming months to offset accelerating inflation, according to the US Embassy. A loosening of wage restraint—along with higher government spending—would bring Argentina out of compliance [redacted]

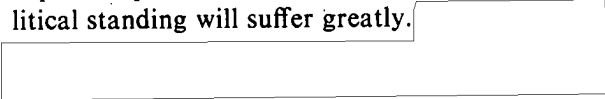
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with its Fund program again, renewing the halt in both IMF and commercial bank medium-term lending. Interest arrearages could again grow, and Argentina probably would resort to tighter import controls. Meanwhile, the economy will continue its current slide, because of lagging investment and depressed private consumption, and Alfonsin's political standing will suffer greatly.



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Algeria: The Economy on the Eve of Bendjedid's Visit

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Algeria—with the strongest economy in North Africa—has maintained an excellent international credit position through prudent financial management that should provide sufficient leeway to complete the current development plan. The vicissitudes of the oil and gas market and the limited prospects for gas sales to Western Europe will be the main factors affecting the government's ability to meet development spending goals. Moreover, continued austerity to cope with the soft oil market will, despite Algeria's pervasive security forces, sharply increase the likelihood of unrest.

Petroleum: The Economic Mainstay

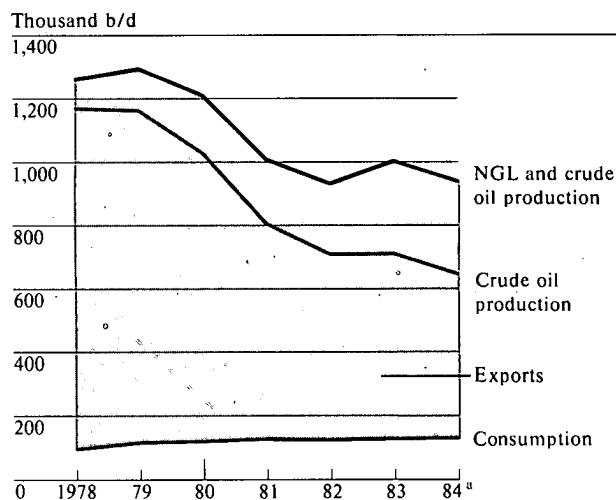
Oil and gas account for nearly all export receipts, 30 percent of GDP, and 40 percent of government revenues. In contrast, despite heavy spending in industrial development, nonoil heavy industry provides only 15 percent of GDP. A limited oil reserve base is causing Algeria—with the fifth-largest gas reserve in the world—to rely increasingly on gas exports for foreign exchange. Crude oil production capacity peaked in 1978 at more than 1 million b/d and is declining about 10 percent annually.

New Development Plan

Algeria has embarked on a \$110 billion 1985-89 Development Plan that emphasizes agriculture—a major break from past policy. More important, the plan reveals President Bendjedid's growing ability to direct the economy—over the objection of remaining socialist hardliners. The evolution toward a market-oriented economy, however, will continue to exclude the priority areas of petroleum and heavy industry.

As part of the new development plan, the government has offered free state land to small farmers

Algeria: Hydrocarbon Production and Exports



^a Estimated.

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around Algiers probably to help raise agricultural production through conversion of collective farms to private ownership. Private-sector farms already produce 60 percent of Algeria's cereal output and 90 percent of meat on less than one-third of available farm land. The US Embassy in Algiers reports that response has been mixed as the government will retain control over crop choice and marketing. This program—one of the first positive steps under the plan—is fraught with risks for the regime, however, because of the bitter struggle to nationalize farmland after independence.

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Algeria: Balance of Payments

Billion US \$

	1980	1981	1982	1983	1984 ^a	1985 ^b
Current account balance	1.6	-1.8	-1.9	-1.7	-2.3	-2.6
Trade balance	5.6	2.4	2.2	2.7	2.4	2.4
Exports (f.o.b.)	15.9	13.5	12.7	12.5	12.6	12.4
Petroleum and products	14.9	12.3	10.7	9.4	9.6	9.4
Gas	1.0	1.2	2.0	3.1	2.9	3.0
Imports (f.o.b.)	10.3	11.0	10.5	9.8	10.2	10.0
Foodstuffs	2.1	2.2	2.0	1.8	1.8	1.7
Semimanufactured goods	4.4	4.2	4.1	3.7	3.9	3.9
Capital goods	2.8	4.0	3.4	3.8	3.9	3.9
Consumer goods	1.0	0.6	1.0	0.5	0.6	0.5
Net services	-3.9	-4.1	-4.0	-4.2	-4.5	-4.9
Capital account balance	-0.5	1.7	0.6	1.2	1.9	2.4
Changes in reserves	1.1	-0.1	-1.3	-0.5	-0.4	-0.2

^a Estimated.^b Projected.

Unlike many other Third World oil producers, Algeria has moved quickly to head off financial problems caused by the soft oil market. The US Embassy reports that sharply lower petroleum revenue projections already have been incorporated in the national budget and the development plan. Algeria's excellent credit rating, despite one of the largest debt burdens of any OPEC country, should allow the government to meet foreign borrowing needs through 1989. We estimate that service costs on the \$16 billion foreign debt peaked in 1982 and will decline slightly to a manageable 33 percent of export receipts this year. Foreign reserves have been maintained at about \$1.6 billion—two months of imports—since 1983. []

Outlook

Algeria's economy will continue to be determined by the international oil market through the rest of the 1980s. Total oil exports this year are not expected to exceed the 800,000 b/d level achieved in 1984—a level that includes about 300,000 b/d of

condensate and natural gas liquids. Overall export receipts of \$12.4 billion will show little growth this year. Even assuming no increase in import costs, we project a \$2.6 billion current account deficit for 1985. Real GDP growth has averaged 4 percent annually since 1979 and is not likely to exceed 5 percent in 1985, according to the US Embassy. []

Slow growth will frustrate government efforts to improve living standards for most of the population—50 percent is under 18—which is growing 3 percent annually. Food prices have recently been increased by as much as 17 percent to trim the growing subsidy burden on the budget. Imports of consumer goods are down 50 percent from the 1982 level and social spending has been sharply curtailed. The US Embassy reports that unemployment probably exceeds 20 percent in urban areas. Algeria's pervasive security forces and the limited expectations of most Algerians have helped control discontent so far. Continued austerity, however, will increase the likelihood of unrest. []

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Algerian Gas—An Alternative to Soviet Supplies in Western Europe?

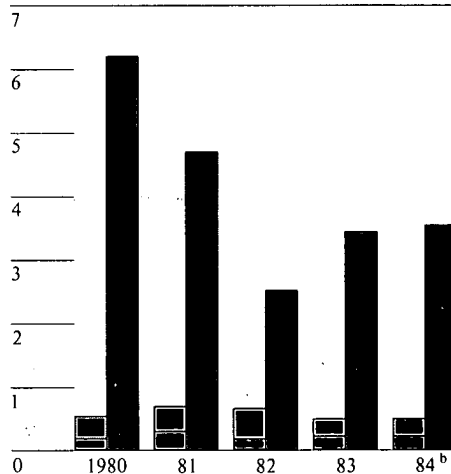
Algeria's potential to be a significant supplier of natural gas to Western Europe is hampered by its hardline stance on pricing and unreliability as a supplier. As a result, purchasers probably will be less willing to sign new contracts for Algerian gas, opening new opportunities for the Soviet Union to capture any growth in import demand in the West European market. [redacted]

Algiers' ability to sell liquefied natural gas (LNG) is limited by its pricing demands that make Algerian LNG 30 percent more costly than Soviet gas. Only gas sold to Italy via the Trans-Mediterranean Pipeline is competitive in the current surplus market. Algeria has been negotiating gas export contracts directly with consumer governments. These deals are at times part of a larger trade package and require subsidies to state-owned utilities that purchase the gas. [redacted]

We believe Algiers' inflexible pricing policy has been in large part determined by production problems that limit the amount of gas available to meet supply commitments during the rest of this decade. Unanticipated problems in existing fields, delays in developing new gasfields, and continuing poor performance of LNG plants are limiting output. The government has considered several alternatives—such as decreasing gas injection and accelerating development of southern gasfields—but most are too costly or politically undesirable. Such measures would allow Algiers to export between 20-25 billion cubic meters annually through the early 1990s. By the mid-1990s, after new gasfields come on line and the production capabilities of existing fields are restored, Algiers should be able to meet its existing commitments and perhaps have an additional 40-45 billion cubic meters per year available for export. [redacted]

Algerian-US Trade

Billion US \$
Algerian imports
Algerian exports^a
Manufactured goods
Foodstuffs



^a All fuel.
^b Estimated.

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Implications for the United States

Algeria's economy is the strongest in the region despite financial constraints. Algiers has provided a half-billion-dollar market for US agricultural goods, heavy machinery, and transport equipment since 1979. The government has expressed interest in US technology and expertise to help meet agriculture and water resource development goals—a \$16 billion market over the next five years. In

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Algeria: Gas Exports*Billion cubic meters*

	1978	1979	1980	1981	1982	1983	1984	1985 ^a
Total	6.6	11.5	6.7	7.6	11.5	18.2	20.0	34.4
Belgium	0	0	0	0	0.4	1.9	1.6	2.5
France	3.1	3.0	2.1	4.6	7.5	9.2	8.8	9.4
Italy	0	0	0	0	0	2.4	6.9	12.5
Spain	0.4	0.7	1.3	1.5	2.0	1.5	1.5	4.1
United Kingdom	0.7	0.7	0.9	0.5	0	0	0	0
United States	2.4	7.2	2.5	1.1	1.6	3.3	1.2	5.9

^a Contracted deliveries.

[REDACTED]

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addition, Algiers is looking for Western sources of resupply for its Soviet-equipped armed forces and has expressed interest in select US military equipment and training, according to the US Embassy.

[REDACTED]

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US companies will have to overcome stiff competition from Algeria's West European trade partners—particularly the French—to gain a share of the market. Financing will be a key element in major contract negotiations. Petroleum barter deals may be offered as payment. In addition, Algiers may look for concessions in gas negotiations with Washington as a sign of US interest in broader bilateral relations.

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Briefs

Energy

New Polish Energy Program



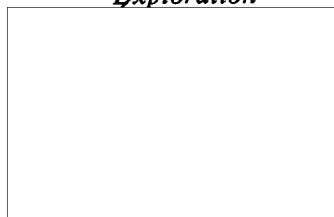
Parliament recently approved a 15-year energy program that includes large investments in new mines and nuclear power plants. There was little emphasis on conservation, even though Polish industry is the most energy intensive in Eastern Europe. The plan calls for increasing hard coal production 8 percent; soft coal, 53 percent; and electricity output, 69 percent by the year 2000. Purchases of Soviet gas are expected to more than double by the year 2000 contingent upon larger Polish coke deliveries and work on the Yamburg pipeline. Crude oil imports from the Soviet Union will remain at 13 million tons at least until 1990. The government also wants to import 3 million tons annually from the West but will be hindered by its chronic hard currency shortage. Spending on energy projects will rise by over 100 percent during 1986-90, as compared with the previous five years—a marked shift in investment policy. Even if these investments succeed, energy supplies will be inadequate to meet growth and export targets. 25X1

China Invites Onshore Oil Exploration



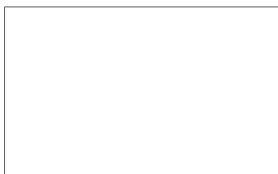
Beijing announced on 30 March it will open up 1.83 million square kilometers in 10 southern provinces to oil exploration by foreign firms. No specific terms were announced. The disappointing results that foreign firms have had in China's offshore waters almost certainly led to this decision. The areas Beijing is opening have few existing fields and are largely unexplored. Although China's oil production grew by 8 percent last year, to 2.28 million barrels per day, the largest fields are reaching maturity, and new sources of oil are needed to fuel China's ambitious modernization plans. 25X1

New Developments in Vietnamese Oil Exploration



A Vietnamese-Soviet joint venture drilling in the South China Sea apparently hit oil for the second time early this year. The new well is near the find announced last May—about 100 kilometers from Vung Tau. 25X1
 the joint venture plans commercial production by 1986, and an oil refinery—to be built by the Soviets at Vung Tau—is also under discussion. These plans are premature, however, pending delineation of the field over the next two to three years. The first discovery well flowed at about only 2,000 b/d, and the flow rate of the second is also reportedly small. 25X1

Electric Power Shortages Growing in Pakistan



Pakistan's Water and Power Development Authority (WAPDA) is projecting drastic electricity rationing for the next three months because lack of rainfall and late snowmelt have severely reduced hydroelectric production. Commercial and residential power cuts have already been longer and more frequent 25X1

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than normal for this time of year. An emergency plan instituted by WAPDA to provide power for tubewells in drought-stricken wheat-growing areas will exacerbate shortages elsewhere. Resulting industrial losses threaten lower exports and further deterioration in the foreign payments position. Foreign exchange reserves are about \$900 million, half last April's level. As shortages intensify, management and distribution of power probably will become a major political issue. The media is claiming that US opposition to Pakistani nuclear programs is making it more difficult to develop nuclear power to help close the energy gap.

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International Finance

Philippine Financial Rescue Package in Jeopardy

According to US Embassy reporting and preliminary data, Manila likely will again exceed the money supply target under its \$615 million IMF standby loan, thereby delaying \$160 million in loan disbursements. Meanwhile, signing of a commercial bank package, which includes \$925 million in new loans, is postponed indefinitely as the steering committee and a key Saudi bank remain deadlocked over conditions for the level of the bank's contribution to the new loan package. The steering committee believes the Saudi bank is just continuing its pattern of not joining debt rescheduling programs—a policy that the committee fears will threaten all multibank rescheduling efforts. The stalled commercial bank package may require the Fund to renegotiate the Philippine economic adjustment program because the original targets assumed significant loan disbursements in early 1985. Protracted negotiations with the IMF, however, will further delay the economic recovery.

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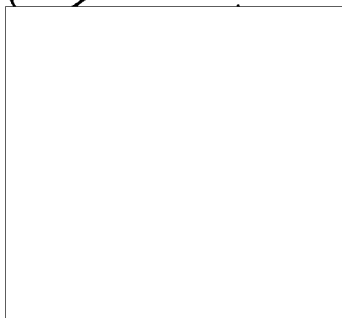
Yugoslavia's Debt Rescheduling

Yugoslavia and Western governments agreed last week to reschedule about \$800 million in debts falling due between 1 January 1985 and April 1986. The agreement reschedules 90 percent of principal over nine years with a four-year grace period and contains a goodwill clause promising support by creditors in future years. Talks with commercial bank creditors are slated for 11 April. Belgrade had sought a rescheduling of debts maturing in 1985 through 1988. The failure to obtain a multiyear commitment may reinforce domestic criticism of the government's handling of foreign debt and increase pressure to obtain more favorable terms from commercial banks. To save face, officials probably will characterize the goodwill clause as a form of multiyear rescheduling. The banks are likely to reschedule at least two years of principal, which the government likely will portray as the better deal demanded by critics.

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Panama's Financial Outlook Bleak



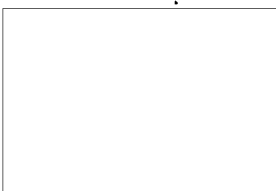
Panama's new budget has reopened IMF loan talks and encouraged commercial bankers to extend their debt repayment moratorium through 30 June, but prospects for a quick solution remain bleak. To gain National Assembly approval, President Barletta scaled back his tax proposals and offered vague spending cuts instead. [redacted] the Fund is skeptical that Panama City can meet its IMF targets. It is asking Barletta to identify specific reductions and to implement new labor, agricultural, and commercial policies. Over the longer term, Barletta must find a way to satisfy international financial requirements without undermining his fragile domestic support.

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OECD Economic Growth Forecast



Global and Regional Developments

The OECD Secretariat has raised its forecast of industrialized countries GNP growth in 1985 to 3.4 percent, mostly because of a substantially higher forecast for US GNP. Partly because US import demand is not expected to rise as rapidly as last year, the Secretariat foresees no pickup in the West European growth rate in 1985. Unemployment is expected to climb to 11 percent in Western Europe but to fall in the United States, Canada, and Japan. Inflation in the OECD is expected to ease to 4.3 percent because of weak commodity prices and moderate wage settlements. According to the Secretariat, the factor most likely to change the forecast is the possibility that tighter US fiscal policies and a falling dollar will dampen US import demand. [redacted]

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OECD: Secretariat's Forecasts of GNP Growth in 1985

Percent

	December 1984	March 1985
OECD	3.0	3.4
United States	3.0	3.7
Japan	5.0	5.0
Canada	2.8	3.7
Western Europe	2.5	2.4
West Germany	2.8	2.7
France	2.0	1.3
United Kingdom	3.0	3.0
Italy	2.5	2.6



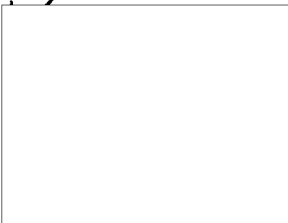
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National Developments

Developed Countries

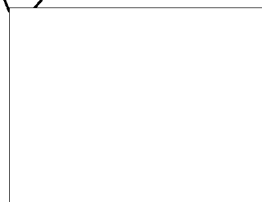
Israeli Economic Package Revisions



The Israeli Government, the Histadrut labor confederation, and the Manufacturer's Association agreed last Friday to revise the current wage-price accord to include new price hikes followed by a two-month price freeze. Most prices then will be raised again, and another two-month freeze will take effect. By proposing further price freezes, Labor and Likud are trying to hold the wage-price agreement together until the Histadrut elections in mid-May. The current \$23 billion budget merely cuts out last year's overspending but makes no other significant cuts—a reflection of the government's inability to reach consensus on stronger economic programs. Persistent inflationary pressures will force the government to consider additional austerity measures after the labor election.

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New French Trade Institute



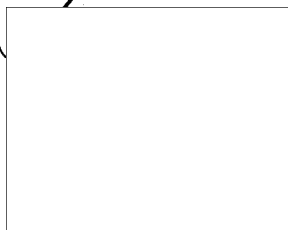
To improve French export performance, the Ministry of Industry and Commerce has established a new, graduate-level school to train industrial managers and government officials in the skills needed to promote French products abroad. The Ecole Nationale d'Exportation, will enroll about 200 students in courses ranging from sales techniques to foreign languages. It will also reportedly offer short courses and seminars for top executives and bureaucrats. Exports have been one of the major bright spots of President Mitterrand's economic program, and the new school is clearly intended to bolster that success. Its program will probably be oriented toward problem areas, such as the USSR and Japan, but it will almost certainly focus on expanding France's already sizable exports to the United States as well.

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Brazilian Austerity Moves

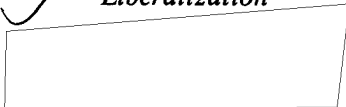


Economic policy makers in the new government have ordered a 10-percent cut in spending, halted new federal lending for two months, and have frozen government hiring. The government also has reinstated price controls, revised the indexation formula both for government bonds and for the exchange rate, and liquidated a failing financial institution. Meanwhile, press reports indicate that officials are meeting with bankers and the IMF this week to discuss Brazil's economic situation. Although the spending and lending reductions are encouraging, the new indexation formula will slow devaluation and undermine the competitiveness of Brazilian goods at a time when export growth is declining. Even tougher fiscal steps are needed, but the uncertainty surrounding the health of President-elect Neves will complicate efforts to impose tougher controls.

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Opposition to Mexican Trade Liberalization



Trade liberalization measures outlined in Mexico's 1985 IMF program will probably not be fully implemented because of strong domestic opposition and a sluggish economy. In response to Fund pressure, Mexico City plans to increase reliance on tariffs and reduce use of import licenses. The most controversial

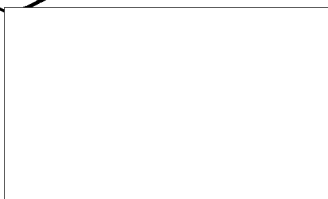
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feature, scheduled to start next month, would allow companies unrestricted use of 40 percent of their export receipts for imports of industrial inputs. Mexico's long-protected private sector strongly opposes the plan, claiming it would force many small and medium-sized firms to close, according to the US Embassy. Many trade regulators also object to loss of their bureaucratic power. Moreover, we believe liberalization would push imports to such levels that, deterioration in the balance of payments would force a cutback. [redacted]

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Venezuela Caps Interest Rates

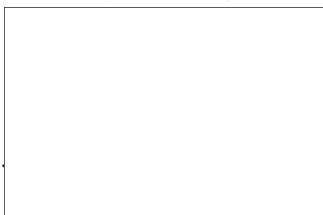


Venezuela last week imposed across-the-board deposit rate ceilings—several percentage points below market rates—probably signaling more interventionist policies to revive the economy. The US Embassy reports Caracas hopes to boost mortgage funds to spur a revival of construction. The government hopes that the ceilings will eliminate the liquidity squeeze on mortgage lenders who now pay higher rates for deposits. Deposit shifts from banks to mortgage lenders are unlikely because public confidence in these institutions has been shaken by recent failures. Moreover, with inflation exceeding interest limits, we expect less saving and added motivation for capital flight. [redacted]

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Labor Troubles in Suriname



Army Commander Bouterse's hardening stance against recalcitrant labor leaders is likely to weaken the fragile unity within Suriname's coalition government and undermine the regime's efforts to create an appearance of democracy. [redacted]

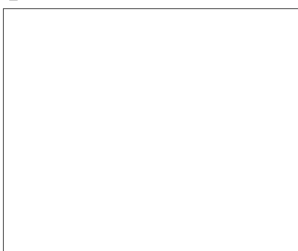
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[redacted] Labor leaders apparently have not decided on their next step, but they are likely to press hard to prevent any erosion in living standards. [redacted]

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Shift in Egyptian Economic Personnel



President Mubarak may use the resignation of Minister of Economics al-Sa'id to revise foreign exchange policies that have damaged Egypt's private sector. Meanwhile, Mubarak has announced the formation of an independent, nonpolitical economic advisory council and has directed the Central Bank to report directly to the Prime Minister rather than to the Economics Minister. Mubarak was fed up with several of al-Sa'id's policies, especially foreign exchange rules established in January that greatly diminished the flow of hard currency through the banking system and sharply reduced private-sector imports. A new probusiness Economics Minister, Sultan Abu Ali, together with greater independence for the Central Bank, suggests a more favorable atmosphere for the private sector. [redacted]

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*Civil Service
Unrest in Tanzania*



President Nyerere has recently announced plans to fire 27,000 government employees, roughly 10 percent of the civil service, in a cost-cutting measure. The announcement has prompted slowdowns and sitdown strikes that have effectively stopped government paper flows. [redacted] [redacted] The civilians complain that Nyerere is cutting the civil sector while continuing to increase military personnel and spending. Although Nyerere probably is reacting to IMF suggestions on government spending, an IMF agreement remains indefinite. We do not believe Nyerere will fire all the workers, and the government has assured that it will help find alternative employment. [redacted]

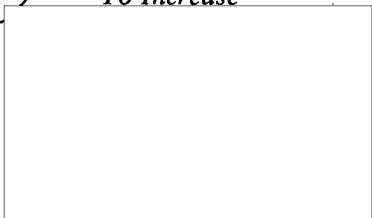
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*Thai-Soviet Trade
To Increase*

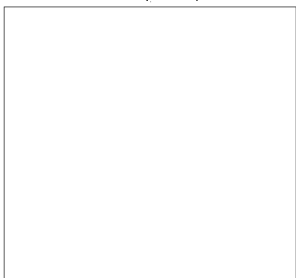


Bangkok last week announced a contract to export 500,000 metric tons of tapioca pellets this year to the Soviet Union for use as animal feed. Soviet officials have indicated, moreover, that an additional purchase of 2 million tons is possible, although they did not specify a time frame. Moscow traditionally has bought Thai sugar, corn, rice, and tapioca flour, but this is the first major purchase since 1981 of tapioca pellets, Thailand's second-largest export. Soviet Deputy Foreign Minister Kapitsa last week in Bangkok suggested that Moscow will seek additional opportunities to expand Thai-Soviet trade, which now amounts to about \$100 million annually. [redacted]

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*Papua New Guinea
Mine Hanging On*



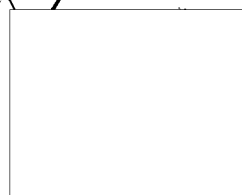
The Papua New Guinea Cabinet last week authorized reopening of the giant Ok Tedi gold and copper mine under a four-month license although discussions on modifying the contract's original provisions continue. The government closed the mine at the end of February over disagreements with the mining consortium on the viability and pace of copper development. Copper production will start in 1988—when the mine's gold reserves are depleted—but construction of a single copper-processing line will begin immediately. Expansion of the copper facilities to the level originally envisaged and construction of an associated hydroelectric dam will be decided at the end of 1986. The government decision apparently reflects significant company concessions and efforts to calm foreign investors' fears of nationalization. Moreover, some of the approximately 2,000 workers dependent on the mine have threatened sabotage. [redacted]

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*Late Spring
Threatens Soviet
Grain Prospects*



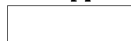
Unusually heavy snowfall last winter in the European USSR, coupled with below-normal temperatures through mid-March, has delayed the start of the spring sowing campaign and created the potential for serious flood damage to winter grains. It is too early in the crop season to assess the full impact of these developments on overall Soviet grain production prospects for 1985. Nevertheless, the delay in sowing means that the spring grains in the Ukraine and North Caucasus will be more vulnerable than normal to damage from hot temperatures this summer. If planting slips even further behind—a likely occurrence—an early frost this fall could interfere with crop maturation,

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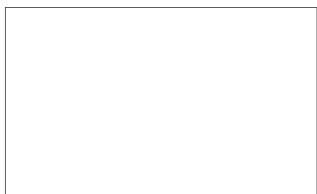
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thereby cutting potential yields. Damage to the winter grains—about one-third of total Soviet grain output—would be greatest with a rapid snowmelt that almost certainly would result in widespread flooding. Even if the snow disappears at a slow rate, however, some plants will drown in waterlogged soils.



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New Soviet-Hungarian Cooperation Agreement



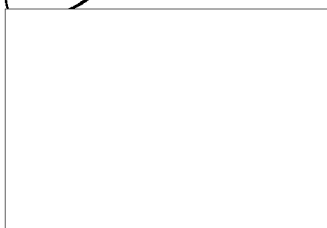
The USSR and Hungary signed an agreement this week for economic, scientific, and technical cooperation until the year 2000, according to press reports. The program calls for cooperation in microelectronics, computers, robotics, nuclear energy, biotechnology, and new industrial materials. The countries will pool efforts to improve technology and increase bilateral trade in metallurgical products, chemicals, food, and consumer goods. Similar agreements have been signed or are being negotiated with other CEMA countries as part of Moscow's effort to limit CEMA's dependence on the West and to exert tighter control over its allies. The agreements, however, seem too general to ensure that Soviet goals for CEMA integration will be met fully, and the USSR will push for specific commitments in subsequent negotiations.



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Growing Vietnamese Rice Imports



A weather-induced crop shortfall may force Hanoi to import 400,000 to 500,000 metric tons of rice this year—up from about 295,000 tons in 1984, according to the US Embassy in Bangkok. Vietnam, which claims self-sufficiency in grain, so far has not publicly requested humanitarian aid and presumably intends to acquire the rice on commercial terms. A foreign exchange shortage forced Hanoi to sell gold to pay for imports in 1984, however, and we are uncertain how it will finance this year's purchases. Japanese trading companies have already provided about 100,000 tons, partially paid for by Vietnamese commodities. A Soviet trading company also purchased 50,000 tons of rice in Thailand for Vietnam early this year, according to the Bangkok Embassy.



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