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International Economic & Energy Weekly

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19 July 1985

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25X1

International Economic & Energy Weekly

25X1

19 July 1985

iii Synopsis

1 Perspective—OPEC: No Solutions in Sight

25X1

25X1

3 Saudi Arabia: Threats To Boost Oil Output Unilaterally

25X1

25X1

5 Latin America: Limited Prospects for a Debtors' Cartel

Prepared by analysts from ALA and OGI

25X1

25X1

9 Key LDC Debtors: Lackluster Investment Portends Problems

25X1

25X1

15 The Sino-Soviet Trade and Cooperation Agreements: A Step Forward

25X1

SOVA

25X1

19 Briefs
- Energy
- International Finance
- Global and Regional Developments
- National Developments

25X1

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International
Economic & Energy Weekly

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Synopsis

1 **Perspective—OPEC: No Solutions in Sight**

25X1

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25X1

3 **Saudi Arabia: Threats To Boost Oil Output Unilaterally**

25X1

Shrinking government revenues have forced Saudi officials to consider boosting crude oil production unilaterally. The Saudis hope their threats will prod other members to agree to a new quota and pricing scheme, but they are prepared to act on their own.

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5 **Latin America: Limited Prospects for a Debtors' Cartel**

25X1

There is little near-term potential for Latin American countries to organize a debtors' cartel, but they probably will soon begin to develop new pressure tactics to try to ease their repayment burdens.

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9 **Key LDC Debtors: Lackluster Investment Portends Problems**

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The high investment growth that powered the economies of the key LDC debtors during the past two decades may be a thing of the past. The fallout from this dramatic shift in investment behavior will multiply the economic and political problems these countries will face during the next decade.

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15 **The Sino-Soviet Trade and Cooperation Agreements: A Step Forward**

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China and the USSR signed a $14 billion five-year trade agreement and a separate economic cooperation agreement—the first such agreements in 20 years—on 10 July as part of Vice Premier Yao Yilin's four-day visit to Moscow. Although trade levels under the agreement will be a function of bilateral political ties, transportation problems may be the principal long-term impediment.

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19 July 1985

Perspective

OPEC: No Solutions in Sight

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OPEC ministers meet on Monday for the second time in less than three weeks amid an atmosphere bordering on despair. As the ministers gather this weekend in Geneva, the near term offers few promising options. Weak oil demand, rising competition from non-OPEC producers, and internal disarray continue to challenge OPEC's ability to avert a major price break. OPEC's falling oil revenues have placed financial pressures on its members and forced them to compete against each other for oil sales.

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At the early July meeting, financially strapped Nigeria, Iraq, and Ecuador bitterly opposed a stopgap plan to reduce every member's production quota by 7 percent. Algeria, Iran, and Libya, who have joined other members in underselling official OPEC prices through barter deals and discounting, argued against any adjustment in the official price structure. Such hypocrisy contributed to an atmosphere of distrust among members, who were quick to blame each other for the organization's predicament.

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A sword hanging over Monday's meeting is the Saudi threat to cease acting as the organization's swing producer. At the last session, Petroleum Minister Yamani bluntly warned that Saudi output would be boosted unilaterally if the members continue to violate established price and production guidelines. Poorer and more populous OPEC nations have little sympathy for the Saudi's economic plight, but they realize that a decision by Riyadh to follow through on its threats would trigger a price war.

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Pressure for a downward price adjustment has mounted in the two weeks since the ministers last met. Mexico lowered its oil prices for the second time in less than a month, US and Canadian producers have cut light oil prices, and press reports indicate that Egypt will do the same. According to US Embassy reporting, Venezuela—with exports down sharply—is waiting until after the meeting to announce a badly needed price cut.

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OPEC members realize that even concerted action in Geneva will not alter the gloomy demand outlook for its oil over the next two years:
- Oil consumption will remain steady, while non-OPEC production is expected to rise by nearly 1 million barrels per day (b/d) this year and about 500,000 b/d in 1986.
- Substitution of other fuels for oil is occurring at a rapid pace, and conservation efforts continue to improve energy efficiency.

As a result, demand for OPEC oil probably will be only 16-17 million b/d through 1986, roughly one-half the 1979 level.

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Indeed, some members are seriously questioning the value of remaining in OPEC, if it means only additional production restraint and declining revenues. Production discipline is no longer viewed as a short-term sacrifice guaranteeing a brighter future, but as a long-term headache with no relief in sight. While OPEC's most effective course of action would be to cut production further, an allocation scheme acceptable to all members does not appear negotiable at this time. The other alternative, price cuts, would be slow to spur demand and would only increase pressure on revenue-starved members to violate production quotas. Bolder initiatives—such as a central marketing organization for OPEC crudes—may be necessary to break the deadlock but have little support going into the meeting.

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In any case, OPEC lacks the innovative leadership and resolve needed to deal with its problems. In the unlikely event that members pull together in Geneva, they will still have little cause to celebrate. Yet, if OPEC fails to act, July 1985 may well mark a de facto dissolution of the cartel as members attempt to solve their problems individually.

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Saudi Arabia: Threats To Boost Oil Output Unilaterally

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Shrinking government revenues have forced Saudi officials to consider boosting crude oil production unilaterally if other OPEC countries fail to adhere to production quotas and official prices. They believe they are bearing an unfair burden as swing producer, particularly now that spending cutbacks are beginning to affect domestic programs. Petroleum Minister Yamani has publicly threatened to boost Saudi oil production if other OPEC countries continue to "cheat." The Saudis hope their threats to increase production will prod other members to agree to a new quota and pricing scheme, but they are prepared to act on their own if no new agreement is reached and observed.

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Financial Constraints

Riyadh's goal of a $55 billion balanced budget was unrealistic from the outset. Despite projected spending cuts of about 14 percent, declining oil revenues are pushing the red ink to levels that Saudi officials find unacceptable. Saudi output fell to an estimated 2.1 million b/d in June, far below the 3.8 million b/d on which Riyadh's current budget is based. We believe Riyadh wants to avoid having to finance a budget deficit much larger than $10 billion because it has already drawn down its liquid international assets from $135 billion to $90 billion in less than three years. If crude production averages 2 million b/d for the fiscal year, at current prices and spending levels, Riyadh would face at least a $20 billion deficit.

If the Saudis tried to pare spending by an additional $10 billion, outlays would be nearly 40 percent below last year's level—an almost impossible feat for both political and bureaucratic reasons. For the first time since oil revenues began to decline, budget cuts are being targeted toward Saudi citizens. Allowances, benefits, bonuses, and other payments received by civilian employees of the Saudi Government already have been severely curtailed, amid loud complaints. Saudi officials are chary of cutting broader consumer subsidies after seeing the political disturbances that followed similar cuts in Morocco, Tunisia, and Sudan.

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The Saudi Game Plan

The Saudis are calculating that the prospect of the market disruption and downward price spiral that a unilateral production increase would cause will induce other OPEC members to maintain better discipline. The opening gambit came during a meeting of OPEC's Ministerial Executive Committee in early June, in which Yamani read a letter from King Fahd stating that, if any OPEC member cheats, they all have the right to do so. According to the US Embassy, Yamani said that Saudi Arabia could easily expand production to 4.35 million b/d—its implied quota under the current OPEC agreement. Yamani subsequently threatened a 9-million-b/d level.

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A tentative agreement at the OPEC Ministers' meeting early this month to reduce quotas temporarily by 7 percent fell through at the last minute, The Saudis insisted on a proportionate reduction for each member, which would allow the kingdom to produce 4 million b/d. Nigeria, Iraq, the UAE, and Ecuador, however, demanded that their quotas be increased.

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The Stakes

There are risks for the Saudis if they unilaterally boost their production. If quotas are abandoned and a price war ensues, some industry experts

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indicate prices might initially fall to $12 to $15 per barrel. Lower prices probably would not be translated into significantly higher demand—particularly in the short run—meaning little budgetary relief for Riyadh. For example, at a price of $15 per barrel and Saudi output of 3 million b/d, Riyadh would still face a $20 billion deficit in the absence of any additional spending cuts. At that price, the Saudis would have to boost output to 5.7 million b/d to hold the deficit to $10 billion without cutting spending. Only a smaller price drop or better demand response would permit the Saudis to stay within their deficit target.

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Outlook

The Saudis have delayed taking any unilateral action until after Monday's OPEC meeting. If an agreement on quotas is worked out then, the Saudis would probably wait a few months to see how well it is observed. If no agreement is reached or if an agreement is promptly violated, the odds are better than even that the Saudis would boost output unilaterally.

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Latin America: Limited Prospects for a Debtors' Cartel

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Latin American debtors probably will soon begin to develop new pressure tactics to try to ease their repayment burdens and draw Washington directly into efforts to solve the region's debt difficulties. In our view, however, there is little near-term potential for these countries to organize a debtors' cartel or formally mobilize collective action to force concessions from creditors. Our judgments are based [redacted] on the results of a simulation exercise.[1] Factors that could raise the odds on collective action include a dramatic deterioration of external economic conditions, an upsurge in domestic political instability, or perceived intransigence on the part of creditors. The decisive roles, in our view, will continue to be played by the leaders of the major debtor states, especially the presidents of Mexico, Brazil, and Argentina. [redacted]

Sentiment among Latin American countries for collective action to obtain debt relief—including forming a debtors' cartel—first surfaced in 1982. The cartel threat waned late last year after the major countries dramatically improved their trade performance, rescheduled their debts, obtained new lending, and saw interest rates fall. [redacted] US bankers still remain apprehensive about the Latin American debtors collectively repudiating their debt. We believe that some governments, such as Bolivia and Cuba, may fuel this concern by advocating a cartel. [redacted]

[1] Threats of a debtors' cartel have resurfaced, but we lack extensive reporting on the willingness of key debtors to support collective action. To assess the potential threat, we simulated a meeting of the Cartagena group (Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Peru, Uruguay, and Venezuela), a consultative mechanism on debt organized in 1984. The participants filled information gaps with their own analysis of the political and economic factors that would prove decisive in new deliberations. Through a role-playing exercise, we considered forming a debtors' cartel and then discussed other types of collective action to force repayment concessions from creditors. In this article, the judgments attributed to individual governments represent those of the participants in the exercise. [redacted]

The Simulation

The forum was a closed-door deliberation of a Cartagena group ministerial meeting, the typical setting in the past. Experienced analysts played finance ministers from Brazil, Mexico, Argentina, Chile, and Bolivia and foreign ministers from Brazil and Uruguay. We believe this incorporated moderate and radical viewpoints, involved the key decisionmakers as well as maverick elements, and struck a balance between financial concerns and political considerations. [redacted]

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We believe the country analysts were good proxies for the Western-educated elites that conduct negotiations. Reliable reporting indicates that the debtors test their perceptions about banker response to their proposals. Consequently, we built in an automatic feedback mechanism by including a representative of a US moneycenter bank. [redacted]

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In the exercise, the participants were instructed to defend their self-interests. The debtors viewed this mandate in terms of reducing the repayment burden while the creditors sought to protect interest payments. Unlike a brainstorming session, the simulation forced the group to interact dynamically. We believe we were able to consider a broad range of variables in making policy recommendations and gauge the extent to which rhetoric influenced the interaction among the participants. [redacted]

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Simulation Results: A Debtors' Cartel

Our simulation persuaded us, however, that there is only a slight possibility that such a group could coalesce:

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- The divergence between the economic interests of the larger, more moderate governments and the

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smaller, more radical debtors fragmented efforts to organize a cartel. Although La Paz and Lima argued there was little to lose, Buenos Aires maintained that confronting creditors would undermine efforts to obtain multiyear debt rescheduling and new loans. As the simulation progressed, we saw a consensus that the economic costs of radical action would be too high. The largest and most influential debtors remain concerned about protecting access to new credit. A cartel, the group decided, might provoke retaliation from industrial governments, resulting in the potential loss of foreign aid and export markets.

- Mexico, Brazil, and Ecuador played key moderating roles in our simulation. Mexico City—fearing the cessation of trade credits and damage to its improving relations with the United States—emphasized potential losses. Brasilia advocated moderation in order to maintain good relations with banks and to head off OECD protectionism. Quito, a strong advocate of market-oriented policies, philosophically rejected outright confrontation with creditors.

Simulation Results:
Collective Action for New Repayment Schemes

According to the US Embassy in Buenos Aires, the foreign ministers of Argentina, Brazil, and Uruguay recently discussed an Argentine proposal for Latin American debtors collectively to reschedule debt payments to commercial banks. this would be achieved by capping interest rates to provide fixed, lower repayments to banks with the IMF and World Bank issuing bonds to creditors to cover the difference. In our simulation:

- The Latin American nations found the idea of a fixed, predictable repayment schedule attractive and considered raising the issue in future discussions with creditors. Most were concerned, however, that collectively forcing the scheme would alienate creditors, causing the immediate loss of trade credit lines and new lending, as well as derailing the possibility of future concessions. The debtor representatives also were sobered by the technical difficulties of formulating a specific plan. No major debtor country currently felt that foreign exchange strains were intense enough to justify a unilateral reduction in interest payments.

- Mexico, Brazil, and Chile each played a key role in our deliberations, but their positions were conditional on other factors. Although Mexico prefers to maintain its good reputation with creditors, it indicated that a drop in oil prices combined with domestic political pressures could push it to threaten a capping scheme. Similarly, Brazil and Chile indicated they would reconsider their opposition to the proposal if exports and reserves drop markedly.

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Over the past several weeks, Fidel Castro has attempted to ally himself with the Latin debtors by publicly speaking out on their financial plight. In numerous speeches, he has argued that creditors should cancel their debt; otherwise, Latin countries should simply refuse to pay. Castro's arguments were given short shrift in our simulation. Some debtors were piqued by his attempt to grab the limelight, while others pointed to his hypocrisy in espousing radical action while privately working out new debt arrangements for Cuba. Except for Bolivia, the group believed his proposal would jeopardize their good relationships with creditors and industrial country governments.

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Simulation Results:
Intensified Joint Pressure for Concessions

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The option of cooperative pressure on creditors for concessions arose spontaneously in the course of our group discussions. It was the only proposal that all debtors would accept, because it highlighted financial problems without jeopardizing the current good relations with foreign creditors. This option emerged, we believe, because Latin governments—under domestic political pressure to restore economic growth—feel compelled to find some course that will gain further debt servicing concessions:

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- In the simulation, the debtors agreed to use both the press and direct lobbying—in particular with the US Congress and Washington bureaucracies—to publicize the need for easing Latin America's debt burden. They also opted to continue the Cartagena group as a loose confederation to provide mutual support and to share information on successful approaches.

- Throughout the discussion, Brazil and Mexico focused attention on the need to reduce trade barriers and lower interest rates. Conversely, Argentina, Bolivia, and Peru advocated highlighting the danger of political instability and resulting economic chaos to nudge creditors toward providing new concessions.

The Imponderables

Although we are confident of our analysis, over the longer run dramatic changes in the economic and political equation could substantially heighten the prospects for a cartel or collective rescheduling. We believe this scenario could occur as a result of any of a number of developments:

- Deteriorating external conditions could severely diminish debt service capabilities. Slowed global economic growth, the spread of protectionism, and the collapse of commodity prices—notably oil—would reduce exports, or rapidly rising interest rates would swell the burden of interest payments.

- Foreign banks and the IMF could require more stringent austerity in return for new money or debt relief. In the view of debtor governments, such policies would likely lead to political instability.

- Domestic political reverses in one or more countries could encourage Latin civilian governments to take firmer stands with foreign creditors.

- A leader of a large Latin debtor—Alfonsin of Argentina seems the most likely candidate—driven by a personal sense of destiny and ambition, may tout revolutionary changes. Other countries could become more receptive to radical action if a well-respected, major debtor led the way.

- Collusion by two or more Latin countries on the debt issue could breed wider acceptance of collective action throughout the region.

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Implications for the United States

The simulation exercise complemented recent reporting that indicates that the views of the Latin debtors are evolving in a more political direction. We expect the Latin Americans to mount increasingly frequent and intense joint lobbying efforts to obtain concessions from commercial banks and industrial country governments. Latin leaders, in our exercise, seemed convinced that resolution of their financial problems hinged largely on US Government policies and actions.

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Key LDC Debtors: Lackluster Investment Portends Problems [1]

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The high investment growth that powered the economies of the key LDC debtors during the past two decades may be a thing of the past. After an unprecedented four-year plunge, investment in these countries is only now beginning to recover. Even if this recovery is sustained, we believe investment growth through 1989 will be slower than in the past. The fallout from this dramatic shift in investment behavior will multiply the economic and political problems these countries will face during the next decade. In particular, slow investment growth will limit their economic recovery, further aggravating existing political and economic tensions. Sluggish investment growth may also place additional strain on the international financial system by jeopardizing compliance with IMF-supported programs and eroding trade competitiveness.

Investment Slump

In general, investment growth in the key LDC debtors was impressive before the international financial crisis shattered the two-decade-old trend. Over the past four years, investment in these countries declined by nearly $55 billion—a 30-percent drop. Investment last year was well below 1980 levels in each country. (See foldout on page 13.) In Argentina, investment plunged by nearly 55 percent during the past four years. The investment slump was severe, but less dramatic, in Chile, Brazil, Peru, and Mexico. At the end of last year, their investment stood 25 to 35 percent below 1980 levels. Nigeria, the Philippines, and Venezuela fared somewhat better, registering investment declines of only 10 percent.

We believe three key factors underlie the recent investment slump:

- *Financing difficulties* probably were the major drag on investment. The pool of funds available for investment fell by 15 percent during the last two years. Lower domestic savings and reduced access to foreign borrowing stifled investment by either pushing up financing costs or, where interest rate controls exist, causing a shortage of funds.

- *Economic recession* produced an unprecedented slump in aggregate demand that led to an investment decline when the expected returns from investment projects plummeted and internally generated investment funds dried up.

- *Heightened economic and political uncertainty* also contributed to poor investment performance. Investors found it impossible to gauge the future returns from projects, and massive capital flight restricted the supply of investment funds.

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Limited Investment Recovery

Our analysis indicates that investment in the key LDC debtors will rebound during 1985-89, but it is unlikely that investment growth will be high enough to restore investment to its level before the international financial crisis. We expect investment to grow at an average annual rate of 3 to 5 percent during the rest of this decade, a dramatic improvement over the average decline of 8.2 percent registered during the past four years, but well below the 7.3 percent average growth of the 1971-80 period. Even if these countries sustain investment growth of 5 percent through 1989, only two-thirds of the 1981-84 investment decline will be reversed.

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[1] This article summarizes an upcoming research paper. Key LDC debtors include Argentina, Brazil, Chile, Mexico, Nigeria, Peru, the Philippines, and Venezuela. Investment refers to gross fixed investment—investment in structures, machinery, and equipment. All dollar values and growth rates are based on constant 1980 US dollars.

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Key LDC Debtors: Rankings by Key Factors Underlying the Investment Outlook

Ranking relative to other Key LDC Debtors

• Highest
↓
• Lowest

	Demand prospects	Availability of investment funds	Stability of political-economic system	Investment prospects
Argentina	●	●		●
Brazil	●		●	●
Chile				
Mexico	●	●	●	●
Nigeria	●		●	●
Peru			●	
Philippines				
Venezuela	●	●	●	●

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In our judgment, a modest economic recovery in the key LDC debtors during 1985-89 will lead to an investment rebound. Rising aggregate demand should stimulate investment by increasing the expected returns from investment projects. We foresee minimal improvement, however, in the other key factors affecting the pace of investment. Sluggish domestic savings and limited access to foreign borrowing suggest that the high cost/limited availability of investment funds will continue to put a damper on capital formation. A significant improvement in the underlying level of political-economic stability in these countries also appears unlikely.

Individual Country Outlooks

Our analysis indicates that investment growth in the key LDC debtors will vary widely across countries during 1985-89. We believe ***Mexico*** will lead with investment growth averaging 4 to 6 percent.[2] Although problems exist, Mexico's demand prospects and political-economic stability are ranked higher than those of the other countries. After a period of harsh austerity, demand is projected by the major economic consulting firms to grow at an average annual rate approaching 5 percent. Although opposition parties are gaining strength, the long tenure of the government party should lead to relative political-economic stability. Regarding the availability of investment funds, only Venezuela is ranked higher. Mexico's banking system is relatively mature and efficient, but inflation, devaluation fears, and capital flight will continue to dampen domestic savings and limit the supply of investment funds.

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In ***Venezuela*** and ***Brazil***, annual investment growth is likely to average 3 to 5 percent through 1989. With demand projected to grow at an annual rate of about 4 percent, the demand prospects of these countries are relatively good. Venezuela's traditionally high savings rate, low inflation, and relatively stable currency earned Caracas the highest ranking for availability of investment funds. Investment funds may be more scarce in Brazil because of triple-digit inflation and high devaluation risk. Given Venezuela's two decades of democracy and the broad popular and military support for the constitutional process in Brazil, the future political-economic environment of these two countries should be relatively stable.

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In ***Peru***, ***Chile***, and the ***Philippines***, we believe investment will grow 2 to 4 percent a year through 1989. Demand prospects are considered fair—GDP

[2] Projections were developed by ranking each country according to the key factors that will determine investment growth during the 1985-89 period—aggregate demand prospects, cost/availability of investment funds, and the stability of the political economic system. By examining these rankings, investment growth projections were assessed and a range of average annual investment growth was set for each country. Our projections were then compared to, and in some cases revised in light of, the investment growth forecasts of outside experts. Given the volatility of investment spending, our projections should be viewed as benchmarks that indicate the underlying trend in investment growth. As has historically been the case, annual investment growth may fluctuate dramatically around such five-year averages.

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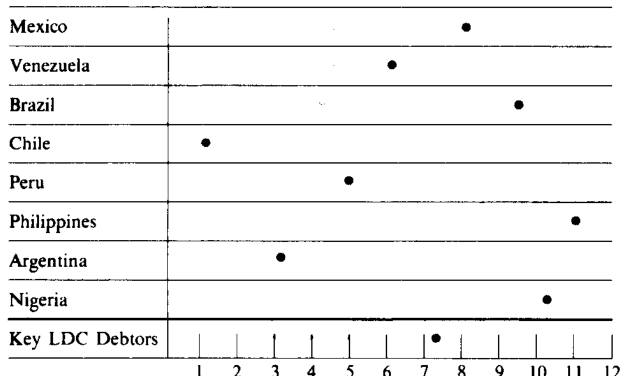
Key LDC Debtors: Investment Growth Outlook

Average annual percent

Indicates projected range, 1985-89
• Indicates average, 1971-80



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is expected to grow, on average, about 3 percent per year. Historically low savings in Chile and inflation and devaluation concerns in Peru and the Philippines should limit the supply of investment funds. Instability in all three countries should stifle investment growth. In Peru, the nationalistic, left-leaning philosophies of President-elect Garcia, the Sendero Luminoso insurgency, and a history of shifting economic policies raise serious concerns about political-economic stability. In the Philippines, a country with a more stable economic system, the Aquino assassination, the presidential succession question, and a growing insurgency have boosted investor uncertainty. We believe rising opposition to the repressive rule of President Pinochet will keep the level of political-economic uncertainty high in Chile.

Investment growth in ***Argentina*** and ***Nigeria*** should be slower than in the other countries, averaging only 1 to 3 percent through 1989. Demand in these countries probably will be sluggish, expanding at about 2 percent per year, on average. Historically, low savings have restricted the supply of investment funds in these countries. This trend should continue as inflation and devaluation risk discourage domestic saving and spur further capital flight. Although Argentina has recently taken bold steps to reduce runaway inflation, the country's economic system may remain unstable. Political stability, however, may improve marginally under President Alfonsin. If the economy limps along, Alfonsin may be the first democratically elected president since 1952 to complete his term. Nigeria, on the other hand, with a more stable economic system has dismal political prospects. Lagos is plagued by divisions in the ruling military, student dissatisfaction, and regional tension.

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Even if investment grows at the highest projected rates through 1989, only three key LDC debtors will regain the ground lost since the international financial crisis. Venezuela, the Philippines, and Nigeria could have investment in 1989 that is 2 to 15 percent higher than before the crisis. Their full recovery will be the result of less severe investment downturns rather than to particularly rapid investment growth during 1985-89. In contrast, we project investment in Argentina will still be roughly 50 percent lower in 1989 than in 1980. Peru and Chile may regain more lost ground than Argentina, but their investment should still fall about 30 percent short of precrisis peaks. Mexico and Brazil should regain all but about 10 to 15 percent of the ground lost following international financial problems.

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Implications

Recent and projected investment performance in the key LDC debtors foreshadow a number of problems. Because investment is required to expand productive capacity, slow investment growth will limit their rate of economic growth over the longer term. On the heels of the drop in living standards registered recently, any further declines would aggravate existing social tensions. Slow investment growth may also impede structural adjustment. Economic restructuring may require investment growth well above our projections. Slower structural adjustment could jeopardize compliance with

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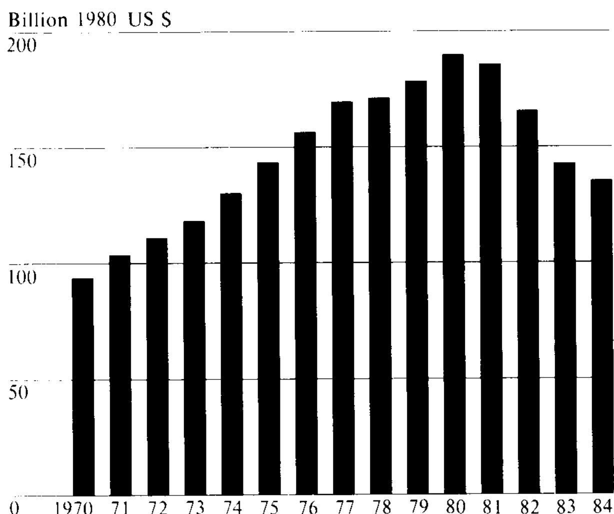
Key LDC Debtors: Investment 1970-84



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IMF-supported programs and cause international financial problems and economic inefficiency to linger over the longer term. Slow investment growth may also limit the flow of new technologies to these countries thereby slowing economic growth and hurting trade competitiveness.

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If these problems develop, US relations with the key LDC debtors could become more contentious:

- There could be increased pressure on Washington to take these countries' needs into account during the formulation of US monetary, fiscal, and trade policies.
- These countries could press the United States for increased development assistance. In a cash flow bind, the United States may be forced into the role of "lender of last resort."
- If debtor-creditor conflicts arise, the United States may be caught in the middle; both debtors and creditors would pressure Washington to support their positions.

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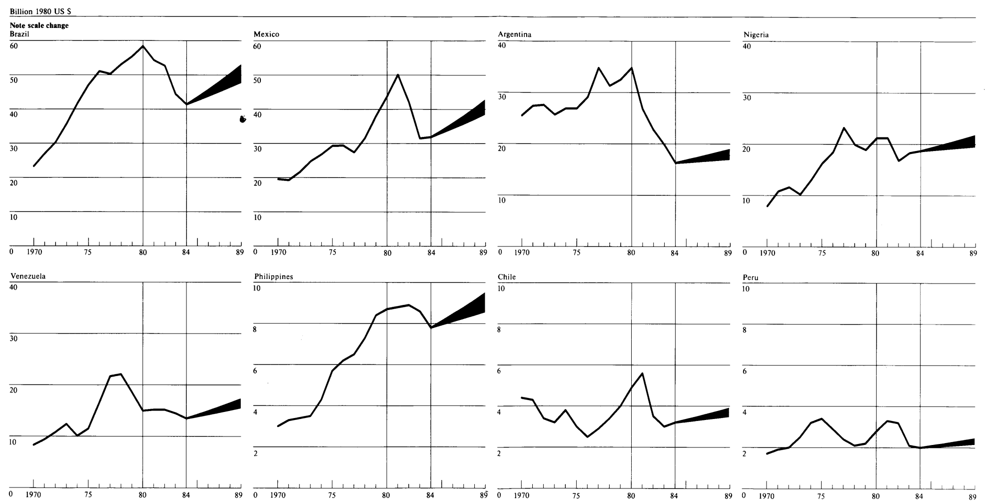
Key LDC Debtors: Investment by Country, 1970-89[a]



[a]Shaded area represents the projected range of investment during the 1985-89 period, assuming our projected range of average annual investment growth.

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The Sino-Soviet Trade and Cooperation Agreements: A Step Forward

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China and the USSR signed a $14 billion five-year trade agreement and a separate economic cooperation agreement—the first such agreement in 20 years—on 10 July as part of Vice Premier Yao Yilin's four-day visit to Moscow. Although somewhat of a breakthrough in economic relations, bilateral trade by 1990 will still only represent less than 5 percent of each country's total trade. The cooperation agreement could prove more significant in that it will result in direct Soviet participation in Chinese industrial projects. Together, the two pacts provide a framework for continued dialogue and improvement in overall political and economic relations.

Terms Negotiated Until Last Minute

The trade accord reportedly calls for rising levels of bilateral trade, reaching $3.5 billion in 1990, for a total of $14 billion over the five-year period. By comparison, trade conducted during 1981-85 is expected to total only $4 billion, with this year's figure projected at $1.6 billion. Unlike the trade accord, no value was given for the cooperation agreement, although in May that USSR participation in Chinese industrial projects could reach up to $1 billion per year by 1988.

the long-term trade agreement sets out a general framework within which annual protocols can be negotiated. Two types of barter exchange have reportedly been established. The first—as is the case for trade now—requires the yearly settlement of accounts. The second allows the Chinese to pay for imports of capital goods and technical assistance over a multiyear period.

The economic cooperation agreement reportedly involves the Soviet supply of machinery, capital equipment, and technical assistance to support China's Seventh Five-Year Plan (1986-90). 25X1

25X1 the USSR will participate in seven new Chinese development projects—including two thermal power plants, two coal mines, and a 1,000 kilometer rail line—as well as the renovation of 17 existing plants. Several smaller projects have also been targeted for Soviet participation. This marks the first time in over 20 years that the Chinese have asked the Soviets for assistance and technology in the construction of new plants. During the height of the Sino-Soviet relationship in the late 1950s, Moscow was involved in over 200 projects in China. 25X1

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Soviet deliveries of manufactured goods, chemicals, raw materials, and transport equipment are also likely to rise as a result of the new agreement. Beijing will continue to need imports of such Soviet metals as nickel and steel alloys. At the same time, despite recurring problems with quality and tardy delivery, China will probably want to increase its imports of timber, industrial chemicals, and fertilizers. 25X1

We expect Moscow will seek higher imports of meat, soybeans, grain—mostly corn—and other agricultural products. Similarly, to supplement its own production, Soviet imports of wool, cotton, apparel, and textiles are likely to rise. Finally if the Chinese can increase their domestic production, the Soviets also may try to boost their imports of such consumer electronics as televisions and radios.

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The Politics of Trade

Clearly, both sides can benefit from an expanded economic exchange, but the decision to formalize

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this expansion within a multiyear trade agreement—after a 20-year hiatus—reflects a slow process of improving relations since 1980:
- Regular political consultations at the deputy foreign minister level.
- A sharp increase in bilateral trade and a resumption of scientific and technical exchanges.
- Low-level nonpolitical contacts at athletic meets, cultural events, and the like.

Probably the most important of these moves was the resumption of Sino-Soviet political discussions in October 1982. Although the six rounds of "consultations" to date have done little to resolve major political and security issues, the dialogue has, nonetheless, helped reduce tensions. Moreover, by expanding various forms of cooperation, as well as increasing bilateral trade, Moscow and Beijing have helped repair some of the damage inflicted on their relationship during the 1960s and 1970s. Their success in improving relations, in turn, has demonstrated to other countries that Sino-Soviet ties are not frozen, even though the two sides remain deadlocked on the main issues dividing them.

Besides helping both sides to show some balance in their ties to the United States, both countries have individual reasons for signing the new accords. The Soviets almost certainly look upon the new agreements with China—especially the project assistance—as a means of regaining some of the influence that they had wielded in Beijing before relations deteriorated in the early 1960s. Indeed, a number of the USSR's top Sinologists believe that there are Chinese officials who are dissatisfied with the current leadership's policy of developing close ties to the West, particularly with the United States. According to these Soviet experts, many of the more "hopeful" Chinese cadres were educated in the USSR during the 1950s, and want a return to better relations with Moscow or at least a more balanced approach to the two superpowers.

The Soviets almost certainly have tailored such remarks to their Western audience. While the degree of Chinese support is probably not as widespread as the Soviets claim, some Chinese apparently do see increased trade and economic exchanges—which are unlikely to evolve into economic dependencies—as a comparatively safe way to improve their relationship with the USSR without compromising on more fundamental political issues. Furthermore, the Soviets appear to be including Chinese who, as Marxist-Leninists, admire the highly centralized Soviet planning system (and who have reservations about China's economic reforms), but who also have serious problems with many Soviet policies, especially toward China.

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Economic Benefits: The Soviet Perspective

In addition to political reasons, both countries had strong economic incentives to sign the new agreement. Moscow is undoubtedly anxious to boost imports of agricultural products and consumer goods from China. Besides reducing shortages and saving on high transportation costs particularly for the Soviet Far East, these increased imports also would provide a boost to the Soviet Long Term Consumer Goods program that is scheduled to be unveiled as part of the upcoming 12th Five-Year Plan.

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Another positive aspect of increased trade from Moscow's vantage is that it will allow the USSR to acquire through barter goods that would otherwise require the expenditure of foreign exchange. At the same time, Moscow will be supplying goods, primarily equipment, which have only limited demand in the West. Any hard currency savings will be relatively small, however, in comparison with total hard currency expenditures. China can probably supply the USSR with 1-3 million metric tons of grain—primarily corn—and several hundred thousand tons of soybeans annually for at least the next few years saving Moscow $200-500 million a year. Hard currency expenditures for meat—which averaged $350 million in 1981-84—could be cut by additional purchases from China; in 1984, imports of meat from China totaled over $100 million.

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The Chinese Side of the Ledger

Increased sales to the USSR will provide China with an outlet for its growing production of textile fibers, fabrics, and apparel. Both the United States and Western Europe have placed restrictions on imports of some Chinese products—including textiles and consumer goods—forcing Beijing to search for alternative markets.

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The use of Soviet capital equipment, machinery, and technical assistance—in addition to raw materials—will also prove beneficial to Beijing. The Chinese have apparently decided that, for some of those factories built originally with Soviet help, it is cheaper to modernize using Soviet equipment. Although this equipment may not be as technologically advanced as that available from the West, it will still improve industrial performance. The Chinese probably also believe that for a number of new projects—primarily energy—the Soviets can provide technology that is as good as in the West and without the expenditure of hard currency.

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Prospects

Given these incentives, we believe the annual trade turnover goal of $3.5 billion by 1990 is possible. Nonetheless, even this level by 1990 would still probably represent less than 5 percent of each country's total trade.

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Although trade levels under the agreement will be a function of bilateral political ties, transportation problems may be the principal long-term impediment. Even now, rail transport is so tight on both sides that many products are shipped by sea. Port congestion in both China and the Soviet Union, however, has also slowed deliveries. China is building new port capacity to alleviate seagoing freight delays, but planned improvements to the rail system in both countries are not likely to be sufficient to eliminate major problems.

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Briefs

Energy

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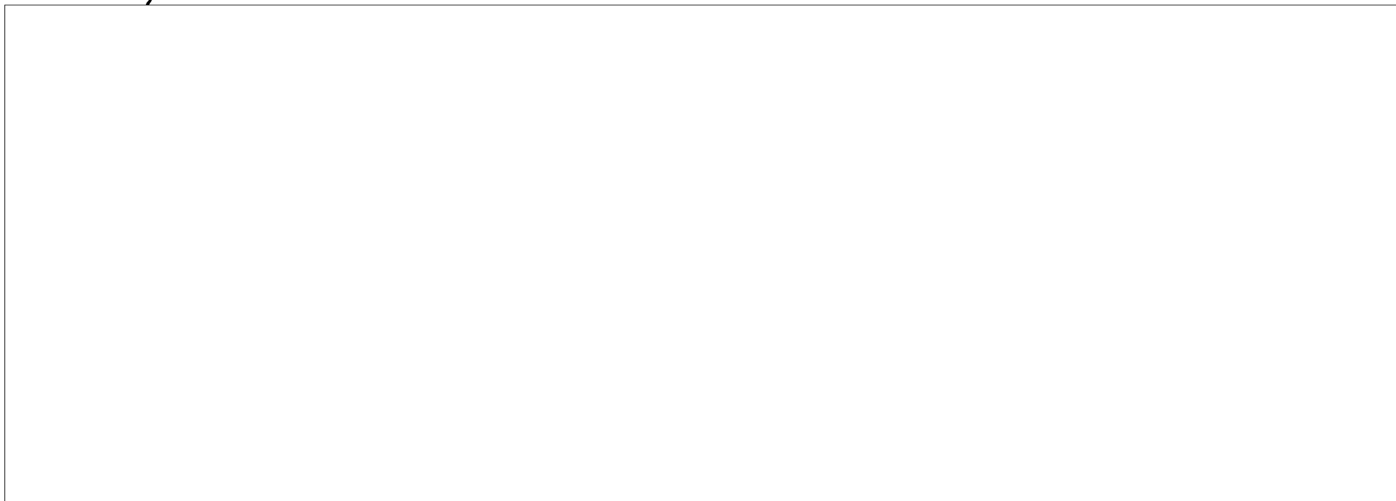
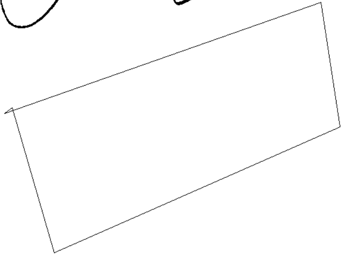
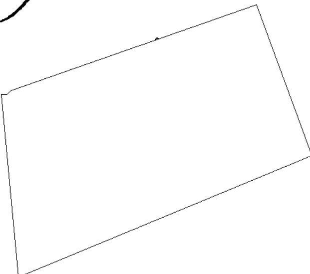


Soviets Interested in US and Canadian Drilling Rigs



The Soviet Union has narrowed the bidding on deep-drilling rigs for the Karachaganak gasfield to three US and one Canadian firm, 25X1 25X1 The Soviets have been negotiating to purchase 54 land drilling rigs with 7,000-meter-depth capacity with a total value of $150-200 million. Further negotiations await final Soviet funding approval which is not likely before late this year. 25X1 each US firm could produce the rigs at its own plants or through licensees in Canada, France, Italy, Finland, or Japan. The decision to limit the competition to US and Canadian firms probably reflects Soviet recognition that rigs made from 25X1 US-designed components are the world's best. If the Soviets opt for a US firm, they may still insist that the rigs be manufactured outside the United States as a precaution against US trade restrictions. US companies may also prefer to produce abroad because of lower manufacturing costs and access to foreign export credits. 25X1

Chinese Offshore Oil Developments



The first 18 offerings in China's second round of offshore oil leases drew bids from 23 firms in ten countries, including at least five from the United States. No date for awarding leases has been set. Four additional blocs south of Hainan Island will remain open to bidding until September. Beijing had to sweeten its terms after blocs auctioned in the first round yielded only one commercial well. Two other blocs negotiated unilaterally by the Japanese and the French have also proved commercial. China and Japan have reached basic agreement to develop commercial production in the Bohai Bay, and will spend 25X1 $200 million to produce 9,000 b/d. Initial production is expected in 1987. 25X1

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International Finance

Brazil's Difficult Negotiations With the IMF

Finance Minister Dornelles believes the differences between Brasilia and the IMF have narrowed sufficiently to permit an early standby agreement, according to US Embassy reporting, but we believe the negotiations that resumed on Monday could be long and difficult. To pave the way for an agreement, Brasilia announced measures in early July to reduce by 36 percent the projected $18 billion public-sector deficit for this year. [redacted] the announced cuts were substantially smaller than those sought by the IMF. [redacted] Brasilia intends to request from creditor banks another three-month rollover through November of debt repayments, suggesting that the government anticipates drawn-out talks. Dornelles continues to have difficulty selling his austerity proposals within the Brazilian government. Not only has President Sarney become increasingly agitated by Fund demands, [redacted] but the US Embassy reports that many of the politicians in the PMDB—the larger of the two parties in the governing coalition—would like nothing better than to force a break with the IMF. [redacted]

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Mexican Budget Overruns

Rising balance-of-payments problems and large budget overruns are pushing Mexico out of compliance with IMF targets and may force the government to seek new foreign loans. Mexico's recent oil price cut averaging about $1 per barrel, combined with earlier price adjustments and lower export volume, will reduce 1985 petroleum export earnings by about $1.5 billion from the 1984 level. Capital flight has doubled and international reserves have dropped by one-half to approximately $4 billion. [redacted] In discussion with the IMF, the Mexicans are likely to plead extenuating circumstances and ask for easier terms; bankers will consider loans only if the Fund declares Mexico is in compliance with the IMF program. The deteriorating foreign payments situation will soon force Mexico City to adjust the exchange rate. This is not likely to prevent financial problems from getting worse, especially if oil prices continue to drop. President de la Madrid so far has been unwilling to cut spending enough to bring the deficit near the IMF targets. While a third round of budget cuts will be made soon, we doubt they will be sufficient. [redacted]

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Poland's Government Debt Rescheduled

Poland and the Paris Club of Western creditor governments signed an accord on 15 July to reschedule approximately $11 billion in overdue debt over a period of 11 years, according to press reports. The agreement was initialed earlier this year, but formal signing was delayed when Warsaw tried to obtain new credits from the governments and failed to make required payments on arrears from the 1981 rescheduling agreement. To implement the new accord, Warsaw is required to sign bilateral accords with individual governments, to

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complete payments on arrears from the 1981 agreement, and to make interest payments on the rescheduled debt. Poland is unlikely to cover more than half of the $900 million due to governments if it continues to give priority to imports and payments to bank creditors. The Poles probably will demand new trade credits in the bilateral negotiations, but Western governments are unlikely to commit more than minimum amounts, at best. If Poland fails to pay, the Paris Club may demand a new private rescheduling that provides for equal treatment of creditors

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IMF Postpones Loans to Morocco

Morocco's efforts to secure $300 million in IMF loans collapsed last week. The government's failure to conclude its 1983-84 commerical debt rescheduling agreement with the London Club, large arrears on official debt to Paris Club members, and poor performance on meeting IMF guidelines this year prompted the Fund's decision to postpone new assistance until at least September. Recent promises of large-scale aid from Saudi Arabia and Libya may be a factor in Rabat's intransigence as well as the favorable terms Morocco enjoys by prolonging the 1983 short-term credit and rescheduling arrangements The problems with the IMF preclude any progress on urgently needed debt rescheduling for 1985 and 1986. This latest setback also is likely to spark renewed attacks by opposition parties who are critical of the government's financial management, bending to creditor demands, and willingness to put the burden of austerity on the poor.

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Tunisian Financial Stringency Considered

Tunis is considering a number of measures to stem the rising debt burden and the outflow of foreign exchange—foreign exchange reserves of $200 million cover less than a month of imports. A devaluation of the dinar of 10 to 15 percent is likely by the end of the year to help control import growth. In addition, cuts in the 1985 budget of up to $100 million are being considered to trim borrowing needs. The US Embassy says the government has not yet approached the IMF for financial assistance or help with debt rescheduling, but a continued oil market slump makes such a move likely by the end of 1986. The current domestic political situation, however, probably will cause officials to focus on short-term financial juggling rather than on long-term debt planning and on the difficult choices in subsidies as well as economic liberalization—especially in agriculture.

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Uncertain Future for Somali Standby Agreement

Somalia's failure to meet an IMF performance target criterion that calls for the elimination of external arrears is jeopardizing financial liberalization efforts and the adjustment program approved earlier this year. Insufficient foreign exchange income has prevented Mogadishu from retiring overdue obligations. Earnings have been reduced by Saudi Arabia's continued ban on imports of Somali cattle, a switch by aid donors from cash to commodity contributions, contractor claims, and diminishing oil grants. Somali officials, moreover, claim that the priority given the private sector by the IMF

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agreement leaves too small a share of export earnings for the government to meet its official obligations. The deteriorating foreign payments situation has eroded Somali confidence in other IMF liberalization measures, such as privatization of state enterprises and the unification of official and market exchange rates. Development programs also have been set back as multilateral donors cut off disbursements in response to Somalia's inability to make payments.

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Uruguay's Preliminary IMF Agreement

The four-month-old Sanguinetti government is counting on an IMF package to avoid suspending interest payments. According to press reports, IMF Managing Director de Larosiere has recently given tentative approval to an 18-month, $120 million standby arrangement in which Montevideo pledged to bring its fiscal deficit down from 10 to 6 percent of GDP, to lower inflation to 60 percent from the current 78 percent, and to maintain a floating exchange rate. We believe that the IMF package is required to keep Uruguay's financing gap manageable. Based on government estimates, capital inflows will total 30 percent less then the projected $110 million current account deficit through December. To cover the gap, Montevideo is approaching its foreign commercial banks—which recently agreed to roll over principal repayments until the end of September—for $130 million in new money, but negotiations have yet to begin in earnest. With foreign exchange reserves virtually exhausted, Montevideo will need to keep a tight lid on imports to remain current on obligations.

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Global and Regional Developments

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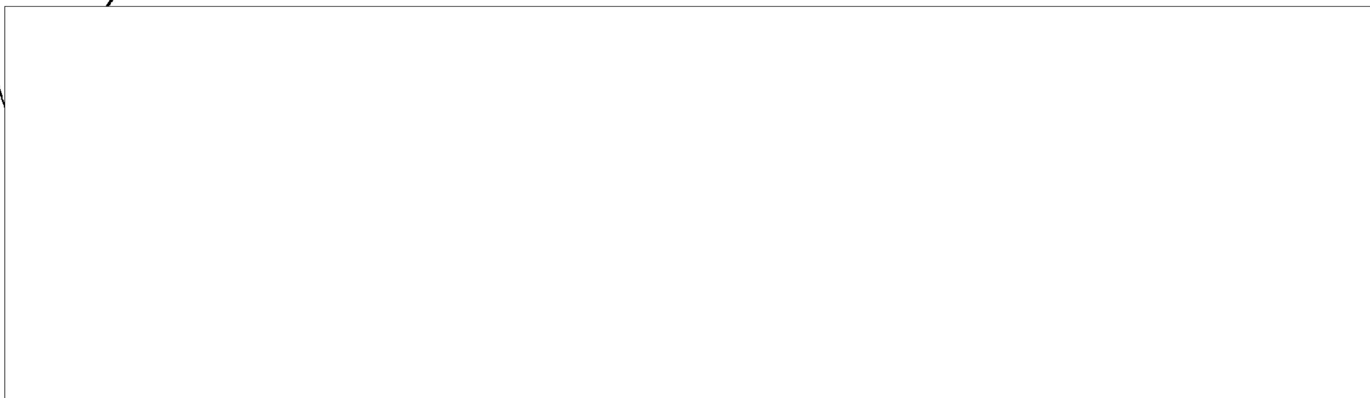

National Developments

Developed Countries

Honda Complicates Canadian-Japanese Auto Negotiations

Honda's decision to export cars to Canada from its US plant further complicates Ottawa's ongoing negotiations with Japan on an auto import restraint agreement. In the recent preliminary understanding, Ottawa agreed to continue the 18-percent limit on Japan's share of the Canadian auto market

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and said it would accept a higher limit if Japan substantially increases its investment in Canada. Tokyo, however, agreed only to avoid disrupting the Canadian market and views anything up to 22 percent as meeting this condition. As a result of Honda's decision, other Japanese automakers are pressing Tokyo to seek a limit higher than 18 percent in the final agreement. 25X1 The others are unhappy at the prospect of Honda increasing its Canadian market share—which it can do because the US-built Honda cars will not count against the quota. Meanwhile, to make up for the US-built cars sent to Canada, Honda apparently plans to ship more Japanese-produced cars to the United States now that Tokyo has eased its US voluntary restraints. We believe the final outcome likely will involve an increase in the quota on Japanese cars in return for a Japanese pledge to modestly boost investment in Canada. 25X1

Canada Not Restraining Korean Cars

Despite complaints from domestic manufacturers about a surge in imports of South Korean Hyundai cars, Ottawa thus far is sticking to its scheduled January 1987 date for imposing a tariff on LDC autos. Hyundai, which is using Canada as a test market before beginning exports to the United States, has seen its Canadian sales soar 270 percent in first half 1985, as compared with the year-earlier period. South Korea is now behind only Japan in the Canadian auto market with a nearly 6-percent market share. The Canadian Motor Vehicle Manufacturer's Association has suggested Ottawa is avoiding action because it does not want to jeopardize attempts to sell South Korea a nuclear reactor. Canadian Finance Department officials stress South Korea's willingness to purchase Canadian auto parts, and especially Hyundai's decision to build a parts plant in Canada, as factors behind Ottawa's decision to delay tariff applications. Canada's resistance to demands to restrict Korean imports may also reflect the success of Seoul's extensive lobbying of prominent Tory politicians. 25X1 25X1

Divestiture of Canadian Aerospace Companies

Potential aircraft sales have increased the likelihood Ottawa will be able to sell Canadair and de Havilland, thereby continuing the Tory government's policy of privatizing public corporations. 25X1 Canadian officials are telling prospective buyers that China is interested in purchasing a number of Canadair's Challenger business jets. In addition, recent approval of a short takeoff and landing airport in the heart of London 25X1 should prove beneficial to de Havilland, whose Dash-7 is the only airplane that meets the strict noise and performance standards. 25X1 Canada must soon purchase $5 billion worth of large transports to upgrade its aging commercial and military fleet. Acquisition of a Canadian aircraft firm would give an investor a "foot in the door," 25X1 and could be used in fulfilling demands Ottawa is likely to make for partial production in Canada. In addition to possible US buyers, a West German firm, Messerschmitt-Boelkow-Blohm, has expressed an interest in the Canadian companies,

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France Souring on Economic Summits

President Mitterrand told Japanese interviewers last week that economic summits are no longer "fruitful exchanges of views" and that he sees no reason for France to participate unless they change. Mitterrand's threat that he will not attend the Tokyo summit next spring is not an idle one. He found the Bonn summit—where he was generally isolated and seen as unwilling to compromise—particularly distasteful, but he has been complaining for several years that summits have become too structured and overly orchestrated. Mitterrand wants more emphasis on exchanging views rather than on winning consensus. If the Socialists lose the legislative elections next spring, it will leave him without a mandate and increase the likelihood he will stay home.

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Italian Government Review Focuses on Economy

Italy's five-party coalition government is reviewing its policies with debate expected to focus on economic problems, particularly the rapidly growing public-sector deficit. Last week, Rome raised its 1985 budget deficit forecast by $5 billion to $60 billion—16 percent of estimated GDP—largely because of higher unemployment compensation and use of the wage supplement fund. So far, Prime Minister Craxi has been unable to win coalition agreement on cutting the deficit, and discussions at the policy review are likely to be divisive. Treasury Minister Goria, a Christian Democrat, has called for new taxes to make up the expected revenue shortfall. On the other hand, Republican Finance Minister Visentini, supported by the Socialists and Social Democrats, insists that spending must be cut before new taxes can be considered. Craxi anticipates a compromise which may include some new indirect tax measures. The outcome of the debate will help to determine which portfolios are changed in the widely anticipated cabinet shuffle later this summer—and will also have a major influence on the longer run stability of the coalition.

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Cut in British Interest Rates

Leading British commercial banks lowered their base interest rates to 12 percent on Monday, the lowest level since the height of the pound crisis in January. The banks followed the lead of the Bank of England, which had made a one-half point cut in its money market dealing rate a few days earlier. The cut came as a surprise to many British forecasters who had assumed that excessive money supply growth would prevent any reduction in interest rates. London—although pleased with sterling's recovery against the dollar—apparently became concerned that the parallel surge against the West German mark would threaten export competitiveness. The government also hoped to appease industry leaders, who recently blamed Thatcher's economic policies for damaging the recovery and demanded an immediate 2-point reduction in interest rates. Although industry lobbies and worried or dissident Tories will continue to press the government to make further cuts in interest rates, London's overriding concern with inflation makes substantial reductions unlikely.

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Israeli Compromise on Austerity

A nationwide general strike was averted this week when the government and labor leaders from Histadrut agreed on controversial wage compensation demands, even though negotiations continue over reductions in public-sector

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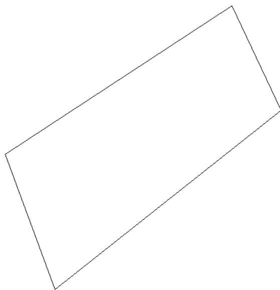
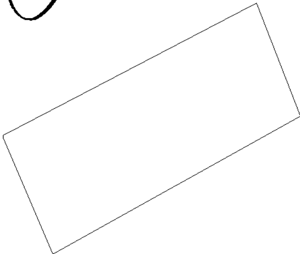


employment. The accord eliminates wage indexation through September; instead it awards employees lump-sum payments less than their usual cost-of-living adjustments. The press reports that the wage talks succeeded in part because the 14.9-percent inflation rate in June was far below what labor had expected. The agreement is a political face saver for Prime Minister Peres and Histadrut leader Kessar, but it is not likely to solve Israel's economic woes. The government realizes that it needs to implement the rest of the austerity program it adopted on 1 July—particularly the budget cuts—and eventually supplement the program with additional tax and monetary reforms. Peres's latest compromise, however, may weaken his hand in future talks. 25X1 25X1

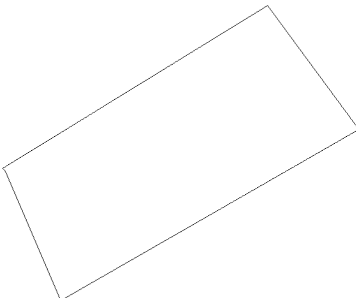
New Zealand's Economy in Trouble



According to recently released government statistics, consumer price inflation in June reached 22 percent at an annual rate—compared with 9 percent a year earlier. The data also show that economic growth has steadily declined during the last 12 months—the economy actually contracting by 1 percent in first quarter 1985, as a result of a major shakeout in manufacturing and farming and a tight monetary policy in the face of rising prices. Nevertheless, unions are setting the stage for a showdown with the government by demanding immediate 15- to 20-percent cost-of-living increases. Wellington has pledged not to award any wage increases until the next round of negotiations in September—and then to grant only moderate pay hikes in order to promote industrial restructuring. 25X1 25X1

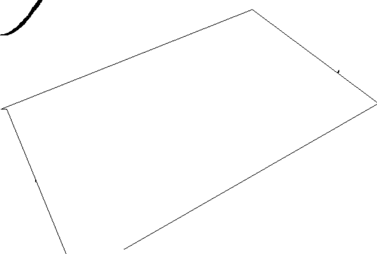
Less Developed Countries

USSR and Egypt Deadlocked on Military Debt



No resolution of Cairo's repayment of its estimated $2.5 billion military debt to the USSR emerged from the Soviet-Egyptian economic talks in Cairo last week, In a week of discussions, the two sides were unable to agree on the debt's size or on whether to apply Cairo's trade surplus funds, now frozen in Moscow, to repayment. Moscow reportedly rejected out-of-hand Cairo's argument that the size of the debt ought to be reduced by the amount Egypt spent on reproducing Soviet spare parts after the arms cutoff in the mid-1970s and by the rapid depreciation of the equipment. The Egyptians told the US Embassy that the dispute is delaying implementation of the trade protocol agreed on in May. Major progress was probably not achievable; even so Cairo proved to be more uncompromising than expected. It is clearly unwilling to sacrifice on thorny economic issues for the sake of improving overall relations. When the talks resume, probably this autumn, the USSR's desire for closer ties may lead it to consider Cairo's proposal that the frozen trade surplus be used to modernize Soviet-built plants in Egypt. While Moscow may allow a small amount for this purpose, it probably will demand that most be used to liquidate the military debt. 25X1 25X1 25X1

Bolivia Gets Tough With Foreign Investors



The Siles administration's increasingly nationalistic investment policies will intensify economic problems passed on to the next government. According to US Embassy reports, the government recently canceled exploration rights for

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Shell Petroleum after it postponed oil drilling in light of current economic and political instability. Shell—the only multinational now exploring for oil in Bolivia—stands to lose its $22 million investment. In addition, the government also nationalized the 38-percent US-owned Totoral Mine, the largest tin mine in Bolivia, alleging fraudulent activities. We believe Siles's moves will worsen the economy's downward spiral. Current operations would be paralyzed as foreign managers leave and access to technology and essential imports is cut. The next administration would also find it more difficult to attract the foreign investment necessary for economic reconstruction.

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Chile Eyes New Export Promotion Measures

Santiago is considering a major export assistance program to reduce its current account deficit. Despite devaluations in March and June, depressed world demand for copper—which accounts for nearly half of export earnings—caused Finance Minister Buchi to reduce the trade surplus projection by 30 percent to $700 million. To encourage export diversification, the US Embassy reports that Santiago is proposing legislation to provide direct incentives to export industries—including a 10-percent export rebate scheme, increased export financing, and new export insurance facilities. The Pinochet government is drafting this legislation carefully to avoid violating GATT rules against export subsidies. Although Santiago advocates free market policies, we believe these proposals indicate a growing state role in directing economic activity.

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Libyan Domestic Problems Mount

An increasing number of Libyans in Tripoli are complaining about an unprecedented deterioration in living conditions. Shortages of food, water, and electricity have become a way of life as a result of spending cuts forced by the slump in oil revenues since 1981. Two people were killed recently in a melee over bananas and another person died while waiting in line for shoes, available for the first time in several months. stenciled graffiti criticizing the regime has appeared on walls near Qadhafi's residence in Tripoli. there is an emerging concensus among Libyans that Qadhafi's social experiment has failed and that change is needed. We believe that continued austerity will further erode Qadhafi's domestic support and exacerbate deep-seated regional tensions over distribution of scarce resources, a condition which heightens prospects for regime-threatening unrest.

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Mozambique Projects Grain Deficit

Maputo claims it can meet only 60 percent of its grain needs through April 1986. The lingering effects of drought—especially in the southern provinces—and the impact of insurgent activity on seed and fuel distribution has severely reduced domestic production. According to the government, local production and foreign aid will provide about 452,000 metric tons of the 750,000 tons of grain Mozambique requires to feed its 13 million people. Maputo probably will seek additional food aid from US and other foreign donors to make up the deficit.

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Chromite Deposits in Greenland

Deposits of chromite ore on the southwest coast of Greenland have been opened to development, according to Embassy reporting. Although extensive drilling and core sampling will be required to determine ore quality, a Canadian mining firm, Greenex, will soon receive a nonexclusive prospecting license for chromite and other minerals in the region. The Danish Government said it would welcome interest by US mining firms as well. If exploitable, these deposits could provide a new, more reliable source of supply for this strategic mineral. The United States presently depends on imports for about 80 percent of its chromite needs—with half coming from South Africa. Currently, South Africa and the USSR provide over 50 percent of world production, and southern Africa holds 99 percent of the world's known reserves.

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Taiwan's Trade Liberalization

Taiwan's 9 July decision to remove the import visa requirement on 3,000 products represents only a small concession in its highly publicized plan to liberalize its trade barriers. The move follows a February 1985 decision which freed some 5,000 textile and agricultural products from the same import license requirement. The impact of these moves will likely be minimal, given the extent to which remaining tariff and nontariff barriers continue to restrict imports. Taiwan's trade surplus for the first half of 1985 was about $5 billion.

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Soviet Interest in Japanese Microcomputers

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A Soviet trade organization has placed a tentative order with a Japanese company for 1 million personal computers for use in schools. An initial order, with shipment desired by September, for 7,000 to 10,000 units will be evaluated for their suitability. The USSR is also interested in obtaining TV monitors and printers but would develop its own software. The Politburo recently endorsed an ambitious computer literacy program with the long-range goal of placing 10 million computers in schools. Limitations in their own industry are forcing the Soviets to purchase foreign computers, at least initially. The computers involved are similar to the Apple II and are not under COCOM controls. A purchase of this size would be unusual, however, and Moscow may be holding out the promise of a major purchase to obtain computer production technology or plants—a gambit it has used with other Western companies.

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Soviet Contract for US Chemical Equipment

A US firm reported winning a $12 million contract to modernize a Japanese-built ethylene plant in Nizhnekamsk. The contract calls for replacement of some Japanese equipment with newer process technology, instrumentation, and controls. The plant, completed in 1976, incorporated US technology and some US equipment. The momentum generated by the recent Joint Commercial Commission meeting and the upcoming summit in November appears to have improved the commercial environment for US firms. This is the first sizable Soviet order of US chemical equipment since 1982. Moscow probably views it as a test of US commitment to expanded nonstrategic trade. The firm expects to obtain a US export license within two weeks.

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China Cuts Number of Open Cities

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Beijing had decided to cut from 14 to four the number of coastal cities opened last year under regulations favoring foreign investment. The decision probably was made at a conference held in late June of mayors of coastal cities. financial controls will be reimposed on the 10 smaller cities. Shanghai, Tianjin, Dalian, and Guangzhou will remain open cities. The decision to modify the policy, which has been closely identified with top leader Deng Xiaoping, probably was made under pressure from conservative leaders, who have increasingly criticized corruption, waste, and inefficiency in the open cities. The reduction—part of an overall retrenchment in the economy—probably represents Deng's decision to cut his losses as he prepares for a major party conference in September. Recent press articles praising the general policy of opening to the outside world and the fact that Beijing is pushing ahead with controversial wage reforms indicate that the reformers are determined to keep the basic program on track.

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China's New Japanese Commercial Credit

China has arranged to borrow $2 billion from a syndicate of Japanese banks—led by the Bank of Tokyo—to finance some of the development projects in its Seventh Five-Year Plan, 1986-90. The loans, which will carry an interest rate of only 0.25 to 0.375 percentage point over the London Interbank Rate and a 10-year repayment period, can be drawn on for the next five years. This line of credit replaces a $2 billion arrangement negotiated with Japanese commercial banks in 1979 that expired unused last month.

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The Chinese probably will continue to avoid using commercial credit lines until all available concessional financing is exhausted. They are currently seeking several billion dollars in export credits from West Germany, the United Kingdom, France, Italy, Canada, and Austria, in addition to those from Japan. The Chinese may buy as much as $50 billion worth of capital goods during the next five-year plan, of which perhaps $10 billion will be financed with long-term loans. Nevertheless, China will have no problems servicing its debt, which currently stands at only about $6 billion.

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Havana Trying To Expand Trade With Japan

a Japanese economic delegation visiting Havana has agreed to establish a joint corporation to promote bilateral trade. The corporation, to be established in Japan by mid-1987, will encourage imports of Cuban rum, frozen fruit pulp, and coffee by allowing Japanese packaging and processing. This would further Cuban attempts to increase exports to Japan through diversification of products. Bilateral trade volume has stagnated over the last two years after recovering from a sharp drop in 1982 and early 1983. Although Japanese exports to Cuba have risen, imports have declined because of decreased sugar purchases. Cuba has had difficulty meeting payment schedules for Japanese goods

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