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# International Economic & Energy Weekly

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**26 April 1985**

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# International Economic & Energy Weekly

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26 April 1985


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# International Economic & Energy Weekly

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## Synopsis

1 **Perspective—*Bonn Economic Summit***

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The Bonn Summit on 2-4 May may well be the first at which economic issues take a backseat to political issues.

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5 **Summit Issues: Big Four Growth Prospects and Options**

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GNP growth for the four major West European economies is generally expected to average 2.5 percent in 1985, the same as last year's pace. Although no policy changes are expected soon, our analysis indicates that the Big Four could boost growth—perhaps enough to reduce joblessness—if they cut either personal income or business taxes.

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9 **European Community: Growing Agricultural Exports**

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Although world agricultural trade has slowed in recent years, we expect the European Community, with the help of substantial export refunds, to agressively promote its exports for the next several years to alleviate mounting surpluses.

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15 **India: Rajiv Gandhi's Search for Technology and Productivity**

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Prime Minister Rajiv Gandhi's interests in technology and productivity have revived economic liberalization efforts. His economic reforms open new opportunities for ties with Western business but do not ensure faster overall growth.

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19 **Spain: Reversing the Economic Slowdown**

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Prime Minister Felipe Gonzalez's Socialist government is now carrying out an ambitious and painful adjustment program to correct the serious economic problems that have beset Spain since the 1973 oil crisis.

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# International Economic & Energy Weekly

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**Perspective**

## *Bonn Economic Summit*

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The Bonn Summit on 2-4 May may well be the first at which economic issues take a backseat to political issues. Most of the Summit countries want it that way—for different reasons—although most will call on Washington to cut its budget deficit.

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Of the political topics, SDI and the space station are likely to head the list. All the Summit governments are committed to promoting high technology, and both programs hold great promise in this area. Even those with misgivings about deploying SDI are enthusiastic about potential contracts and sharing US technology. French Defense Minister Hernu commented this week on French television about the role envisioned for French mirrors in SDI.

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The West Germans and the Japanese prefer to emphasize political issues to avoid discussions of possible shifts in their economic policies. Bonn, for example, expects other governments to encourage it to move up tax cuts now planned for 1987. The West Germans have publicly ruled out such a move, comparing it with the ill-fated "locomotive" policy package agreed on at the 1978 Bonn Summit. Bonn will argue that acid rain should receive top billing. Tokyo views the Summit as its annual exercise in international damage control and will try to avoid the limelight. Both Bonn and Tokyo—as well as London—believe that reducing the government deficit is the key to their countries' long-term economic health. Attempts to reflate the economies of the industrial world, they argue, would lead to minimal short-term benefits and could cause a buildup of debt that would undermine their ability to adopt countercyclical policies in the next recession.

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The Canadians plan to support Bonn on acid rain, a major political issue at home. They also want the other Summit countries to support US goals in the trade area so the US administration can use the communique to fend off protectionist proposals from Congress. The British, as well as others, link the US budget deficit with higher interest rates worldwide and would like a pledge from Washington to reduce it—even if a tax hike is the only way possible.

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The Italians will avoid taking positions on their own in Bonn and also probably would be content to see economic issues deemphasized. With Italy holding the presidency of the European Community, Rome is afraid of squabbles between Bonn and Paris that could stymie the EC's ability to reach decisions.

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The French may be the only unhappy participants if economic issues are played down. Since the first Summit in 1975, the French have maintained that the Summit should focus on economics. Last year, the French did not want a statement condemning terrorism and this year refused to participate in pre-Summit talks on the environment. Their primary goal this year is to firm up details on an international monetary conference, and they are holding up agreement on a date for a new trade round until they get their way. They would also like Bonn and Tokyo to reflate while Washington trims its budget deficit.

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## Bonn Summit Positions

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| United States | West Germany | France | United Kingdom | Italy | Japan | Canada |
|---|---|---|---|---|---|---|
| ***Economic Policy*** | | | | | | |
| Sustainable economic growth and job creation must be based on market-oriented adjustment, reduced government spending, and stable monetary growth. Europe and Canada must restructure faster; Japan must accelerate liberalization of imports and capital markets. | Will refer specifically to high US budget deficit, interest rates, dollar, and trade deficit. Wants Summit to express deep concern about persistence of high unemployment. Favors more vigorous action on structural rigidities. | Trying to restructure and modernize without sacrificing "social justice." Concerned that high US interest rates, volatile dollar, and US protectionism could abort recovery. Must rely on others to lead growth and could push surplus countries to expand. | Tight fiscal and monetary policies, plus free market principles, have achieved almost five years of economic recovery. Labor market rigidities being overcome, but likely to take several years to reduce unemployment significantly. | US budget deficit, high interest rates, and trade deficit are main threats to world economic stability. Wants more expansionary policies in West Germany. Will move slowly on structural adjustment; time not ripe to liberalize capital flows. | Concerned it will be pressed to solve others' structural problems by stimulating Japanese imports. Will point to efforts to open domestic market, while noting that severe budget deficit prohibits stimulative policies. | Structural adjustment necessary, but will move slowly because of already-high unemployment. Primary economic policy problem is US budget deficit and resulting high international interest rates. |
| ***Monetary System*** | | | | | | |
| Willing to consider conference to discuss G-10 recommendations to improve monetary systems, but fundamental exchange rate trends are determined by market supply and demand. Improvements most likely through better coordination of economic policy. | Not interested in French monetary reform proposals but believes monetary conference under IMF auspices needed to allay French concerns. | Argues volatile exchange rates are the biggest barrier to world trade and the United States is irresponsible in managing dollar. Feels that others, particularly LDCs, bear burden of US policies. Would like to see more intervention and more use of the ECU. | Exchange rate intervention cannot alter underlying market trends, but may push for renewed agreement on coordinated intervention by central banks under certain circumstances. | Considers flexible exchange rate regime the only viable system, but concerned about noneconomic factors creating excessive exchange rate fluctuations. Unlikely to support all French reform proposals. Would like more use of ECUs. | Tokyo does not want trade round linked to monetary reform, which it considers impractical given differences in economic performance among industrial nations. | Believes in international coordinated intervention to reduce exchange rate instability but argues against radical changes in world financial system. Supports increased SDR allocation. |
| ***Trade*** | | | | | | |
| Freer trade is essential to world economy. To ensure more open trade and resist protectionism, must move rapidly to formal negotiations within GATT for increased liberalization. Seeks specific commitment to begin negotiations in early 1986—with no monetary preconditions. | Wants strong free trade statement. Will endorse new GATT round for early next year; favors rollback of trade barriers and progress on current GATT work program to maintain credibility of previous trade commitments. Deeply concerned about protectionist pressure in the United States. | Fears new trade round emphasis on high tech and services will favor the United States and Japan and preserve status quo to French disadvantage. At same time, often argues need to protect own infant industries. Will not support new trade round without promise to discuss monetary reform. | Favors firm commitment to launch new trade round in 1986. Anxious to discourage protectionist trends at home and abroad. Opposes linking trade round to a monetary conference. | New round of trade negotiations must be preceded by firm agreements on subject matter, participation, and timing. Suspects Japan wants new round to continue stalling on import promotion. Soft on including services in new trade round. | Strongly supports new GATT round focusing on services, high technology, and agriculture. Announced a package of market-opening measures in April to try to defuse mounting US and European criticism of closed markets. | Freer trade is essential given heavy Canadian dependence on exports. Strongly supports a new trade round, primarily because new round may reduce what is seen as increasing protectionism in US Congress. |
| ***North-South Relations*** | | | | | | |
| Case-by-case debt strategy, plus prudent, free market LDC policies to improve their economic performance and reduce debt, are still valid. No need yet for World Bank capital increase. | Believes steady expansion of trade and opening developed-country markets is best for LDCs. Favors current, case-by-case approach to LDC debt. Wants increase in World Bank capital at "appropriate time." | Favors multiyear rescheduling, more concessional lending and aid flows, new SDR issue, and increased World Bank lending. High interest rates and volatile dollar seen as hurting LDCs. | Prefers case-by-case approach to debt rescheduling rather than attempts to make global reforms. Has become more selective in aid disbursements. | Desires a capital increase for the World Bank to appease LDCs and head off calls for a special debt relief program. Wants debt issues kept out of such forums as UNCTAD. Wants World Bank lending for adjustment purposes, not for projects. | Has stressed case-by-case approach in handling debt problem and urged debtor nations to implement economic readjustment policies. Has proposed general capital increase for World Bank. | Explicit link should be made between short-term adjustment of LDC debt and the issues of longer term growth and development. |
| ***Environment and Technology Cooperation*** | | | | | | |
| Can agree on cooperative research into ways to improve environment but wants to avoid action commitments until more authoritative studies on causes have been completed. | Will call for concrete action on increased international environmental cooperation, especially on acid rain. Wants Summit to stress compatibility of economic growth with environmental policies. | Environment not a key issue. Hopes to become a high-tech power but fears that the United States and Japan will work to maintain their lead. Will resist commitment not to aid high-tech industries. | More research needs to be done before costly measures are undertaken, or agreements made, to further reduce atmosphere pollutants. Agrees on need to protect strategic technology but believes US approach too broad. | Little high-level concern on acid rain issue; more concerned about seacoast pollution. Believes international technological collaboration necessary but bilateral cooperation more likely to produce desired results. | Environment and technology cooperation not key issues for Tokyo. Has shown concern for environment by decision not to dump radioactive waste in Pacific, but considers acid rain a non-Asian problem. | Will argue strongly for a firm statement against acid rain and likely to support any initiatives from Chancellor Kohl. Will seek increased technology cooperation but likely to defer to US security considerations. |
| ***Space Station*** | | | | | | |
| Promote technology cooperation but recognize security constraints. Secure strong, unanimous endorsement of participation in US program by other Summit partners. Avoid endorsement of autonomous European program. | Enthusiastic about space technology cooperation provided technology sharing satisfactory. Opposes equal endorsement of French space proposals. | Trying to foster a European space program under French leadership. Insisting that European Space Agency (ESA) program receive equal billing with US program in communique. | Views space station as opportunity for British industry. Already committed $8 million to consolidate British research efforts and wants guarantees that participation will ensure access to US technology. | Supports US space station initiative. Sees good commercial opportunities for Italian firms, but may begin supporting independent European industry if perceives Europe not allowed full and equal participation with the United States. | Has allocated funds for participation in US space station, | Committed to participating in US space station program but leery of any connection with development of military technology in outer space. |

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## Summit Issues: Big Four Growth Prospects and Options

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GNP growth for the four major West European economies—West Germany, France, the United Kingdom, and Italy—is generally expected to average 2.5 percent in 1985, about the same as last year's pace. Growth almost certainly will be too small to keep average unemployment rates from rising above last year's 10.3 percent. A further moderation in inflation and expected gains in the share of world trade should help make investment and exports the two bright spots in an otherwise lackluster economic situation this year. Although no policy changes are expected soon, our analysis indicates that the Big Four could boost growth—perhaps enough to reduce joblessness—if they cut either personal income or business taxes.

**Big Four: GNP Growth** [a] *Percent*

| | 1981 | 1982 | 1983 | 1984 | 1985 [b] |
|---|---|---|---|---|---|
| **Big Four** | **−0.2** | **0.6** | **1.1** | **2.4** | **2.5** |
| West Germany | −0.3 | −1.1 | 1.3 | 2.6 | 2.7 |
| France | 0.2 | 2.0 | 0.7 | 1.8 | 2.0 |
| United Kingdom [c] | −0.7 | 2.1 | 3.4 | 2.5 | 2.7 |
| Italy | 0.2 | −0.4 | −1.2 | 2.8 | 2.6 |

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[a] OECD Secretariat data.
[b] Consensus forecasts from the 15 February 1985 issue The consensus forecast is calculated as the average of projections by 40 US and foreign companies and economic institutes.
[c] The OECD uses an average of three UK GNP series that differs from the series in the *Economic and Energy Indicators.*

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### A Lackluster Recovery

According to 40 forecasters the West European recovery will be the weakest in the last 40 years. Growth in consumption, which makes up two-thirds of GNP, will lag because of the small expected rise in employment and real aftertax income. Although lower wage hikes will improve West European competitiveness and profits, an expected slowdown in US and Canadian GNP growth will make Western Europe more dependent on investment and increased trade with other areas to keep their economic expansion going.

Investment should continue to make an important contribution to Big Four growth in 1985. Capacity utilization in the European Community already has reached 82 percent this year and is only 2 percentage points below the 1979 peak; this is due in part to the closings of outmoded factories. Cost cutting, export expansion, and the declining inflation—5 percent this year versus 6 percent last year—with its beneficial impact on interest rates and debt service should help firms improve their cash positions for needed investment.

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The Big Four countries will probably continue benefiting from the expansion in world trade. The West Europeans expect to go on gaining market shares worldwide because of the strong dollar, despite its decline in recent weeks. The major forecasters believe that the foreign trade sector will give the Big Four economies as much, if not more, of a boost this year despite the projected slowdown in US import demand. According to the preliminary OECD forecast, net exports will account for almost one-third of the Big Four's growth in 1985.

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West European governments are cutting their budget deficits by shifting more of the tax burden from businesses to households while holding the line on transfer payments. The exception has been the United Kingdom, where 1982 personal income tax cuts spurred an early start to its recovery. The

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**Big Four: General Government Budget Deficits as a Share of GNP** [a] *Percent*

| | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|
| **Big Four** | **4.5** | **4.7** | **4.8** | **4.5** |
| West Germany | 3.4 | 2.7 | 2.2 | 1.4 |
| France | 2.5 | 3.3 | 3.3 | 3.8 |
| United Kingdom | 2.4 | 3.5 | 3.3 | 2.7 |
| Italy | 12.7 | 11.8 | 13.7 | 13.6 |

[a] OECD estimates.

OECD estimates that the average Big Four government deficit (national plus local) will fall to 4.5 percent of GNP this year, down from last year's 4.8 percent.

### Policies To Boost Growth

Although none of the Big Four governments currently is considering a shift in economic policy, leaders undoubtedly will be reassessing their strategy as they face elections over the next two years. Opposition focus on unemployment could create considerable political pressure on incumbent governments to shift gears and stimulate growth. Using our Linked Policy Impact Model (LPIM), we looked at several policies to raise GNP growth by 1 percentage point for the Big Four. We found that:

- Cuts in personal income tax rates would be the most effective way to raise growth and stabilize or possibly lower unemployment without igniting inflation.
- Individual tax cuts combined with reduced business taxes or with more government spending also would raise GNP growth but would be somewhat less effective in reducing unemployment.
- More rapid money supply growth produced little growth but quickened the pace of inflation and exchange rate depreciation.

The benefits and costs of each policy would be spread unevenly among the Big Four. In the personal tax cut scenario, Bonn would have to cut taxes by 15 percent, Paris and London by 10 percent, and Rome by only 5 percent to achieve a 1-percentage-point hike in growth. The British Government would suffer the sharpest deterioration in its budget. Reduced unemployment in France and West Germany, however, would offset some of the initial decline in revenues. Italy, on the other hand, would see its government deficit actually decrease. All four countries would enjoy lower inflation because gross wages could go up by smaller amounts and still give workers their desired take-home pay. The decline in French inflation would be double that of any other Big Four country.

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The OECD has pointed out that West Germany and the United Kingdom both have current account surpluses and small government deficits, giving them room to reflate their economies. Again, using our model, we found that, if Bonn implemented in mid-1985 tax cuts planned for 1987 and London doubled the 1 April 1985 tax reduction to the level originally proposed, the economic benefits for the Big Four would compare favorably to the scenario where all four countries cut taxes to boost growth. GNP growth in 1987 would be 0.4 percentage point higher in West Germany and Italy, 0.3 percentage point higher in France, and only 0.2 percentage point higher in the United Kingdom. The unemployment rate, however, would be 0.9 percentage point lower in West Germany and 0.3 percentage point lower in the other three countries.

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### Outlook for Change

The near term prospects for a change in direction in Big Four economic policies appear dim but may change as elections begin to dominate government thinking. Several times this year, West German Finance Minister Stoltenberg publicly ruled out any loosening of West German fiscal policy; he was probably trying to preempt suggestions at the Bonn Summit that West Germany reflate. Despite National Assembly elections in 1986, the French

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**Big Four: Effects of Alternative Tax and Spending Scenarios**

*Change from baseline*

| | West German and UK Individual Tax Cuts [a] | Big Four Individual [b] Tax Cuts | Individual and Business Tax Cuts | Individual Tax Cuts and Increased Government Spending |
|---|---|---|---|---|
| | ***Percentage Point*** | | | |
| Real GDP growth | | | | |
| 1985 | 0.2 | 0.5 | 0.5 | 0.5 |
| 1986 | 0.5 | 1.0 | 1.0 | 1.0 |
| 1987 | 0.3 | 1.0 | 1.0 | 1.0 |
| Government deficit as a share of GDP | | | | |
| 1985 | −0.2 | −0.5 | −0.4 | −0.3 |
| 1986 | −0.4 | −0.7 | −0.8 | −0.4 |
| 1987 | −0.3 | −1.1 | −0.9 | −0.6 |
| Unemployment rate | | | | |
| 1985 | −0.1 | −0.2 | −0.1 | −0.2 |
| 1986 | −0.3 | −0.6 | −0.4 | −0.5 |
| 1987 | −0.5 | −1.1 | −0.7 | −0.9 |
| Inflation rate | | | | |
| 1985 | −0.3 | −0.8 | 0.1 | −0.2 |
| 1986 | −0.4 | −0.7 | 0.3 | −0.1 |
| 1987 | −0.2 | −1.3 | 0.6 | 0 |
| | ***Billion US $*** | | | |
| Current account balance | | | | |
| 1985 | −1.9 | −3.2 | −4.1 | −3.9 |
| 1986 | −6.1 | −10.8 | −13.6 | −13.1 |
| 1987 | −8.4 | −19.8 | −24.3 | −23.4 |

[a] Assumes that West German tax cuts planned for 1987 are implemented in mid-1985 and that the United Kingdom doubles the 1 April 1985 tax cuts.
[b] Assumes that all four major West European governments adopt policies in mid-1985 that boost their economic growth by 0.5 percentage point in 1985 and 1 percentage point in 1986 and 1987.

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Government appears wedded to maintaining austerity. Although the Thatcher government has a solid parliamentary majority, Tory backbenchers probably will become more difficult to control if the British economy continues to grow too slowly to reduce joblessness. The fractious character of Prime Minister Craxi's coalition makes a dramatic shift in Italian policy unlikely regardless of economic conditions.

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# European Community: Growing Agricultural Exports

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Although world agricultural trade has slowed in recent years, we expect the European Community, with the help of substantial export refunds, to aggressively promote its exports for the next several years to alleviate mounting surpluses. The EC has become the world's second-largest agricultural exporter after the United States. Trade tensions between the EC and rival exporters—the United States, Australia, Brazil, and others—will increase, particularly in grain and meat markets.

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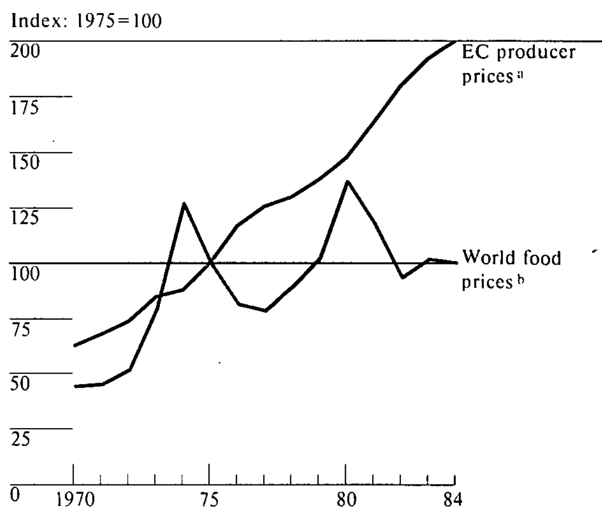
## Community Subsidies and Protection

The EC's generous system of price supports and import levies has created huge agricultural surpluses while protecting Community farmers from outside competition. The Common Agricultural Policy's (CAP) support prices are set not at market prices but at levels that provide politically acceptable incomes for farmers. From 1970 to 1984, EC producer prices rose steadily at an average 8.6 percent annually. In contrast, world food prices fluctuated widely around a trend rate increase of only 6 percent annually and, moreover, are currently well below the peak years of 1974 and 1980. To protect its farmers from these lower world prices, the CAP also uses import levies to equate import and domestic farm product prices.

EC farmers' response to guaranteed high prices, import protection, and no production limits was a sharp increase in production in the 1970s. Agricultural output rose 20 percent in volume and by the late 1970s, the EC had largely achieved the overall goal of the CAP—self-sufficiency in foodstuffs. Production of most commodities continues to grow. In 1984 a combination of exceptionally good weather, broad use of new plant strains, and increased culling of herds helped boost grain production 21 percent and beef and veal by nearly 6 percent. The Community already has substantial

**Food Prices, 1970-84**




[a] Weighted average of EC member countries' prices in national currencies.
[b] Weighted average of traded food commodities in US dollars.

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stored surpluses in dairy products, meat, and wine. The "butter mountain," for example, now stands at 1 million metric tons, more than the combined weight of the entire population of Belgium; the "wine lake" exceeds 9 billion liters; and beef supplies exceed 600,000 tons.

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## The Export Push

As surpluses mounted, the EC has looked increasingly to world markets, using export refunds to make its products competitive. In 1983, for example, the Community spent $1.4 billion on grain



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**European Community: Production of Major Agricultural Commodities**

*Million metric tons*

| | 1970 | 1975 | 1980 | 1981 | 1982 | 1983 | 1984 [a] |
|---|---|---|---|---|---|---|---|
| Grains | 90.3 | 100.0 | 118.0 | 122.0 | 131.0 | 124.0 | 150.0 |
| Wheat | 36.7 | 40.2 | 55.1 | 54.4 | 59.8 | 59.2 | 75.8 |
| Beef and veal | 6.0 | 6.7 | 7.1 | 6.9 | 6.6 | 6.9 | 7.3 |
| Pork | 7.0 | 7.8 | 9.3 | 9.5 | 9.4 | 9.7 | 9.7 |
| Poultry | 2.7 | 3.2 | 4.0 | 4.1 | 4.4 | 4.3 | 4.3 |
| Dairy [b] | 86.3 | 92.5 | 104.7 | 104.9 | 108.2 | 112.3 | 105.0 |
| Eggs | 3.8 | 3.9 | 4.1 | 4.2 | 4.2 | 4.1 | 4.3 |
| Sugar | 8.8 | 10.4 | 13.0 | 16.0 | 15.9 | 14.7 | 14.7 |

[a] European Community and USDA estimates.
[b] Fluid milk equivalent.

**European Community: Self-Sufficiency Ratios for Selected Agricultural Products**

*Self-sufficient:Index=100*

| | 1968-69 | 1980-81 |
|---|---|---|
| Cereals (excluding rice) | 86 | 103 |
| Wheat | 94 | 118 |
| Potatoes | 100 | 102 |
| Sugar | 82 | 136 |
| Total vegetables | 98 | 97 |
| Total fresh fruit | 80 | 79 |
| Wine | 97 | 102 |
| Fresh milk products | 100 | 105 |
| Cheese | 98 | 105 |
| Butter | 91 | 119 |
| Whole milk powder | NA | 393 |
| Skimmed milk powder | NA | 126 |
| Eggs | 99 | 102 |
| Beef and veal | 90 | 105 |
| Pork | 100 | 101 |
| Poultry | 101 | 110 |

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export refunds, more than the total it has earmarked over the next five years for the development of information technology. Although export refunds have risen fourfold since 1970, the Community still finds it cheaper to subsidize exports than go on storing the goods.

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The Community's aggressive marketing of its surpluses has been successful in increasing total EC agricultural exports from less than $5 billion in 1970 to nearly $24 billion in 1983, and in increasing EC world market shares from 8 percent to 11 percent. EC gains have come in many product categories. EC red meat exports have climbed to third place by volume from fifth place in 1970. Before 1978 the Community was a net wheat importer, but its exports now trail only those of the United States and Canada. The EC now supplies nearly 10 percent of USSR agricultural imports—up from 2.5 percent in 1970—and 31 percent of OPEC farm imports—up from 23 percent in 1970.

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Increasing EC exports have caused considerable tension between the Community and other exporters. The United States especially, but Australia, New Zealand, and Brazil, as well, have criticized the Community's system of export subsidies for distorting competition in world markets. Problems continue to worsen in at least three agricultural commodities:

- The EC has more than doubled its share of wheat exports to the world to 16 percent since 1970, primarily at the expense of Australia; the US share remained stable at 38 percent. According to a USDA study, the United States would have gained 3.5 percentage points of world market share—and world wheat prices would have climbed by nearly 9 percent—had the EC adopted a free trade policy for wheat in 1980.

- The Community accounts for about one-half of world butter exports, and sales in 1982-83 to the Soviet Union were at prices as much as 50 percent below world market prices. Australia, New Zealand, and the United States have claimed these sales violate the GATT and the International Dairy Agreement.

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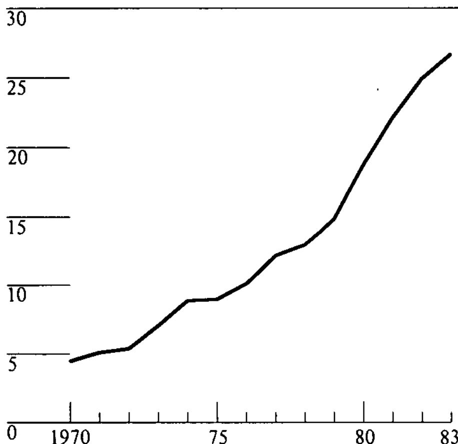
**European Community: Agricultural Exports[a], 1970-83**




[a] Excluding intra-European Community trade.

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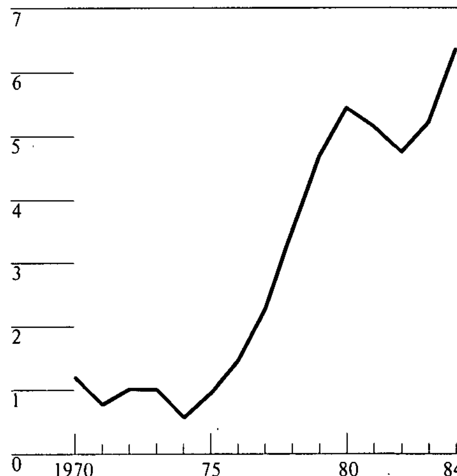
**European Community: Agricultural Export Refunds, 1970-84**

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- The EC's beef exports to developing countries have stymied sales by Australia, Brazil, and Kenya.

## Prospects for EC Agricultural Exports

In our judgment, the EC agricultural sector has the technology and financial resources to continue boosting production faster than consumption—particularly in grains and meats. Given this capability, and given present CAP policies, we believe most EC agricultural exports will continue growing at a relatively rapid pace. EC grain export supplies by 1987 could rise by nearly 50 percent over 1983 levels. Because of restrictions on dairy production and EC sugar trade preferences under the Lome convention, sugar and dairy export supplies are likely to remain stable.

EC enlargement to include Spain and Portugal—now scheduled for 1 January 1986—also will tend to boost surpluses. Enlargement will initially reduce EC exports to the rest of the world as the two new members purchase more food from the EC Ten. In the longer run, however, once Spain and Portugal's 3 million farmers come under the full umbrella of CAP support, high-support prices will encourage Spanish and Portuguese agricultural output.

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The expected slowdown in the annual growth of world food trade—from 4 percent in the 1970s to 2 percent in this decade, as projected by the USDA—is not likely to hold back EC exports. EC export refunds will continue to guarantee Community price competitiveness in world markets. The Community is now seeking to boost CAP revenues

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by 20 percent in 1986. Under these revenue plans, we expect the Community to be able to finance subsidies and export refunds, at least until 1987.

**Implications**

Competition among US, EC, and other exporters will intensify, particularly in wheat and beef over the next several years. Although the EC will have additional funds that could be used for storing more goods, we believe it will become more aggressive in exporting. In the case of wheat, we expect US and other producers' market shares will be seriously challenged over the next two years. Moreover, EC beef exports will probably continue to cut into the market shares of Australia, Argentina, and some developing countries. Bilateral trade frictions are likely to increase at about the same time the proposed GATT negotiations are in full swing. Although the EC agreed to the study of agricultural export subsidies under the GATT, its recent statement ruling out discussions on the fundamentals of the CAP will probably come under strong attack.

Internally, growing EC financial support for agriculture will continue to soak up financial resources that could be spent to revitalize the region's industrial base. The fourfold increase in support of agriculture in the past decade yielded no new jobs—the number of farmers actually declined by nearly 30 percent in the 1970s. With the prospects of double-digit unemployment and lackluster economic growth for the next few years, the EC's current heavy emphasis on agriculture—politically and economically—will limit the Community's research in new technologies and restructuring of older line industries.

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# India: Rajiv Gandhi's Search for Technology and Productivity

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Prime Minister Rajiv Gandhi's interests in technology and productivity have revived economic liberalization efforts. His moves to ease government restrictions on private production and investment—basically moderate in our view—are so impressive by Indian standards that press reports describe Indian businessmen as "drunk with euphoria." A more cautious approach in foreign trade and investment policy, however, probably reflects concern about future foreign payments problems as well as continuing emphasis on self-reliance. Although Gandhi still plans to retain overall government control of the economy, he apparently believes that a dose of bureaucratic efficiency and competition in the private sector will spur modernization, limit corruption, and ease strains on the budget. Gandhi's economic reforms open new opportunities for ties with Western business but do not ensure future overall growth.

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## Shifting Economic Approach

Since independence, Indian policymakers have regulated the economy through an extensive system of direct controls as well as a full range of macroeconomic policies. Even though a multitude of minor policy adjustments since 1980 has loosened bureaucratic bottlenecks, Rajiv inherited policies that protect most Indian businessmen from foreign and domestic competition and require them to seek government permission before increasing output beyond authorized ceilings. After Indira Gandhi was assassinated last fall, Indian businessmen enthusiastically anticipated further reforms from a Prime Minister with technical interests.

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> *Improvement in productivity, absorption of modern technology, and fuller utilization of capacity must acquire the status of a national campaign.*[1]

Rajiv Gandhi's initial moves have fueled an unprecedented atmosphere of optimism among corporate leaders:

- Licenses are no longer needed to establish or expand capacity outside big cities in 25 industries including machine tools, automobile parts, scientific instruments, and some electronic components.
- Manufacturers of motor vehicles, paper products, and some types of machinery and electronic goods may now vary their product mix within broad categories but must still seek government permission before investing in additional capacity.
- Antimonopoly legislation, which imposes additional restrictions on production and investment, will now apply to only about 800 corporations, compared with more than 3,000 in 1984.
- Small firms may now triple their sales and almost double their investment without losing tax exemptions or becoming subject to the industrial licensing system.
- The government department that supervises private corporations has been shifted to a ministry that favors production rather than restraint.

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Businessmen will also benefit from a substantial reduction in corporate and personal tax rates and lower import duties on some machinery imports. According to press reports, they are especially pleased that the government is beginning to plan tax policies for several years ahead. Fiscal incentives will be partially offset by cuts in business writeoffs, increased prices for petroleum products and rail services, higher excise taxes on many

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[1] Excerpts from Rajiv Gandhi's speeches and interviews.

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manufactured goods, and restrictions on government loans to poorly managed or nonessential private corporations.

*Another turning point has arrived with . . . microelectronics and computers. In the earlier (industrial) revolutions, whoever got left behind found it extremely difficult to catch up . . . we must see that we are not left (behind).*[1]

The electronics industry is a major beneficiary. Production licenses will be issued far more freely, even to large companies and for consumer goods previously viewed as luxuries. Ceilings on output of micro- and mini-computers have been eliminated and import duty on computer components has been greatly reduced while high tariffs on finished computers protect domestic manufacturers. The software industry has been made eligible for tax concessions. Development of mainframe computers and some high-technology products will continue to be a government monopoly.

### Modest Moves in Foreign Trade and Investment

*We want a new dynamism in our economy, but we cannot do it entirely on our own. . . . We need help from foreign business to help us build self-sufficiency. . . . It is not feasible to open up industry completely to free competition from other countries. It would not be fair to our industries.*[1]

Import policy changes have been relatively cautious, combining safeguards for domestic manufacturers with liberalization to promote modernization and exports. Licensing regulations, which will be valid for three years, remove restrictions on some industrial machinery and offer a new duty-free import scheme for exporters, but tighten controls on additional items that compete with Indian products. New Delhi has promised easy access to imported technology, especially for electronics and export industries, and procedures for employing foreign technicians have been simplified. The government has even emphasized that foreign equity investment—previously tolerated but not encouraged—will be welcomed in electronics and oil exploration.

Other export promotion initiatives are surprisingly meager in view of the emphasis Gandhi's economic advisers have placed on the need to earn more foreign exchange. Press reports suggest that new income tax concessions on reinvested export profits provide little additional incentive since they replace previous benefits and are no longer available for trade with the Soviet Union. Gandhi is apparently relying on easier access to imported technology and improvement in overall industrial performance to make Indian exports more competitive in world markets.

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Overall Indian economic policy still stresses self-reliance. Government approval is necessary before an Indian firm may purchase or lease foreign technology, even in industries recently exempted from industrial licensing restrictions. Domestic manufacturers are still required to reduce gradually their use of imported parts and now are also expected to develop their own research skills. New Delhi remains reluctant to open the Indian market to foreign investors who cannot contribute technology or promote Indian exports.

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### Government Still in Driver's Seat

Gandhi clearly intends the government to retain control of the direction of the economy. Although easing detailed regulations, he has retained the basic structure of import and industrial licensing, preferences for small producers, and close supervision of large corporate groups. He has even tightened controls in a few areas—on pollution, for example, following the Bhopal disaster. Gandhi apparently has no plans to rely on market forces to allocate basic consumer goods and will continue the public distribution system that supplies grain to urban consumers and supports prices farmers receive for wheat and rice.

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Gandhi hopes to make the bureaucracy more efficient, not less important. He has repeatedly emphasized decentralization of decisionmaking so that public sector corporations can make business decisions without interference from government ministries. Indian industrialists report that bureaucratic

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approvals for private projects can be obtained more quickly than in the past—perhaps because Gandhi has ordered that no file be reviewed more than twice.

Concern for bureaucratic efficiency—and government revenues—has also prompted an anticorruption drive. Gandhi hopes to encourage increased reporting of taxable income by lowering tax rates and relaxing some controls that led businessmen to conceal part of their production. Rewards for information about smuggling have been increased; and corporate contributions to political parties are once again legal. According to press reports, some businessmen were surprised to discover that payoffs could no longer influence excise tax policy. Many Indian journalists remain skeptical of Gandhi's "Mr. Clean" image, however, and question whether he will forgo payoffs on large contracts that help fund the Congress Party.

**Economic Policy Still Evolving**

Gandhi's resolve to create a more competitive economic environment is yet to be tested. Despite hints that some hardship is an acceptable price for efficiency, Gandhi has retained substantial protection against imports and may slow the pace of domestic decontrol if unemployment mounts or business confidence weakens. Policy statements expected during the next several months will help define Gandhi's commitment to economic liberalization. Press reports suggest that a revised industrial policy will focus on chronically unprofitable firms in both the public and private sectors, and may modify regulations that subsidize investment in "no industry" districts. Gandhi assured a meeting of international business leaders that he will ease foreign investment rules further. Details of the next five-year plan and of agricultural policy, scheduled for release by July, will clarify government investment and welfare plans. Reforms in education—one of Gandhi's special interests—will not be proposed until next year.

Gandhi's policy reforms and his probusiness image do not ensure faster overall growth. His decontrol moves directly affect only a small share of the Indian economy—primarily exporters and corporations that produce capital equipment and consumer durables. Even if liberalization is extended substantially, the potential benefits can be realized only if shortages of electricity become less severe and agricultural output increases sufficiently to sustain domestic demand for manufactured goods. Perhaps most important, forthcoming foreign payments strains may block India's ability to import goods needed to modernize and increase production.

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***Foreign Payments Constraint***

*Increasing foreign payments strains could jeopardize India's ability to become more productive and efficient. Although international financial reserves are now adequate—about $6 billion, equivalent to four to five months' imports at the 1984/85 rate—expansion of the domestic economy would require a much faster growth in the volume of imported petroleum and capital goods. Scheduled payments to the International Monetary Fund and military suppliers will mount sharply within the next two years. Wary of falling into a debt trap, Gandhi and his economic advisers are reluctant to risk a substantial increase in commercial borrowing to finance imports. We see a less than even chance for discovery of additional petroleum deposits, rapid export growth, or improved foreign aid prospects, which would provide a more favorable foreign payments scenario.*

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Mounting criticism that Gandhi is slighting the poor in favoring India's middle class may emerge as a significant political issue. Large cuts in taxes on personal income, wealth, and inheritances directly affect less than 3 percent of the population while indirect tax hikes and the large budget deficit threaten most pocketbooks. Few will be able to afford products from the new boom sectors—automobiles and electronic goods. Central government spending on welfare and rural development programs is stagnating. Although Gandhi says that

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reducing poverty is his primary objective, his enthusiasm lies with middle-class issues.

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Gandhi's economic approach will accelerate interest in business ties with the United States. At the same time, the potential for bilateral misunderstanding and friction is high. A new sense of urgency about modernization suggests India would turn increasingly to Japanese or European suppliers promptly if US export controls remain a significant trade barrier, and Gandhi's belief that the United States is an unreliable supplier then would be reinforced. Indian officials already contend that economic liberalization, which the United States has encouraged, can continue only if concessional aid receipts remain high. If balance-of-payments strains limit India's ability to modernize, they will probably blame the United States for limiting Indian borrowing from multilateral lending institutions.

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## Spain: Reversing the Economic Slowdown

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Prime Minister Felipe Gonzalez's Socialist government is now carrying out an ambitious and painful adjustment program to correct the serious economic problems that have beset Spain since the 1973 oil crisis. Although OPEC price hikes and world recession obviously were major causes, we believe Spanish policy errors made a bad situation substantially worse. Although the Gonzalez program still has a long way to go, the current account swung into surplus in 1984, and real GDP growth has picked up and should average 3 percent over the next few years. Serious structural weaknesses still exist, however, and the unemployment rate likely will remain above 20 percent for the next few years.

### Preliminary Efforts To Cure the Problems

Spain's economic growth rate plunged from 7 percent annually during 1960-74 to only 1.6 percent during 1975-83—the sharpest fall recorded in any OECD country for these time periods. Real investment declined 2 percent per year on average and more than 2 million jobs were lost, pushing the unemployment rate to 18 percent. Spain's external accounts also deteriorated sharply and severe inflationary pressures built up after 1975.

Madrid was slow to respond to its economic problems, in part because the leadership was preoccupied by the effort to establish democracy. In 1979 Madrid finally passed a national energy plan and removed subsidies on oil prices that helped return oil use per unit of GDP to its 1973 level. The pace of peseta depreciation accelerated after 1979 reversing the decline in Spain's price competitiveness.

In an attempt to contain labor costs, the Suarez government tried to reform labor regulations, but the effort was belated and sometimes counterproductive. The Workers Statute in 1980 made layoffs slightly less difficult, but also required high separation payments. In addition, the introduction of collective bargaining made wage settlements more rigid. Agreements reached at the national level between the unions and the employers' association establish a narrow band within which wage gains must be negotiated at the company level. This has particularly hurt firms operating on the margin and in the less dynamic sectors.

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### The Socialist Program

After taking office in December 1982, the Gonzalez administration— in contrast to the expansionary tradition of Socialist governments— concentrated on restoring economic stability. It moved quickly to establish and maintain a more realistic exchange rate policy—restoring price competitiveness to about the 1973 level—introduced a stringent monetary policy, and reined in government spending.

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Although the Socialists promised 800,000 new jobs, their efforts to spur job creation have centered on real wage cuts and legislative changes. Madrid was able to hold wage increases this year to 5.5 to 7.5 percent under the Socialist UGT trade union's agreement—inflation in 1985 will be in the 7- to 8-percent range. Another decline in real wages is expected in 1986. To stimulate youth employment, Madrid has eliminated the obligation to pay an indemnity to new hires if they are later laid off, put youths under 25 under their parents' social security benefit plan, and provided tax incentives. Madrid has not introduced legislation to make layoffs easier, however, because of the UGT's opposition.

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The centerpiece of the government's longer term economic strategy is the industrial reconversion program. Under the first part of the plan, the



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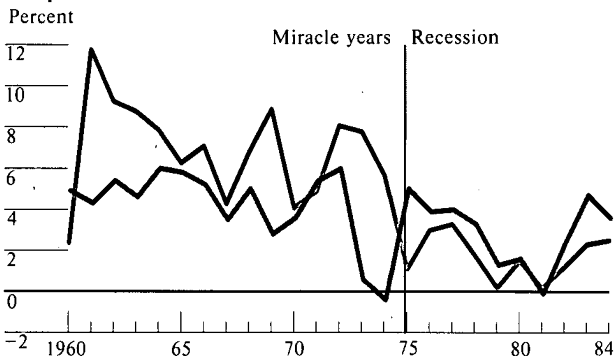
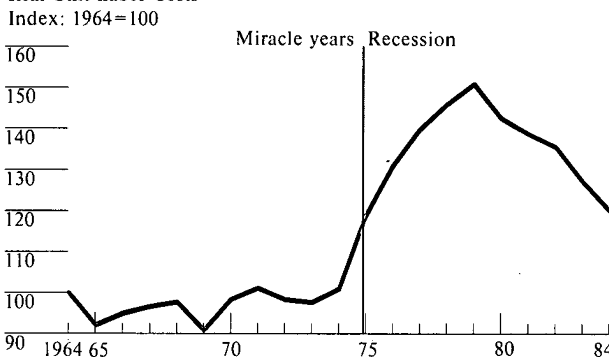
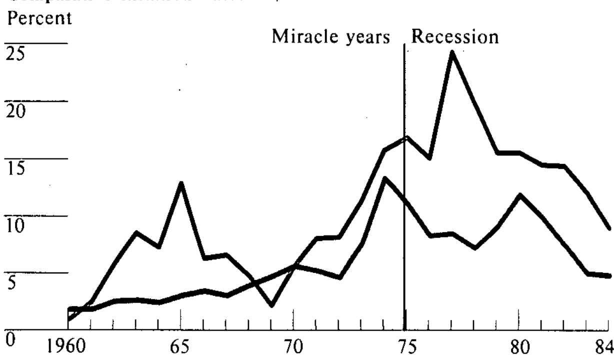
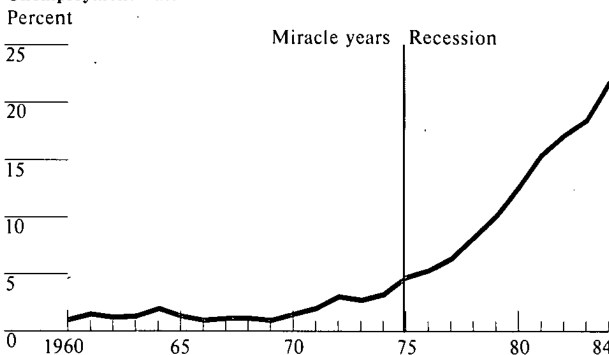
## Spain: Economic Indicators, 1960-84

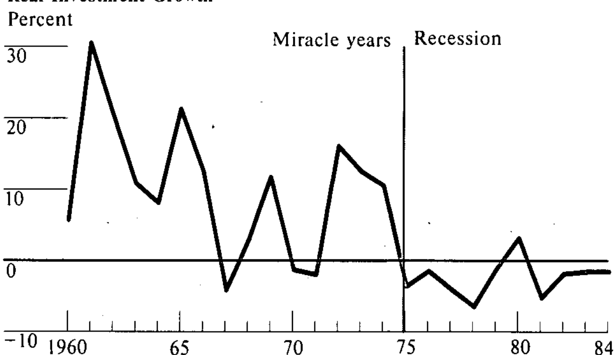
—— Spain
—— Industrial countries

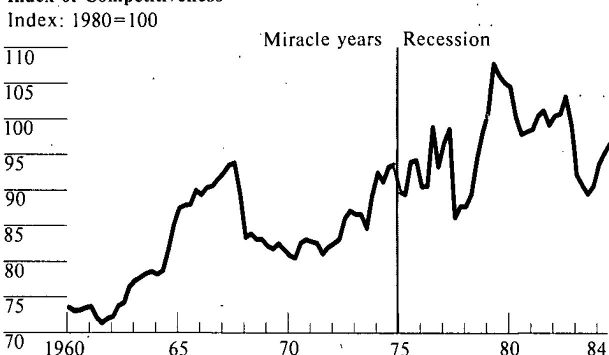



[a] The Spanish Government did not collect data for labor costs or productivity prior to 1964. Real unit labor costs were measured by deflating the industrial labor cost index by the wholesale price index and dividing by the industrial productivity index.

[b] Quarterly data. The index is a ratio of Spanish consumer price inflation to a trade-weighted average of inflation in competitor countries, adjusted for exchange rate fluctuations. A decrease in the index indicates an improvement in competitiveness.

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**Spain: Balance of Payments**

*Million US $*

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 [a] |
|---|---|---|---|---|---|---|
| Current account balance | 1,109 | −5,188 | −4,980 | −4,217 | −2,482 | 1,995 |
| Trade balance | −5,687 | −11,725 | −10,115 | −9,181 | −7,387 | −4,018 |
| Exports, f.o.b. | 18,352 | 20,581 | 20,971 | 21,332 | 20,868 | 24,333 |
| Imports, f.o.b. | 24,039 | 32,306 | 31,086 | 30,513 | 28,255 | 28,351 |
| Services, net | 5,014 | 4,489 | 3,443 | 3,383 | 3,734 | 5,182 |
| Tourism | 5,558 | 5,720 | 5,709 | 6,122 | 5,942 | 6,958 |
| Transfers, net | 1,782 | 2,048 | 1,692 | 1,581 | 1,171 | 831 |
| Long-term capital, net | 3,216 | 4,252 | 4,294 | 1,827 | 3,088 | 3,299 |
| Short-term capital, errors, and omissions | −1,340 | −406 | −94 | −1,096 | −907 | −734 |
| **Change in reserves** | **2,985** | **−1,342** | **−780** | **−3,486** | **−301** | **4,560** |

[a] Preliminary.

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Gonzalez administration introduced harsh measures to restructure "sunset" industries during 1984-86. For the first time, inefficient plants and shipyards are being scrapped. In all, 9.5 percent of the labor force in these sectors will lose their jobs. The sharpest cutbacks, 30 to 40 percent, are envisaged for steel and shipbuilding. Madrid is also supporting investments in technological improvements in these traditional industries to increase efficiency, lower production costs, and enhance competitiveness on the world market.

The most far-reaching part of the plan aims to reallocate resources to new industries that can spur economic growth and lay the foundations for domestic high technology. Madrid hopes to more than double electronics production, more than quadruple real exports, and boost private consumption. The government's success in lining up joint ventures with foreign multinationals and securing foreign investment suggests some of these goals will be within reach by 1987.

Madrid's restructuring program has met strident opposition in regions where the Communist trade union has been able to exploit worker resentment of job losses. The Gonzalez government has nevertheless proceeded with its plans and has sent a strong signal of its resolve by dismissing striking Communist shipyard workers. In most regions, Madrid can count on the support of the UGT to limit strike activity.

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## The Short-Term Outlook

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Spain appears to be on the road to a modest recovery. Real GDP last year showed an increase of about 2.5 percent, due mainly to a strong export performance—which also turned 1983's $2.5 billion current account deficit into a surplus of $2 billion. Slack domestic demand, lower import prices, and moderate wage gains helped reduce inflation 3 percentage points to 9 percent.

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With export growth expected to slacken because of a loss of price competitiveness and slower US growth, Madrid is counting on private consumption and investment to take up the slack this year.

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Because of the gains made in 1984, the Gonzalez administration apparently believes that it can ease monetary policy over the near term to stimulate investment and employment. It has also introduced tax cuts in hopes of boosting private consumption. Madrid has balanced revenue losses with reductions in military spending and transfers to public-sector companies in order to avoid sacrificing the gains made so far in reducing the budget deficit.

We expect that GDP will expand no more than 3 percent annually in 1985 and 1986. Real wage losses, and a lagged response to lower interest rates and labor law reforms probably will limit private consumption and investment growth. Firms may respond to real wage cuts and greater labor market flexibility by hiring more workers, but the slow pace of economic growth and demographic trends suggest that the jobless rate will be above 20 percent as the Socialists enter the 1986 elections.

**Political Implications**

Even though Gonzalez will have made little or no progress on unemployment—the issue that concerns voters most—and his austerity program has hurt his constituents, he should win next year's election because he faces no strong opposition. We believe workers have no incentive to undermine the Socialists as long as the only alternative is the rightwing Popular Alliance. Moreover, all of Spain's political parties, with the exception of the far left, agree on the need for an industrial restructuring program—a topic that probably will stay on the political front burner because it directly affects workers' interests.

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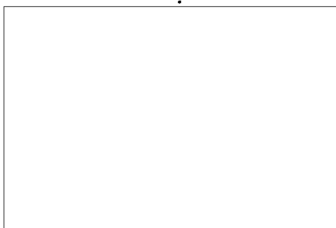
# Briefs

## Energy

*Moscow Plans More Investment, Less Oil*



The US Embassy says the Oil Ministry is planning to produce slightly less crude oil this year than originally targeted in 1984. This is the first time that the Ministry has planned to produce less than was targeted in a previous year. Output during the first quarter was 6 million tons, about 4 percent, below that posted in the same period last year. Investment in the industry, however, is planned to increase substantially—by about 15 percent. Meanwhile, several West Siberian oil officials reportedly have been fired in recent weeks. This second wave of dismissals is in keeping with General Secretary Gorbachev's demand that appointments be based on ability rather than political connections. For the first time some of those dismissed reportedly face criminal charges, probably for mismanagement.

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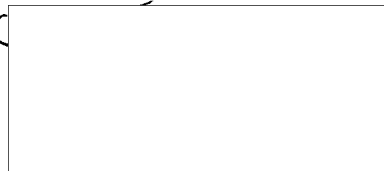
*Record Soviet Oil Exports to the West in 1984*



OECD data indicate that in 1984 the USSR sold to OECD nations over 1.6 million barrels per day (b/d) of oil and oil products. This level surpasses the previous record in 1983 by about 50,000 b/d. The increase evidently came in reexports of OPEC oil. Recent Soviet trade data indicate that the reexports were steped up by roughly 50,000 b/d in 1984, primarily from Iraq and Saudi Arabia. Total Soviet oil exports to the West and to LDCs that pay hard currency probably earned the Soviets almost $16 billion last year—an increase of some $300 million over 1983 earnings, despite the slight fall in world oil prices.

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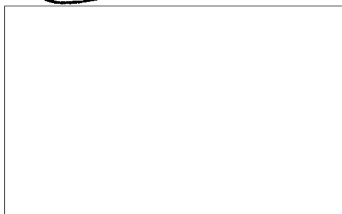
*Soviets Concentrate on Gas Production*



The Soviets are likely to sign contracts soon totaling nearly $3.5 billion for three sour-gas processing facilities that will substantially expand Soviet production capacity by 1989. A gas extraction and processing complex near Karachaganak will process nearly 20 billion cubic meters per year and will produce almost 225,000 b/d of condensate along with other products. Another plant at Astrakhan will expand current facilities by an additional 6 billion cubic meters per year, and a new desulfurization plant will handle associated gas from the Tenghiz oilfield. In addition, the Soviets have recently reached agreement to expand a gas pipeline to Finland and build a new one from Bulgaria to Turkey, and plan a gasline to Greece. The projects highlight Soviet emphasis on gas processing and distribution for domestic use and hard currency exports that could preempt Western efforts to develop alternative gas sources for Western Europe.

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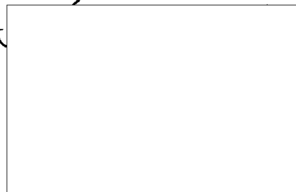
*Mauritanian-Algerian Refinery Venture*



Algiers has agreed to provide partial financing to rehabilitate Mauritania's sole oil refinery. The $13 million package is less than half the IMF estimated cost to bring the idle facility on line. The US Embassy in Nouakchott believes that the competitive position of the 22,000 b/d refinery will remain weak because of limited domestic demand, high production costs, and low world oil prices. The IBRD recently recommended that the state-owned facility remain closed or be turned over to private operators for use as a storage facility. The decision to proceed is contrary to the Taya regime's protests against the previous government's financial imprudence but may be an attempt to gain some benefit from the $150 million white elephant. Nevertheless, the loan is another sign of Algeria's willingness to support the new regime.

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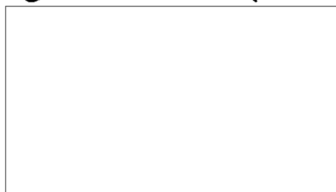
**International Finance**

*New Algerian Borrowing*



Algeria is seeking $1 billion in new foreign financing for its development program. This loan follows closely on the heels of a $600 million loan floated in January and brings to $5 billion the total amount of foreign borrowing since 1982. Algiers continues to enjoy an excellent credit rating despite lower oil revenues and the largest debt burden of any Arab OPEC state—$16 billion. Terms of the new loan—one-half of 1 percentage point above LIBOR—are slightly above the January rate but still low compared with other Third World countries. Recent borrowing only partially offsets the $4 billion in debt service costs this year—33 percent of export receipts. The government probably will increasingly rely on trade credits to bridge the financing gap during the 1985-89 Development Plan.

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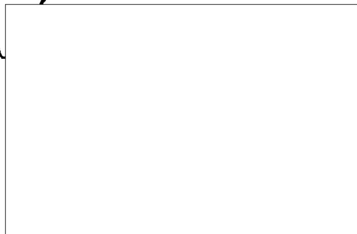
**Global and Regional Developments**

*Malaysia's Participation in International Rubber Agreement*



Malaysia—which produces almost half of the world's natural rubber—is reassessing its participation in the International Natural Rubber Agreement (INRA). Kuala Lumpur has been disappointed with INRA's reference price structure that has not kept pace with rising production costs. Earlier this month Malaysia and other members of the Association of Natural Rubber Producers agreed to make higher reference prices a key issue at this week's INRA renegotiation meetings. Kuala Lumpur last week also announced a pricing move that effectively eliminates Malaysia's rubber export duty, probably as a bargaining maneuver. We believe producer countries will be successful in negotiating a higher reference price structure, in which case Kuala Lumpur is likely to sign the new agreement. If not, Malaysian participation will be in doubt.

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*USSR May Ratify Common Fund*

A Hungarian diplomat told a US official that there is a 60-percent chance the USSR will ratify the Common Fund Agreement on Commodities. The Fund has 85 of the 90 ratifications and $237 million of the $313 million in capital contributions needed to go into effect. Moscow

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may try to gain the maximum political benefit by becoming the 90th country to ratify. The United States has signed but not ratified the agreement. Moscow prefers to keep its economic relations with developing countries on a bilateral basis but realizes it would significantly enhance its image in the LDCs by joining the Fund. The agreement has great symbolic value to the Third World as the first step toward the "New International Economic Order."

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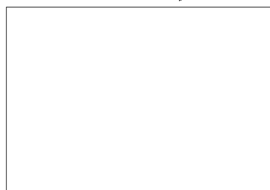
*India Blocks Jute Agreement*



The International Jute Organization (IJO), a producer/consumer group, met in Bangladesh last month against a background of flood-ravaged crops and gloomy predictions for future markets. India, a major exporter, effectively vetoed two agricultural projects designed to reduce production costs and increase yields making jute competitive with synthetics. The Indians apparently were reluctant to share commercial data with competitors, although the US Embassy in Dhaka doubts that India's growers have any secrets worth protecting. Bangladesh, where sales of jute and jute products are the second-most important source of foreign exchange, bitterly criticized India. The Embassy notes that US unwillingness to pay its IJO assessment will draw increased criticism at the next IJO session in November 1985.

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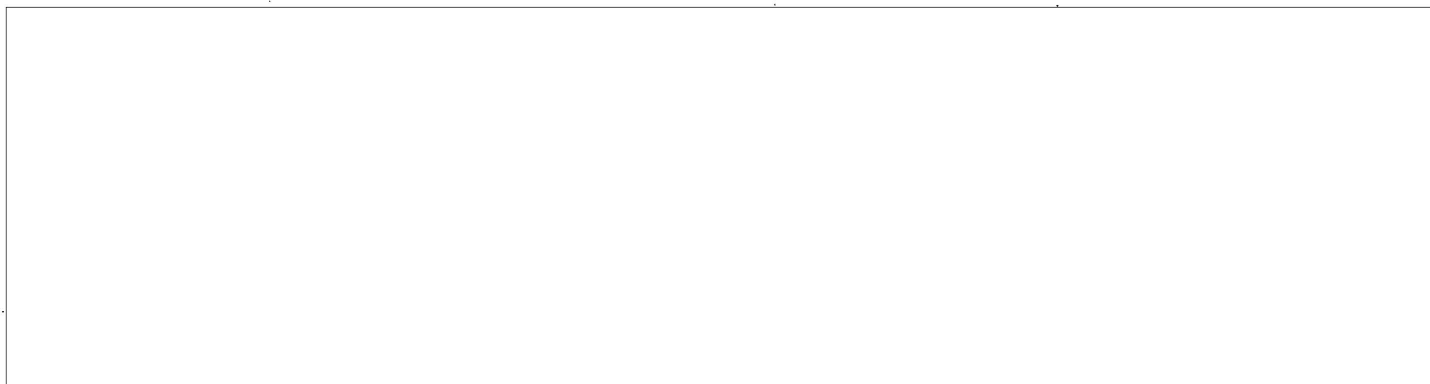

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**National Developments**

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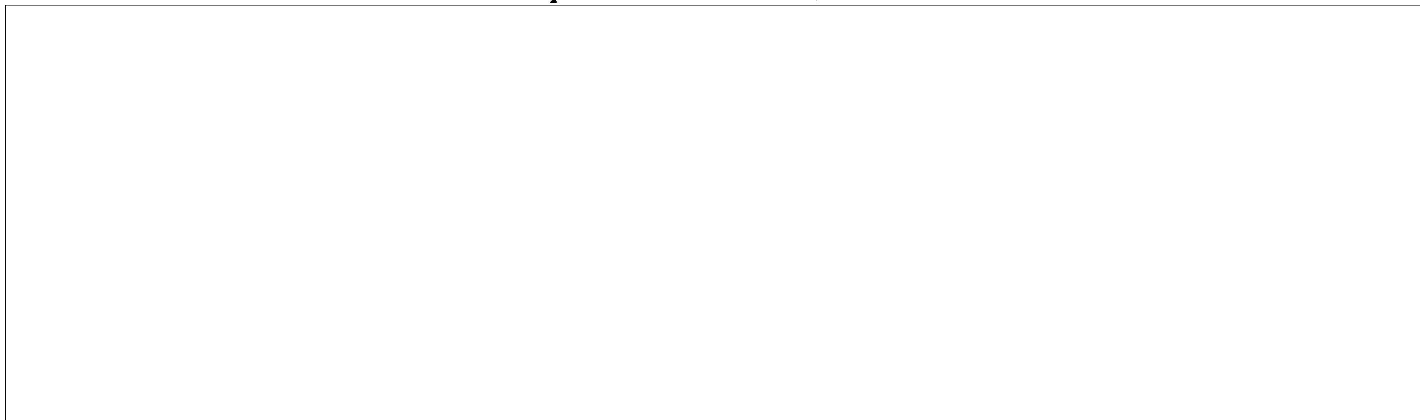
***Developed Countries***





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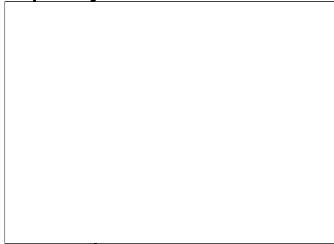
*Opposition Strategy on UK Unemployment*



Several senior Labor and Tory politicians have established an Employment Institute to devise strategies for dealing with unemployment. The aim, according to press reports, is to study the causes of joblessness, attack the government's record on the issue, and promote alternatives. The institute, which will begin work after the local elections in May, will reportedly seek a common ground between the opposition and the left wing of the Conservative Party on measures to reduce unemployment. The Tory government is most vulnerable on unemployment—now 13 percent and rising—but, given other economic priorities, has done very little about it. Despite broad concern over joblessness, the creation of the institute does not presage a political realignment. Its proposals, however, may embarrass Thatcher, keep unemployment high on Parliament's agenda and in the public eye, and force her to defend her record.

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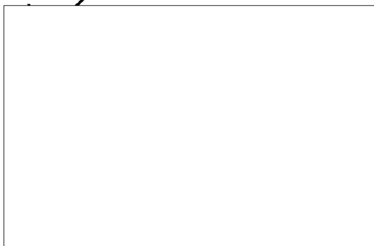
***Less Developed Countries***

*Peru's Probable New Economic Path*



Center-left candidate Alan Garcia—the likely winner of the May runoff—favors highly nationalistic economic policies. Domestic economic policy will be aimed at restoring growth and reducing foreign dependency. He will stress agricultural development to eliminate food imports and import-substitution and tariff barriers to reactivate industry. To fund development, the candidate wants to heavily tax wealthy individuals and corporations and implement tighter planning to balance the budget. On debt, Garcia has also called for bypassing the IMF, limiting Peru's annual debt servicing to 20 percent of exports, and promoting joint action among Latin nations to secure easier repayment terms. Tighter control over foreign investment is likely, but foreign firms probably would not be nationalized. The candidate also is on record as favoring multiple exchange rates and exchange controls to bolster exports and reduce imports.

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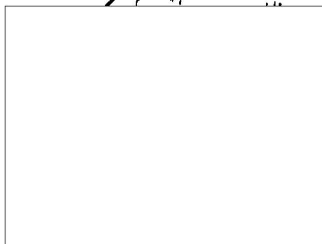
*Flooding in Brazil's Northeast*



Extensive flooding in impoverished northeastern Brazil will present a serious economic challenge to recently installed President Sarney. Floods have left over half a million people homeless in a region that suffered six consecutive years of severe drought, which ended only last year. Polio and diphtheria and higher reported incidences of influenza and hepatitis are adding to the northeast's woes. The government is sending relief shipments of food and temporary shelter, but high waters will slow deliveries to many areas. Plans are being made for massive reconstruction but the costs—probably hundreds of millions of dollars—will be a heavy burden for debt-ridden Brazil. Meanwhile, standing water in more productive southern areas has slowed the cotton and soybean harvests, raising prospects of additional economic problems.

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*Mexican Sale of State-Owned Firms*

Mexico City's highly touted plan to sell many of its state-owned enterprises to help cut the public-sector budget deficit in 1985 is unlikely to result in significant savings. Last week's announcement that the government is seeking bids for shares of 35 of the 127 state firms promised for sale has evoked little

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enthusiasm from domestic or foreign investors.

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*Moroccan Harvest Prospects Dim*

Morocco's important winter grain crop is seriously threatened because of drought over the past two months. The US Embassy estimates that production will fall to 3.4 million tons this year, down 8 percent from 1984 and far below the 6.3 million tons required to meet domestic demand. Four of the past five cereal harvests also were sharply reduced by drought. The grain shortfall this year will exacerbate the already serious shortage caused by the cutoff of US CCC grain credits for 1985. Larger-than-anticipated cereal imports will burden Morocco's strained financial position—$49 million in foreign exchange reserves remain. Sufficient grain supplies probably have been secured to see Morocco through June, but additional supplies will have to be found to avert a serious crunch in the last half of 1985.

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*Nigerian Truck Shortages and Relief Efforts*

Lack of trucks to move goods from Nigeria's major ports is becoming the biggest obstacle to transshipping food aid for famine-stricken Chad and Niger, according to the US Embassy in Lagos. Congestion at Nigeria's ports is greater than at any time in the past three years. The truck shortage results from lack of spare parts and replacement vehicles and the already heavy use of Nigerian trucks to move food aid in neighboring states. Fear of delays in delivery of essential domestic goods, such as fertilizer, may reinforce the government's reluctance to allow donors to use the port at Lagos. Port congestion also provides the government a justification for denying transshipment of food aid to Chad despite growing international pressures to do so.

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*Zambia To Establish Foreign Currency Auction*

Lusaka's IMF standby agreement will be reinstated upon final agreement on a limited auction system designed to improve the efficiency of Zambia's foreign currency allocations, according to US Embassy reporting. The Fund suspended the standby agreement when Zambia fell behind on repayment of its foreign debt, which had been rescheduled last July. The auction system that was pioneered in Uganda allows for a limited amount of foreign currency to be sold on the open market each week in addition to that allocated under official foreign exchange controls. Lusaka also must pay some $3 million in arrears owed to the IMF since February before the Fund will resume disbursements.

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***Communist***

*Status of Soviet Consumer Program*

The "Long-Term Consumer Goods and Services Program" has not gotten very far, as indicated by a recent joint resolution by the Central Committee and the Council of Ministers that addresses only housing repairs and improvements. The resolution follows similar actions this year on telephone services and footwear. The program has been in the works since 1983. Completion of the program—a major component of the next five-year plan—was originally scheduled for mid-1984. Last January a commission staff member said it was delayed because a sufficiently "impressive" program could not be devised in part due to the shortage of internal investment and drawn-out negotiations over appropriate consumer goods deliveries from Eastern Europe. The recent piecemeal approach indicates the Politburo has not yet decided on any major redirection of resources to consumers.

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*Soviet Activity in the International Titanium Market*

In a major departure from recent Soviet marketing policy, Techsnab, the organization newly appointed to take responsibility for Soviet titanium exports, lowered its price of ingot-grade titanium sponge to compete with Japanese producers. As a result, a large quantity of the titanium sponge was recently sold to a West German steel company. In a related move, the Soviets reentered the European titanium scrap market after several years' absence to take advantage of recent price increases. Soviet titanium exports declined in the early 1980s largely because of increased military and civilian demand and low world prices. The moves to expand exports may reflect a desire to increase hard currency earnings now that sufficient titanium is stockpiled or otherwise available for internal consumption.

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*Cuban-Soviet Sugar Problems*

a poor harvest has forced Havana to purchase several hundred thousand metric tons of sugar on the world market since October to satisfy its export commitments.

Havana sells sugar to Moscow at over 10 times the world market price. Cuban sugar output this year will do well even to equal last year's harvest of 8.2 million tons. Havana's export efforts probably are motivated by President Castro's pledge last December to honor commitments to CEMA.

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*Vietnamese Devaluation*

Hanoi in early April devalued its currency by nearly 90 percent against the US dollar in an attempt to reverse last year's sharp drop in hard currency export earnings and to divert black-market revenues into the government's nearly empty foreign exchange coffers. The new rate (100 dong per dollar) is still less than half the black-market rate. Long recommended by the IMF, the

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devaluation represents a victory for the pragmatic faction in the Politburo and may presage further economic reform. The pragmatists are considering measures to improve trade relations with the West. Restrictions on foreign trading companies in Ho Chi Minh City have been loosened and a liberalized foreign investment code is under consideration. Opposition from hardliners, however, could reverse the trend if substantial economic improvement is not soon evident.

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