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International Economic & Energy Weekly (U)

21 October 1988

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21 October 1988
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International
Economic & Energy Weekly (U)

21 October 1988

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Comments and queries regarding this publication are welcome. They may be directed to the editor, [redacted] *Directorate of Intelligence,* (b)(3)
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International Economic & Energy Weekly (U)

Synopsis

[redacted]

9 **France: Trade Unions Unlikely To Regain Influence** [redacted] (b)(3)

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13 **Fiji: Political Instability Undercuts Economic Growth** [redacted] (b)(3)

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17 **Sweden: Social Democrats Face New Economic Challenges** [redacted] (b)(3)

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France: Trade Unions Unlikely To Regain Influence [redacted] (b)(3)

French trade unions have increased strike activity in recent weeks to win higher wage gains and to impress on the Socialist Rocard government the need to cooperate with the unions. Nevertheless, we believe that the continued decline in union power will limit their success and will allow public- and private-sector employers to maintain the upper hand in industrial relations. As a result, wage hikes will probably remain moderate, helping the government meet one of its chief goals of keeping inflation under control. [redacted]

Labor Threatening Unrest

French trade union leaders are pressing for an end to government wage restraint and are threatening labor unrest if their demands are not met. Real wages were virtually stagnant between 1984 and 1987 while corporate profits soared, and unions hoped this year's strong economic growth will offer an opportunity to catch up. Public-sector workers have already widely publicized staged high-visibility protests, including strikes by prison guards, nurses, rail workers, and employees of the state-owned Renault automobile manufacturer. Moreover, [redacted] government officials believe the popularity of the health employees strike in September has emboldened France's largest trade union, the General Labor Confederation (CGT), and they expect considerable labor unrest in the coming months. [redacted]

Although the overt goals of labor are economic, political maneuvering is fueling much of the discontent. The CGT has coordinated its strategy with the Communist Party (PCF)—its longtime mentor [redacted] The Communist Party is probably seeking leverage with the Socialists to strike a favorable deal before next year's municipal elections, which would allow it to maintain control in some cities. [redacted]

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Government Trying To Head Off Labor

To escape pressure for large concessions during this year's wage negotiations, Rocard has taken steps since becoming Prime Minister in May to ease labor tensions. Immediately after his nomination, he emphasized the need for labor/management consultations. In August, the government announced an extra 1-percent increase in civil servants' wages, which brought this year's total wage increase to above the official 2.8-percent inflation rate. At the same time, Finance Minister Beregovoy called for private-sector wage increases to keep workers' purchasing power constant and for even larger increases by more profitable firms. Although the idea of more profitable companies granting higher wage increases is popular among workers at the plant level, national labor leaders are concerned it could reduce their power. The Rocard government has also announced it will repeal some of the Chirac government's antilabor legislation, although government officials have stressed that a "rigorous" wage policy is a mainstay of its efforts to contain inflation. [redacted]

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Labor's Decline

French labor is attempting to reverse a long-term trend of declining power caused by structural changes in the economy, waning worker interest in union representation, and tough government labor policies. According to several studies, French union membership has declined at a rate faster than in other West

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The CGT's Decline

The General Labor Confederation (CGT) has lost some of its prestige because workers apparently are identifying themselves less with a particular labor organization than with the whole labor movement. The government reports that, in 1986, 25 percent of all strikes were conducted under the banner of multiple organizations, with an additional 18 percent started by workers instead of by unions. Most French labor analysts believe this shift of focus from the federations will continue and will lead to less labor militancy. [redacted]

Although the CGT has suffered the greatest reduction in membership, it remains a dominant force in French labor relations. According to government statistics, the Communist-dominated federation accounted for almost half of all strikes in 1986, and Embassy reporting suggests that it may be responsible for 95 percent of labor-caused violence. While most French workers do not agree with the CGT's radical politics, they tend to look to the militancy of the CGT to help out when negotiations are going badly. [redacted]

European countries. Most estimates claim that 12 to 18 percent of the labor force is unionized, down from approximately 26 percent a few years ago. The primary reason for the fall in membership has been the 2-percent average annual decline in industrial employment since 1976, despite an average 2.2-percent annual economic growth. The largest falls have come in such heavily unionized, traditional industries as steel, shipbuilding, and automobiles. As in other West European countries, the services sector has experienced the most growth, but its lower unionization rate has not compensated for union losses in traditional industries. [redacted]

The center-right Chirac government reversed hard-fought union advances through legislation, but, somewhat ironically, the acceleration in union decline occurred during the years of the previous Socialist governments of the early 1980s. The unions welcomed the election of President Mitterrand in 1981, and, when deteriorating economic conditions forced the government to retreat from its free-spending policies the following year, the unions felt betrayed but were reluctant to turn against the leftist government. The unions' prestige declined further with the Chirac government's passage of three pieces of legislation that:

- Eased regulations on firing workers.
- Relaxed limits on the number of hours a person could work each week.
- Docked public-sector workers for a full day's pay even if they were on strike for only part of the day. (b)(3)

[redacted] (b)(3)

Growing worker apathy toward union representation has compounded the labor movement's woes. Most analysts point to poor turnouts in elections for representatives to the labor conciliation/arbitration courts as a clear signal that workers are becoming less interested in unions. For example, almost 55 percent of eligible workers did not vote in the election last December, compared to 41.4 percent in 1982. Growing apathy can be traced to the increasing tendency by trade union, especially Communist union, leaders to be unresponsive to the rank and file. A recent report by a French research institute asserts that the growing detachment is because organized labor receives most of its funding from the government rather than from union dues. [redacted] (b)(3)

The inability of the various union federations to work together has also added to their problems. In 1986, for example, instead of staging a united demonstration to protest job cuts and low wages, the three major federations held separate marches on the same day. We believe union leaders probably fear that cooperation with other federations could reduce their individual strength and are not likely to cooperate on many issues. [redacted] (b)(3)

The weakening of union influence has resulted in a marked drop in strike activity in recent years, with substantial benefit to the economy. Working days lost due to strikes fell from 2.3 million in 1982 to fewer than 1 million in 1987, the lowest in 20 years. The improvement in labor relations has also helped in increasing productivity and in moderating the growth in unit labor costs. [redacted]

Government To Retain Upper Hand

Because of the labor movement's weakness and its lack of institutional ties to Rocard's Socialist Party, the Rocard government will probably be able to fend off union efforts to gain significant wage increases, which bodes well for the government's efforts to contain inflation. Employers and politicians no longer automatically agree to union demands to avoid Communist-led strikes, and government officials probably realize that, if they gave in, the financial markets would begin to question the government's resolve in fighting inflation and would prompt concerns about the future value of the franc and of French international competitiveness. [redacted]

If the unions perceive that the government is having difficulty in the National Assembly, however, they may try to capitalize on its weakness with an increased agitation effort to wrest more concessions from the government. The CGT takes its cues from the Communist Party, which dislikes Rocard and would like to have him replaced. On the other hand, the CGT tries every year to agitate workers but has had little luck in recent years. Although recent strikes have received widespread publicity because they involve public facilities such as prisons, hospitals, embassies, and the Eiffel Tower, they will do little damage to the economy. In addition, the relative calm in the private sector means there is little likelihood of major economic disruptions in that area this fall. [redacted] (b)(3)

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The decline in union power has led to a slow change in industrial relations, which are now characterized by a more civilized dialogue and a reduction of the animosity between management and workers. The more democratic unions now concentrate on working with management to help employers adapt to changing technologies without needing to cut work forces significantly. The Rocard government intends to continue promoting the idea of a social contract among workers, business, and the government. [redacted] (b)(3)

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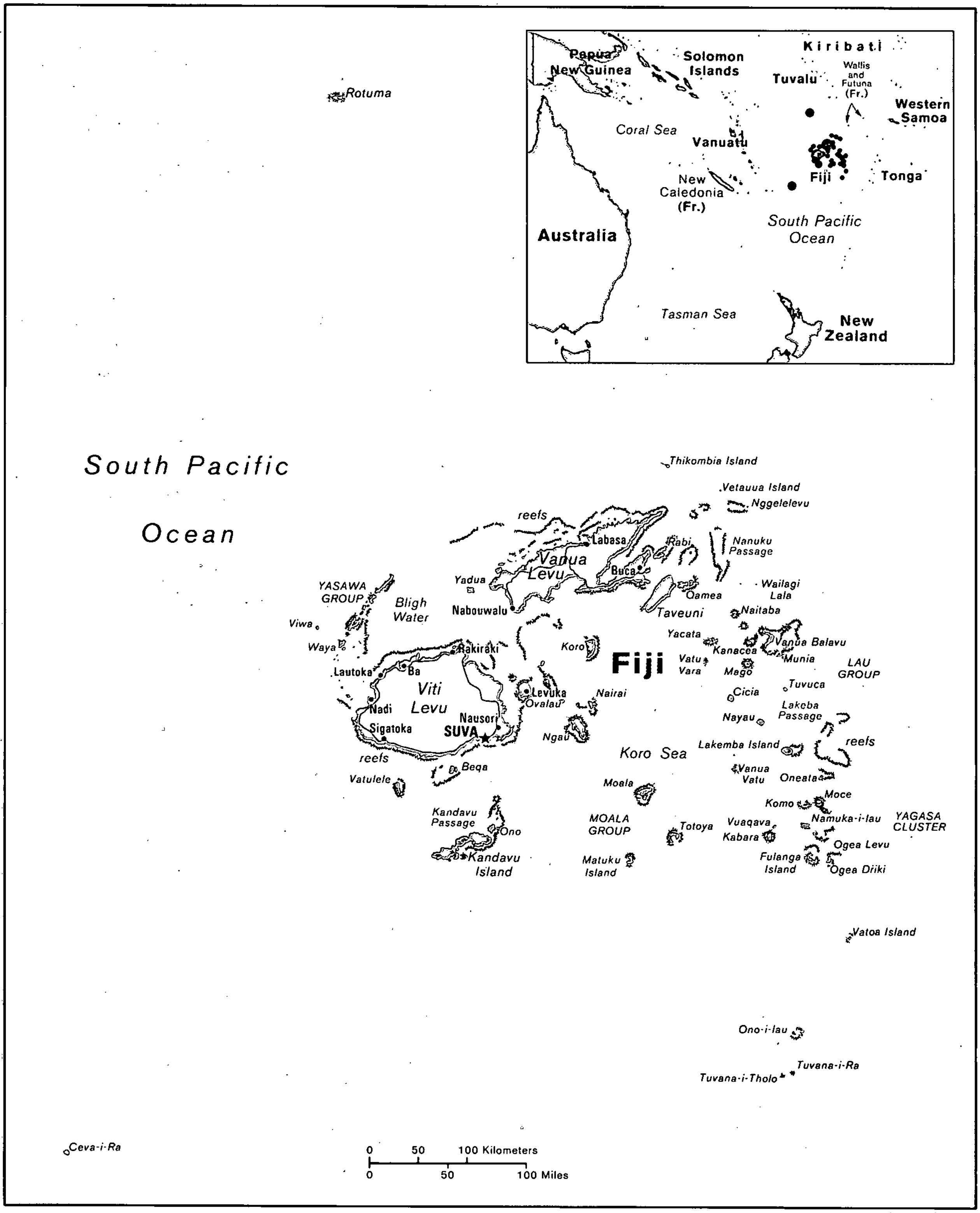

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Fiji: Political Instability Undercuts Economic Growth [redacted]

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Fiji faces a formidable challenge of restoring the political stability and economic prosperity that were shattered by two military coups in 1987. The fragile Fijian economy—dependent on sugar and tourism for the bulk of its foreign exchange—has suffered on both fronts as ethnic unrest has contributed to declining sugar production and a fall in tourism revenues. We believe that the government's inability to resolve racial tensions between the minority native Fijians and the ethnic Indian community will undercut progress toward restoring stability and stimulating economic recovery. [redacted]

A Swift Downturn

Political and racial tensions, culminating in the first military coup, brought the Fijian economy to a halt. [redacted] the heavily Indian-based middle class and service sector reduced their economic activity up to 60 percent while radical Fijians agitated against Indians, at times violently. Virtually all foreign investment and aid, mostly from Commonwealth countries, disappeared as Fiji's Commonwealth status was called into question. According to a senior US official, Fiji probably lost at least $1.5 billion in potential private foreign investment in 1987. The effects reverberated throughout the economy:

- Fiji's economy contracted by 11 percent in 1987 and could shrink an additional 6 percent this year—a sharp contrast to the record 9.1-percent growth claimed in 1986 and Suva's precoup forecast of 4- to 5-percent growth.

- Foreign exchange reserves fell sharply from $129 million in May 1987 to $86 million at the end of last year.

- Devaluation of the Fiji dollar in 1987 pushed up the price of imported goods, forcing Suva late last year to temporarily suspend all imports except food and medical supplies, according to the US Embassy.

- Inflation reached 8 percent last spring and will probably hit almost 20 percent by the end of this year. Unemployment, which had been climbing steadily since the early 1980s, probably now has risen to 16 to 20 percent, and has been accompanied by an upswing in crime. [redacted] (b)(3)

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Structural Damage

Fiji is still suffering from the blows dealt to the sugar and tourist industries. Sugar revenues, which account for 50 percent of foreign exchange earnings, shrank 30 percent in 1987 from the previous year because of sporadic racially instigated sabotage of crops and equipment, deliberate harvest delays by Indians, and an unexpected drought. The 1988 harvest has been disrupted by Indian farmers' refusal to work on Sundays despite Suva's decision that the harvest was exempt from the bans on Sunday work. According to the US Embassy, Fiji could lose up to $50 million, almost 16 percent of total exports, in export earnings this year because of the resulting inefficiencies and expensive mill startup and shutdown costs. Fiji will probably also lose revenue because drought and long-term soil exhaustion have lowered the sugar content in the cane. [redacted] (b)(3)

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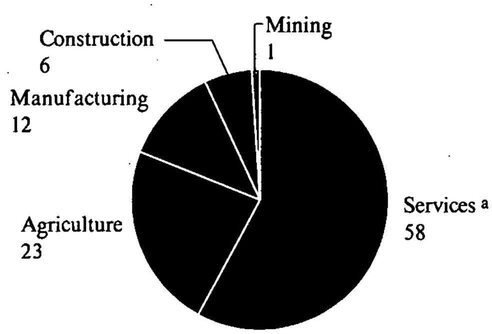
Tourism has suffered the greatest setback of all sectors in the Fijian economy. Following the coups, several major airlines canceled flights to Fiji, scuttling Suva's plans to expand the industry. Indeed, according to US officials, Suva had based its 1986-90 economic plan on a projected 11-percent expansion of

[1] This article summarizes a forthcoming Research Paper. (U)

Fiji: GDP Sector Breakdown, 1987

Percent



[a] Includes tourism.

[redacted] 319190 10-88

tourism, an industry—largely operated by foreigners—that generates substantial rental income for native Fijians, who by law own virtually all the land. Earnings from tourism were cut by nearly half in 1987 to $65 million and are expected to pick up only minimally this year. Tourists continue to stay away, discouraged by reports of violence and instability in the Australian and New Zealand press and constrained by the lack of commercial flights to Fiji. At present, the industry is operating at about 30-percent capacity, forcing employers to lay off the mostly Fijian work force. [redacted]

Brain Drain

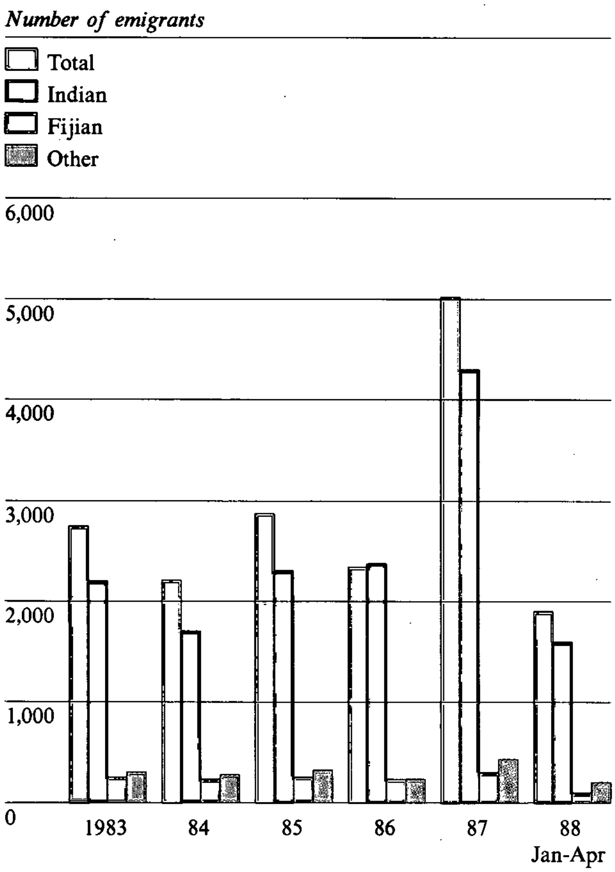
The composition and productivity of Fiji's labor market is changing because of the widespread emigration of the Indian middle class. Brought to Fiji as indentured servants under British colonial rule in the last century, Indians now dominate the service sector as well as the sugar industry, where they are mostly tenant farmers. [redacted] [redacted] many Indian lawyers, teachers, and medical personnel have left Fiji since the May 1987 coup because they are fearful of rising anti-Indian sentiment and of losing their economic holdings as well as

An Unstable Political Environment

Racial tensions between the native Fijians, 46 percent of the population, and the immigrant Indian community, 49 percent of the population, are at the crux of political instability in Fiji. The Fijian-based Alliance Party, led by Prime Minister Ratu Mara, was in power upon independence from Great Britain in 1970 until April 1987, when the Alliance Party was defeated in elections by the Indian-based Coalition Party. Immediately after the elections, rumors of the Coalition Party's intentions to change laws mandating Fijian ownership of land and the tribal system coincided with the emergence of the fiercely nationalistic Taukei Movement, which began violent agitation against Indians. Democratic institutions were subsequently suspended in May 1987, when Army Colonel Rabuka ousted the government with the publicly stated intent of reestablishing Fijian political dominance. (b)(3) *Loath to hold administrative power, however, Rabuka allowed Commonwealth Governor General Ratu Ganilau to mediate the precarious situation. Ganilau's solution—an equal power-sharing arrangement between the Coalition and Alliance Parties—was unsatisfactory to Rabuka, which led to the second coup in September 1987. This time Rabuka named Fiji a republic, appointed a strongly nationalistic governing council, and handed power over to veteran Fijian politicians in December 1987.* [redacted] (b)(3)

Over the past year, this "interim" government, led by once again Prime Minister Ratu Mara and Ganilau as President, and including Rabuka as Minister for (b)(3) *Home Affairs with responsibility for state security and Fijian interests, has repeatedly announced the drafting of a new constitution to replace the 1970 document that tied Fiji to the Commonwealth. We believe that government foot-dragging on producing a constitution is in part caused by attempts to satisfy all competing interests.* [redacted] (b)(3) *the debate is mainly over the extent of Indian political participation. Internal fighting between the civilian politicians and military leaders over the military's participation and authority in government is* (b)(3) *complicating the process.* (b)(3) *In the meantime, the interim government will continue to rule on the basis of decrees announced in early 1988 and restrictive security measures promulgated by Rabuka.* [redacted] (b)(3)

Fiji: Emigration, 1983-88



[redacted] 319189 10-88

their political status. According to the US Embassy [redacted] this brain drain has left Fiji with an alarming lack of medical and other professional services and has forced schools to close or lose their accreditation. [redacted]

The US Embassy reports that the Indian-dominated sugar industry has been hit hard by emigration. About 20 percent of the managerial staff of the Fiji Sugar Corporation—the government-owned entity that oversees all aspects of the industry—has left the country since the coups, taking with it much-needed technical skills. As a result, the corporation now has only one data-processing technician [redacted] (b)(3) Of further concern is the emigration of key members of the Fijian community, including former Reserve Bank Governor Siwatibau, who ably guided the country through the immediate economic repercussions of the May 1987 coup. [redacted] (b)(3) (b)(3)

[redacted] considerable capital flight is accompanying emigration, despite Suva's imposition of strict ceilings on amounts of money that can be taken out of the country. Although Indian emigrants are allowed to take only $2,600 out of Fiji, the government does not have the resources to identify and block the overseas movement of capital, according to a senior US official. Those Indians engaged in commerce reportedly have moved large amounts of cash to Australia, New Zealand, and Great Britain, where they have longstanding business contacts, families, and good prospects for settlement. [redacted] (b)(3) (b)(3)

Suva's Response Falling Short

Fiji's leadership, largely consumed by the competition for power and the laborious process of drafting a new constitution, is hard pressed to grapple with the country's economic problems. Efforts to resuscitate the economy have so far concentrated on bringing in new investment and foreign aid:

- Despite an austerity budget in 1988 and a 19-percent cut in government and military wages since May 1987, Suva is still scrambling to finance its over $83 million budget deficit this year. Although some of the deficit may be financed by borrowing abroad, Fiji is still considered a high risk by international commercial banks, and we are aware of only one loan offer of $20 million from the Hong Kong and Shanghai Banking Corporation. We believe that some of the 1988 deficit is likely to be financed by printing money—further boosting inflation. (b)(3) (b)(3) (b)(3)

- Suva views France, China, and Japan as the most likely new sources of foreign assistance. In early 1988, Fiji negotiated an aid package with France totaling $14 million in grants, loans, and military equipment, according to press reports. Beijing is moving ahead with a second $1.5 million hydroelectric project, while Suva is courting Japanese investment in tourism. The aid so far garnered, however, is inadequate to address the deficit problem or replace previously high levels of private foreign investment.

- In the wake of tourism's drastic downturn, Suva is seeking to diversify the economy by participating in joint ventures, boosting existing small industries, and starting up specialty industries. We believe that Suva is especially anxious to expand its fledgling mining, garment, and distilling industries, and is searching for new markets abroad, including the United States. Suva also is banking on its new policy of establishing tax-free zones around a factory or commercial area to lure joint ventures and foreign investment. [redacted]

Grim Economic Outlook

In our judgment, Fiji's economy will be kept afloat, albeit pinched, by revenues from the sugar industry as long as Fiji's contracts with British sugar buyers—who traditionally have purchased Fijian sugar at about three times more than world prices—are honored. We believe that, over the longer term, the quickly growing garment industry is likely to replace tourism as a key sector of the economy, with mining and forestry also increasing in importance. The textile industry in Fiji in the past year has become competitive with New Zealand's, according to press. Malaysia recently invested in Suva's garment industry—lured by the factory's tax-free-zone status, but we believe that the garment industry is vulnerable to further serious racial tensions. Most of the unskilled factory workers are Indians who probably do not have the resources to emigrate, but who could disrupt the industry with strikes or other agitation organized by the heavily Indian dominated trade unions. [redacted] (b)(3)

The underlying divisive racial issues that have the potential to further damage the economy through continued high emigration, violence, or noncooperation have yet to be resolved. High emigration rates, likely to continue until political stability is achieved and Indians receive a fair portion of the political pie, will undermine real progress toward economic recovery, however. Fijians, generally less educated and motivated than Indians, will be unable to fill vacant professional positions in the near term—Suva's finances will be further stretched if forced to bring in higher paid expatriate workers—and we expect a continued erosion in the quality and efficiency of services. [redacted] (b)(3) (b)(3)

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Sweden: Social Democrats Face New Economic Challenges

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Although the Social Democratic Party (SDP) will largely maintain current economic policy following the election last month, its ability to handle new economic challenges will increasingly be tested over the next several years. The Social Democrats campaigned on the theme that "Swedes never had it so good"—pointing to an export-led expansion, the lowest unemployment rate in more than a decade, lower inflation, reduced budget deficits, and an improved current account deficit. Domestically, the SDP will have to grapple with continued erosion of the "Swedish model" of labor-management relations and the resulting competitiveness of their firms. Over the next several years, Stockholm will be especially concerned about adapting to the EC's 1992 reform effort without joining the EC. Eventually, Sweden may face growing isolation from the EC, which accounts for more than one-half of its trade, if the SDP is forced to maintain its union support by slowing or even reversing implementation of EC reforms.

Dominating the Economic Agenda

The ruling Social Democrats' generally successful approach to economic policy—almost entirely attributable to the influence of Finance Minister Kjell-Olof Feldt—has bolstered the government's credibility with the business community and has enabled it to dominate economic policy debates on tax reform and privatization. The Social Democrats' industrial policies have also diminished the nonsocialists' ability to claim that their alternative policies would yield a more efficient economy. Indeed, the SDP point to an export-led expansion, the lowest unemployment rate in more than a decade, lower inflation, reduced budget deficits, and an improved current account deficit.

In the last six years, the government has pushed economic restructuring by refusing to prop up major failing industries, such as shipbuilding—which now is about one-tenth its size in the 1970s. In addition, Stockholm has quietly privatized significant portions

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Social Democrats Reelected

The Social Democrats maintained their working majority with the Left Party–Communists (VPK) following the 18 September parliamentary election. Most preelection predictions indicated that the VPK would fail to gain the 4 percent of the vote required for parliamentary representation and that the SDP would then have to turn to the Greens to secure a working majority.

Under these circumstances, a strong showing by the nonsocialists was expected to bring them back to power. The actual outcome of the vote, however, confounded these widely held expectations. The VPK won almost 6 percent of votes cast and even increased its representation by two seats, while the nonsocialist bloc—the Moderates, the Liberals, and the Center Party—lost a total of 19 seats in their worst showing in over 20 years. Most important, the SDP lost only three of its 159 seats—despite a series of recent scandals involving top Social Democrats—underscoring the firm grip that the SDP holds on Swedish political life. (b)(3)

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of the nationalized sector, which traditionally has accounted for only about 10 percent of industrial output. Since 1984 the government has sold 15 percent of PKbanken, Sweden's largest bank; all of its 30-percent stake in the electronics firm Luxor; 19 percent of the giant conglomerate Procordia; and all of its holdings in several other machinery, textile, and manufacturing firms. The SDP has not trumpeted these moves in order to avoid analogies with the efforts of British Prime Minister Thatcher and other conservative Western leaders who are anathema to many Swedes. Instead, the government has portrayed privatization as a way to free up increasingly scarce resources and maintain social programs. (b)(3)

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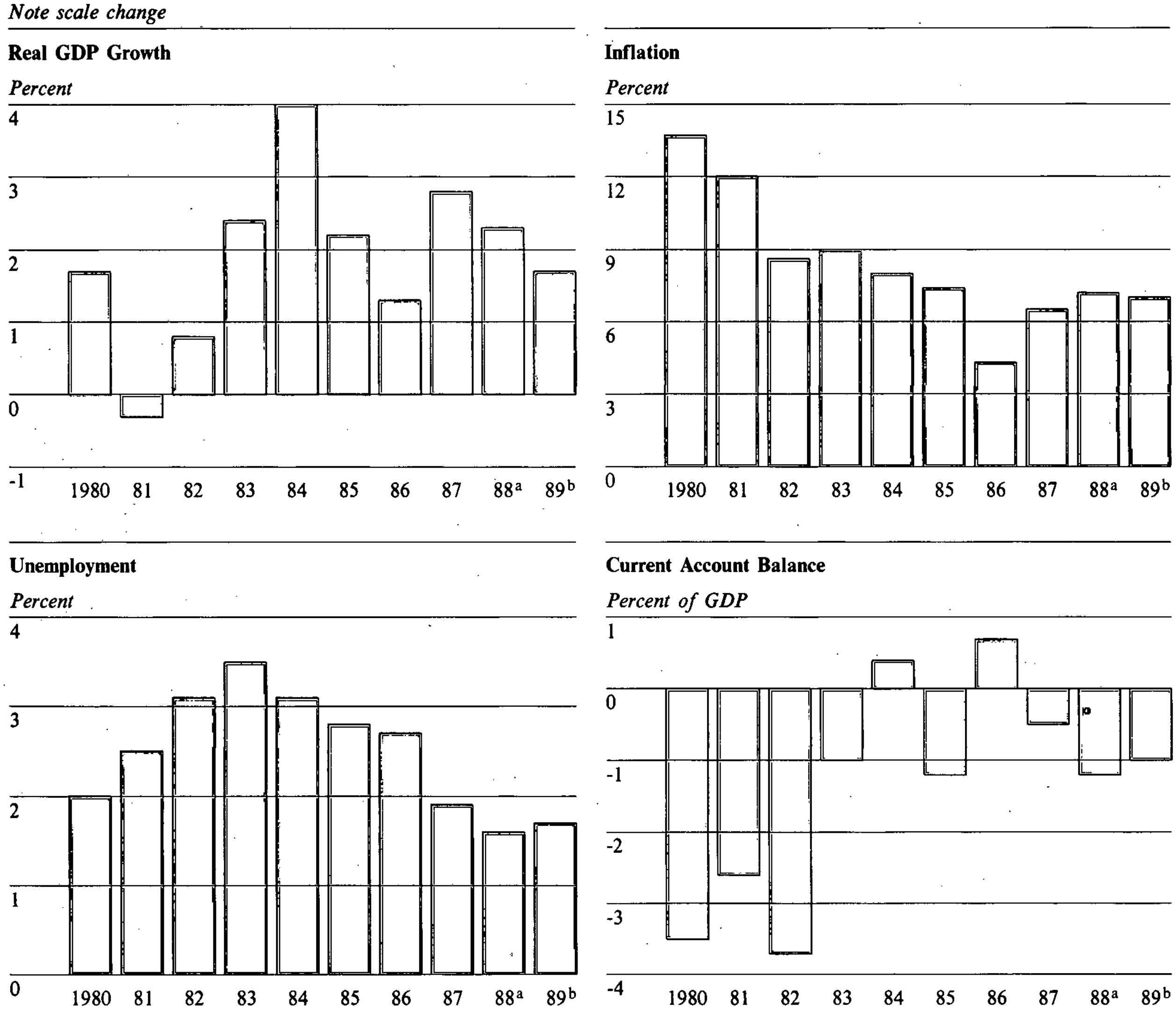
Sweden: Economic Indicators, 1980-89

Note scale change



[a] Estimated.
[b] Projected.

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Because the nonsocialists would, if in government, pursue policies that differ little from the SDP's focus on fiscal retrenchment and strengthening the private sector, their main avenue of attack has been to exploit popular discontent over Sweden's high tax rates. The Social Democrats have thwarted these efforts, however, by raising questions about whether lowering the overall tax burden would be compatible with maintaining the sacrosanct cradle-to-grave welfare state. To further ensure that opposition attempts to cut tax rates do not gain momentum, the SDP has been formulating its own plans for lowering personal tax rates—but its plans would likely raise the 23-percent value-added tax, which now provides almost 25 percent of government revenues, to offset any decline in income tax receipts. [redacted]

Doubts About the Future

Winning the election while dominating the national economic agenda has strengthened the SDP's belief that it is the only party capable of guiding Sweden through its emerging economic challenges:

- ***Economic Growth.*** Swedish policymakers remain concerned about economic growth because they believe Sweden's steady—though modest—growth in recent years mainly has been attributable to the strong US economic recovery. Consequently, they fear a potential drift toward protectionism by the United States—especially if the EC erects barriers to nonmembers—that would disrupt international trade and damage Sweden's export-driven economy. Stockholm is also concerned that continued dollar stability removes the export stimulus that the falling dollar provided. Stockholm also views the dollar's depreciation as a fortuitous event that brought the dollar's fall and pulled the krona down against the deutsche mark; Sweden's exports were helped because West Germany is its largest market and its main competitor in third markets.[1] In addition, Stockholm worries that lower oil prices, which provided Swedish industry relief from rising labor costs and sagging productivity, will again rise.

- ***International Competitiveness.*** Sweden's economic policy makers have been frustrated that their efforts to bring inflation more in line with its trading partners—including price freezes, tax incentives, and outright warnings to unions that excessive wage demands will lead to higher unemployment—have had only a modest impact. They worry that Sweden's inflation problem undermines export competitiveness and that the economy has been overreliant on the large krona devaluation in 1982 for much of its subsequent economic growth. Stockholm also is concerned that another devaluation may be necessary in the next year or two to ward off a serious economic slowdown.

- ***Erosion of the "Swedish Model."*** While the "Swedish model" of labor-management relations fostered Sweden's affluence in the 1950s and 1960s, its effectiveness increasingly has eroded in recent years. This model traditionally has been characterized by highly centralized collective bargaining negotiations with an absence of government interference. With the explicit goal of ensuring industrial competitiveness, workers and employers accepted joint responsibility for reaching wage settlements. In recent years, however, workers and employers increasingly have recognized that centralized negotiations inefficiently allocate labor. For example, the diminuition in wage differentials among workers—the so-called solidaristic wage policy that has been central to the Social Democrats' objective of equalizing incomes—has undermined incentives for workers to train for skilled positions and increasingly has fostered shortages of skilled labor. The main consequence of the breakdown of the Swedish model has been the reliance on five devaluations since 1975 to maintain industrial competitiveness.

- ***EC Internal Market Reforms.*** The government's ability to maintain consensus support for its handling of economic issues may face its severest test in adjusting to the EC's 1992 reforms. Earlier this year, the SDP and the nonsocialist parties united to pass a bill on relations with the EC that endorsed the free movement of capital and labor across

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[1] The value of the Swedish krona is tied to a basket of 12 currencies, of which the dollar is weighted 20 percent. [redacted]

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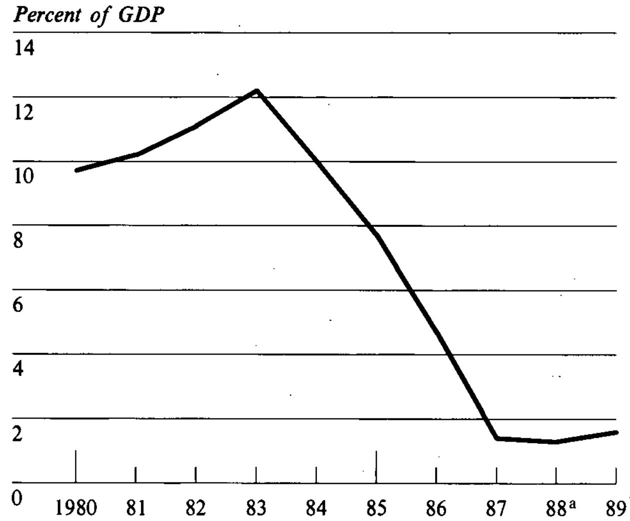
Kjell-Olof Feldt
Minister of Finance (since 1982)

Feldt is Sweden's key economic decisionmaker and a close adviser to Prime Minister Carlsson. Feldt, who has told US diplomats that philosophically he is a capitalist, successfully has fought against Social Democrats who ideologically are committed to expanding the welfare state. Indeed, he continues to restrain government spending to eliminate imbalances in the economy. Although he believes the government should maintain its monopoly in providing public services, he notes that room exists for limited deregulation. To encourage the overseas investment of surplus Swedish capital, he favors relaxing foreign exchange controls. Feldt, 57, has a doctorate in economics. He has been a member of parliament since 1971 and served as Minister of Commerce during the 1970s.

Sweden: Central Government Budget Deficit, 1980-89



[a] Estimated.
[b] Projected.

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borders. Nonetheless, because of their anxiety over neutrality, the Social Democrats have virtually ruled out Swedish membership in the EC. Sweden's business community and private-sector industrial unions, on the other hand, almost unanimously supports Swedish membership in the EC. To hedge against failure by Stockholm to secure the advantages of the EC's market-integration efforts, Swedish firms are sharply increasing their investment in the EC—either by merging with firms already there or by building new plants.

- ***"Postmaterial" Values.*** The entry of the Greens into Parliament indicates a growing preoccupation of many Swedes with "postmaterial," or quality-of-life, issues, especially the environment. A flurry of environmental initiatives launched by the SDP in the past year failed to thwart the Greens' rise, indicating a growing disenchantment with the SDP's emphasis on economic growth. This class of voters has emerged as the decline in industrial employment has been offset by expansion of public-sector employment over the last decade. As a result, more than half of all voters now depend on the state either for employment or pensions, and, according to a variety of press reports, a growing number of them view industry more as a threat to the nation's quality of life than as the source of its wealth.

(b)(3)

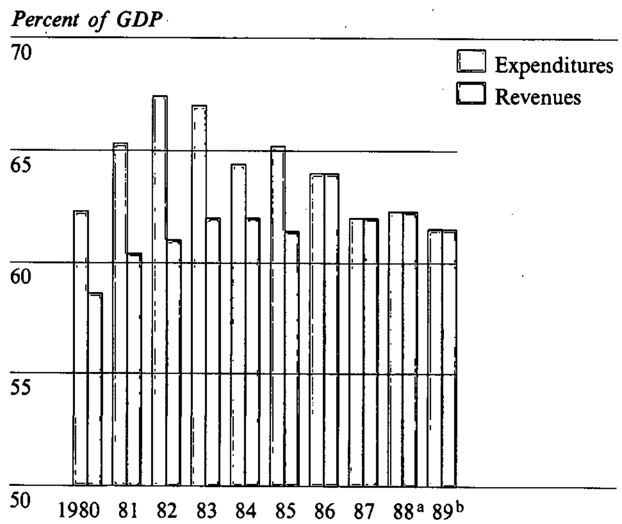
(b)(3)

Another Devaluation?

Swedish policymakers often suggest that another devaluation may be necessary, because the inflation rate remains about twice the average rate of its major trading partners. They reserve the devaluation option because of their concern that Sweden's export-driven economy would not otherwise be able to grow, since Swedish firms increasingly would be priced out of markets by the lower labor costs of almost every other economy. Although devaluation aids competitiveness, that impact is only temporary, according to our econometric analysis of Swedish data. We estimate that every 1-percent devaluation of the average (trade-weighted) exchange rate tends to raise consumer prices by about 0.2 percentage points after one quarter, and to a lesser degree thereafter. Because this higher inflation probably influences demands for higher wage increases, the total inflationary effect of devaluation is much greater. Consequently, the inflationary impact of the devaluation probably negates the positive initial effects on export prices after two or three years. [redacted] (b)(3)

Despite the continued high labor costs in Swedish industry, Stockholm has been able to avoid another devaluation because the dollar's depreciation has pulled down the krona against other European currencies. Swedish policymakers do not count on continuing to benefit from this, however, because they anticipate a stable or strengthening dollar, which would pull the krona up. We believe there is a better-than-even chance that Stockholm would then resort to a devaluation. Stockholm may not be deterred from implementing a devaluation if the EC warns that such a move would damage Sweden's efforts to maintain its ties to the EC without joining it. [redacted] (b)(3)

Sweden: Government Expenditures and Revenues, 1980-89



[a] Estimated.
[b] Projected.

[redacted] (b)(3)

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Continued Domestic Challenges

The Social Democrats may experience growing difficulty dominating the domestic economic debate over the next several years. The SDP increasingly will be at a loss over how to handle the decline of the Swedish model, particularly because it may have an adverse impact on relations with its blue-collar electoral base.

On the one hand, the Social Democrats realize that wage determination must become more market oriented for industry to remain competitive. Indeed, many Swedish firms see more flexible pay structures as a way to boost productivity and offset high domestic inflation. Some wage agreements reached this year even take into account market conditions by introducing much greater discretion for bargaining at the firm and plant level and by facilitating higher merit bonuses for skilled workers. In addition, the government will have increasing difficulty jaw-boning against the pay hikes demanded by workers in the multinational firms whose strong profits have been encouraged by SDP policies. [redacted] (b)(3)

At the same time, the SDP cannot politically afford to acquiesce in increased decentralization of wage talks. The Federation of Swedish Trade Unions (LO)—a key player in SDP politics—now claims that wages are rising too fast. Whereas the government is focused on the impact on export competitiveness, the LO is concerned that the spread of decentralized wage agreements will loosen its grip on labor unions and diminish its political clout. Both the SDP and the LO probably worry that decentralization will spread and increasingly inject self-interest into wage negotiations, which, to the extent it replaces workers' interest in the "solidaristic" wage policy, will weaken a mainstay of Swedish social democracy. [redacted]

The Emerging EC Question

We believe the economic agenda will be challenged equally by the EC's internal market reforms. Stockholm, for example, may not be willing to harmonize its taxation—especially the VAT—with the EC's because reducing the VAT to the 14- to 18-percent rate planned by the EC would force Stockholm to sharply raise either personal or corporate taxes to maintain the welfare state. Moreover, while businesses are determined to adapt to the EC, they are suspicious that the SDP will remain committed to full liberalization of capital movements. Businessmen anticipate that current movement toward financial liberalization will result in a sharp increase in mergers and takeovers of Swedish firms, both by domestic and foreign owners. As a result, the unions have already lobbied the SDP to clamp down on such activity. Swedish businesses also realize that the Swedish market has a long way to go before foreign financial institutions can expect reciprocal treatment, and they worry that this could jeopardize their access to the EC. In addition, the business community points to the SDP's imposition earlier this year of a tax on stock and bond transactions—which drove away most foreign bond and equity business to London—as evidence of the SDP's antiliberalization attitude. More important, it was indicative of the influence that labor unions exert on economic policy, since the proponents of the tax were unions that were angered by the high "antisocial democratic" incomes of brokers and traders. [redacted] (b)(3)

Despite the apparent parliamentary consensus to implement the same reforms as the EC, we believe Stockholm may balk at full implementation. For example, Stockholm now views free movement of labor as acceptable because of its current labor shortages. Although immigrants generally have been accepted because they assimilate quietly into Sweden's society, many Swedes are growing resentful of foreign workers. If a new wave of immigration brings workers who are less malleable, growing public demands to limit such an influx would emerge. [redacted] (b)(3)

(b)(3)

In the long run, the SDP will probably increasingly have to appease the unions to offset the erosion of the Swedish model and the resulting decline in government influence over workers. Although industrial unions acknowledge that firms must invest abroad to have access to export markets, their acceptance of overseas investment will diminish if they perceive that it "exports jobs." Consequently, the SDP might take actions to bolster its standing with the unions—such as slowing financial liberalization or other reforms intended to adapt Sweden to the EC—which would undermine business confidence in the Social Democrats. [redacted] (b)(3)

[redacted] (b)(3)

Saudi Arabia: Learning To Live With Less

(b)(3)

Slack oil market conditions will constrain economic growth prospects in Saudi Arabia for the next several years, but Riyadh's substantial financial resources should allow the regime to cover most current financial shortfalls. At the same time, planned domestic and possibly international borrowing will enable the government to cope with budget and foreign payment strains. Nonetheless, the regional slowdown increases pressure on the King to spread the burden of austerity more equitably or risk the growth of discontent among the business community, students, and conservative religious quarters of society.

(b)(3)

Adjusting to Slower Growth

Saudi Arabia has yet to fully recover from the slump in oil prices. As a result of reduced revenues, real GDP, which declined by an annual average 3.8 percent in the 1982-86 period, fell by 3 percent last year. Oil revenues have fallen $40 billion since 1982, while foreign financial assets declined to $50 billion from a peak of $140 billion in 1981.

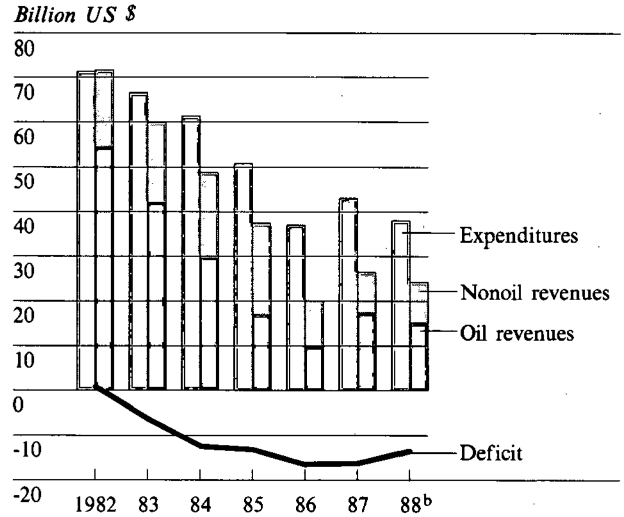
(b)(3)

Even though Saudi Arabia has sought to diversify its economy, other sectors have not compensated for the slowdown in the oil sector. Bad loans to LDCs and to Saudi citizens by domestic banks, weak worldwide demand for petrochemicals, and high agriculture production costs have frustrated growth of these important sectors:

- Although most domestic commercial banks will probably show a profit this year, they continue to be reluctant to fill the borrowing gap left by the slowdown in government credit extended to the private sector.
- Nonoil exports, such as fertilizers and plastics, have leveled off at about $2.8 billion despite Saudi Arabia's excess petrochemical production capacity.
- The government continues to heavily subsidize agriculture, resulting in a growing surplus of wheat that costs $800 per metric ton to produce.

(b)(3)

Saudi Arabia: Budget Trends, 1982-88 [a]



[a] Fiscal years. The 1982-86 Saudi fiscal year was based on the Islamic year. As of 1 January 1987, the fiscal year will coincide with the calendar year.
[b] Projected. Does not include proceeds from domestic bond issue.

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The adjustment process for the government and the population has been difficult because both have grown accustomed to surplus wealth. The government has increasingly relied on its financial reserves—primarily foreign assets—to maintain subsidies and development programs. To cope with slower growth and the outflow of funds, Riyadh has introduced an expanding list of belt-tightening measures:

- Government expenditures on social and economic development programs have been scaled back. New projects, including additional refining plants, have

Saudi Arabia: Current Account Balance, 1982-88

Billion US $

	1982	1983	1984	1985	1986	1987	1988 [a]
Current account balance	**7.6**	**−17.1**	**−18.4**	**−12.9**	**−11.9**	**−9.6**	**−9.6**
Trade balance	39.4	12.4	8.9	7.0	3.4	5.3	6.2
Exports, f.o.b.	73.9	45.7	37.4	27.4	20.0	23.1	24.7
Oil	72.9	44.7	36.1	25.8	18.0	20.4	21.9
Nonoil	1.0	1.0	1.3	1.6	2.0	2.8	2.8
Imports, f.o.b.	34.4	33.2	28.6	20.4	16.6	17.8	18.5
Net services	−22.1	−20.3	−18.4	−11.5	−7.5	−6.7	−7.6
Investment income	14.1	15.9	13.4	12.4	11.3	10.5	10.0
Freight and insurance	−6.2	−6.0	−5.1	−3.3	−2.5	−2.8	−2.9
Other	−30.0	−30.2	−26.6	−20.6	−16.3	−14.4	−14.7
Net private transfers	−5.4	−5.2	−5.3	−5.2	−4.8	−4.9	−5.0
Net official transfers	−4.4	−4.0	−3.6	−3.3	−3.0	−3.3	−3.3

[a] Projected.

[redacted] (b)(3)

been delayed or canceled and ongoing projects slowed to ease the burden on the budget. Moreover, government financial infusions into public credit institutions—a primary engine of growth in the past—have been substantially reduced.

- Wages of foreign workers have been sharply cut back. Nevertheless, foreign labor still costs the economy $11.3 billion annually with up to 60 percent remitted to home countries, according to the US Embassy in Riyadh.

- Official foreign aid disbursements of $4.3 billion last year were down one-third from the 1982 level.

Although import spending in current dollars has been flat since 1985, Saudi Arabia purchased fewer goods and services because of the depreciation of the dollar, to which the riyal is closely tied. [redacted]

The Budget Dilemma

Despite these measures, reducing the budget deficit remains a formidable task. After registering substantial surpluses in the early 1980s, the budget recorded a deficit that reached 23 percent of GDP last year. We project that government cost-cutting programs will help hold the deficit to $14 billion—20 percent of GDP—this year. Moreover, new government initiatives, including debt financing of the deficit and subsidy reduction programs, will slow the need to draw down remaining financial reserves. Although a new bond program has not elicited the level of support anticipated, the US Embassy believes that the program will probably generate $6.2 billion in revenues this year, reducing the drain on financial reserves to about $8 billion. Riyadh has moved swiftly, albeit cautiously, to remove obstacles to further bond sales by approving secondary trading of the bonds and by expanding sales to the general public over the objection of religious leaders. The government is also considering raising the interest rate paid on the bonds to encourage additional sales to domestic banks. [redacted] (b)(3)

(b)(3)

Defense spending remains a priority, despite the Iran-Iraq cease-fire. Although the dollar cost of Saudi Arabia's defense program has declined, it has continued to increase as a share of the budget—25.8 percent of planned expenditures this year. This figure, however, probably does not include the cost of large

Riyadh's "Hardline Oil Policy"

Riyadh's revenue crunch has caused the King to take a harder line with other oil producers to gain cooperation on petroleum production levels. [redacted]

deliveries of equipment or provisions for new arms agreements, such as the purchase of new Tornado fighter aircraft that could reach $20 billion. [redacted]

Limited Growth Prospects

Saudis are generally optimistic that the end of hostilities between Iran and Iraq will contribute to domestic economic recovery, although the benefits may be illusory. Many believe that the large aid disbursements of about $1.5-2.0 billion annually to Iraq will end and that the freed funds would be used to stimulate the Saudi economy. The Saudis are also optimistic that substantial business opportunities are likely to be generated by reconstruction in Iran and Iraq, according to US Embassy reporting. Despite this optimism, the war's end may have more negative consequences for the economy. Increased oil production by Iraq to support reconstruction—perhaps up to double their current level—will most likely put further downward pressure on oil prices. Moreover, aid to Iraq may have to be continued, albeit at reduced levels, to ensure Baghdad's cooperation on OPEC production quotas. Iran also is likely to demand reconstruction assistance that will have to be partially funded by the Gulf states. [redacted] (b)(3)

We believe that growth prospects for Saudi Arabia—despite government fiscal measures—will remain limited during the next several years. [redacted] the Embassy says that many ministers expect additional cuts in project financing, subsidies, and imports, as well as new taxes while the government attempts to control budget deficits and the drawdown of financial resources. A devaluation of the riyal also has been rumored and may be used to help trim domestic demand. The national debt burden is low, which allows considerable latitude for domestic and foreign borrowing. The government appears committed to the bond program and to the development of domestic capital markets, and it will probably increase the interest rate paid on domestic bonds—currently about half a percentage point above US Treasury rates—to stimulate demand, [redacted] (b)(3) (b)(1) (b)(3) (b)(1) (b)(3) (b)(3)

Continued austerity would almost certainly heighten religious and public disgruntlement about the regime's management of the economy. Bad loans and the need for government borrowing have raised concerns among the religious establishment about the payment of interest and the Islamic legitimacy of the regime's economic policies. [redacted] Although unemployment is not officially recognized, a continued recession will mean fewer suitable jobs for Saudi youth accustomed to the belief that a college education entitles them to a managerial position. We believe these expressions of discontent, however, do not represent a serious near-term threat to the regime. [redacted] (b)(3) (b)(3) (b)(3) (b)(3) (b)(1) (b)(3)

[redacted] (b)(3)

International Financial Situation: Update on LDC Debt [redacted]

(b)(3)

Developments this week focus on Brazil, Mexico, Argentina, and the Philippines:

- ***Brazilian*** officials have publicly acknowledged that they will need to request a waiver or revision of economic performance targets from the IMF by yearend. Brasilia already missed several targets set for 30 September, thus delaying disbursement of part of the IMF standby loan, and is certain to overshoot the inflation and nominal budget deficit goals set for 31 December. Brasilia projects that inflation will rise at least 900 percent this year, sharply higher than the 600 percent agreed to with the Fund in June. In addition, the nominal budget deficit, equivalent to the public sector's borrowing requirements—which includes interest payments on the domestic debt adjusted for inflation—is likely to reach 45 to 50 percent of GDP this year, rather than the 40 percent in Brazil's IMF program. Finance Minister Nobrega claims that he is still on track to meet the (b)(3) operational budget deficit—which excludes inflation adjustments—set at 4 percent of GDP. Higher-than-expected inflation, however, will push up government payroll expenditures, given automatic cost-of-living adjustments. [redacted]

- ***Mexican*** policymakers, considering a return to minidevaluations and ways to further cut the budget, have been seeking new money to offset the drop in world oil prices. Washington has agreed to provide up to $3.5 billion in a bridge loan while Mexico City negotiates for fresh funds, including $1.5 billion from the World Bank with additional cofinancing from Japan. Mexican President de la Madrid on 16 October announced a four-part plan to offset falling oil prices. The measures include a $260 million spending cut, the authorized sale of 50 state-owned companies valued at $310 million, a more restrictive monetary policy, and additional external financing. The spending cuts will be applied to the industrial sector and not to social programs. President-elect Salinas has announced his decision to extend the Economic Solidarity Pact—which includes a freeze on prices, wages, and exchange rates—through the end of December. After the freeze expires, however, [redacted] economic planners may (b)(3) reimplement monthly minidevaluations to keep exports competitive and help stem capital flight. [redacted] (b)(3)

- ***Argentina*** has reportedly agreed to pay commercial creditors $100 million out of the approximately $1.3 billion it owes in interest arrears. The payment will pave the way for formal negotiations with Argentina's Bank Advisory Committee (BAC), which could begin 19 October. Buenos Aires has informed the BAC that it requires about $3.6 billion in new financing during 1988-89, [redacted] (b)(3) Argentina's offer may be an attempt to lend the (b)(3) appearance of interest in immediate negotiations, when in reality it wants to forestall serious discussions until after the May 1989 presidential election. [redacted] (b)(3)

Key LDC Debtors:
Economic/Financial Indicators

Country/ Foreign Debt *(yearend 1987 in billion US $)*	**Exchange Rate** *(currency per US $)*	**Months of Import Coverage by Reserves**	**Other Indicators**
Brazil 113	401.68 (18 Oct) 115.54 (Mar 88)	3.5 (Jun 88) [a] 3.3 (Mar 88)	Brazil's trade surplus was $1.9 billion for September and $14.5 billion year-to-date.
Mexico 103	2,290 (18 Oct) [b] 2,270 (Mar 88)	11.2 (Jun 88) [c] 13.6 (Mar 88)	Bank of Mexico reported consumer prices were up 0.6 percent in September, bringing cumulative inflation for the last nine months to 45.5 percent.
Argentina 55	14.97 (18 Oct) 5.045 (Mar 88)	2.4 (Jul 88) [d] 2.0 (Dec 87)	After an agreement between government and business to restrain prices went into effect, consumer price inflation slowed to 11.7 percent during September.
Indonesia 49	1,705 (18 Oct) 1,660 (Mar 88)	4.3 (Jun 88) [c] 5.6 (Dec 87)	Indonesia crude was being discounted by more than $4 per barrel in early October, relative to an official government selling price of $17.5.
Egypt 39	2.303 (18 Oct) [e] 2.235 (Mar 88)	2.1 (May 88) [a f] 1.4 (Jan 88)	Food prices increased at an annual rate of 30 percent during September, according to US Embassy estimates.
Nigeria 37	4.66 (27 Sep) 4.3 (Mar 88)	2.3 (Feb 88) [a] 2.0 (Oct 87)	Leading newspapers carried articles reporting a large drop in food prices, due to increased supplies from an excellent harvest, according to US Embassy reports.
Venezuela 37	37.31 (18 Oct) 29.25 (Mar 88)	5.8 (Apr 88) [a] 6.8 (Dec 87)	The Central Bank estimates operating reserves were $2.4 billion at end September, representing a $100 million increase compared to end August.
Philippines 27	21.35 (18 Oct) 21.03 (Mar 88)	2.1 (May 88) [c] 1.9 (Mar 88)	Consumer price rises slowed to 7.6 percent for the 12 months ending September, compared to 8.6 percent ending August. Gross international reserves rose from $1.62 billion to $1.66 billion during August, the first increase since April.
Chile 20	246.64 (18 Oct) 244.60 (Mar 88)	9.6 (Feb 88) [c f] 8.0 (Dec 87)	Consumer prices increased 0.9 percent in September, bringing inflation to 6.9 percent for the first nine months of 1988. Open unemployment edged down to 9.0 percent.
Peru 16	471.0 (18 Oct) 33.0 (Mar 88)	3.9 (Feb 88) [c f] 4.7 (Dec 87)	Hyperinflation appears to have set in, and price increases could average 40 percent a month for the remainder of 1988, according to US Embassy reports.

[a] Ratio of foreign exchange to imports.
[b] Controlled rate.
[c] Ratio of gross reserves, minus gold, to imports.
[d] Ratio of net reserves, minus gold, to imports.
[e] Commercial bank rate.
[f] Estimate.

(b)(3)

Status of Debtor-Creditor Relations	Domestic Political Scene
Incorporating money-losing nuclear plants into the state-owned electric company will delay the World Bank's disbursement of a $500 million power sector loan and the second tranche of $600 million from commercial creditors.	With October inflation expected to jump to 27 percent, Brasilia may implement another wage and price freeze in the near future, which may result in Finance Minister Nobrega's resignation.
Canadian banks have been liquidating their Mexican Government loans on the secondary market since July 1988, pushing the value of Mexican debt down to 47 percent of face value. [redacted]	Following the ruling party's sweep of local elections in Veracruz in early October, the government announced its intentions to begin loading fuel at the Laguna Verde nuclear plant; ecological groups have mounted ineffectual protests. (b)(3)
The World Bank's Board of Directors will meet next week to consider a package of loans worth $1.25 billion for Argentina.	The government and business organizations have agreed on an objective of 4-percent monthly inflation for November 1988 to March 1989, which will be achieved by "administering" prices for leading companies.
New declines in oil revenues are increasing strains on Jakarta's already austere budget for fiscal year 1988/89. If low prices persist, as industry experts expect, debt service obligations will become even more burdensome.	Official rice stocks are low and Jakarta may be forced to import rice for the first time since 1983. [redacted] (b)(3) (b)(1)
The IMF appears intent on obtaining more serious action by the Egyptians on making reforms than it did in 1987; Cairo apparently assumes it can win donor support for another soft program, according to the US Embassy.	President Mubarak announced on 20 September that the government would not pay public employees the bonus customarily made at the start of the school year, sparking nonviolent protests.
Nigeria's arrears on foreign debt obligations have continued to mount in the first half of 1988 despite payments of $1.1 billion; debt service payments absorbed 38 percent of foreign exchange inflows.	President Babangida said there will soon be a cabinet reshuffle, affecting primarily civilian ministers involved in economic matters. Finance Minister Okongwu and Petroleum Resources Minister Alhaji Lukman appear vulnerable.
Finance Minister Hurtado again denied that Caracas would unilaterally suspend debt repayments and ruled out any new economic adjustment measures before the presidential election on 4 December.	Democratic Action Party leaders urged President Lusinichi to provide political and financial support to Carlos Andres Perez as a sign of party unity, but with little success, [redacted] (b)(3)
In early October, Philippine commercial creditors decided to wait for Manila to complete a new financing deal with the IMF before reconvening talks, according to press reports.	Manila accepted a compensation package for the US military bases, but many Philippine politicians are frustrated at settling on US terms. The Philippines will receive $481 million annually in 1990-91.
Despite political pressures in the wake of President Pinochet's plebiscite defeat on 5 October, the Central Bank still plans to use $200 million in exchange reserves to buy down Santiago's foreign debt.	The Chilean Government and opposition groups are now carefully weighing alternative political strategies as they prepare for direct presidential and congressional elections to be held by late 1989.
Finance Minister Salinas claimed to have lined up about $650 million in foreign assistance. The French and Spanish Embassies in Peru are surprised by Salinas' remarks about credits from their countries.	Agriculture Minister Morales Bermudez resigned in October; he is the third ally of President Garcia to be forced out under pressure from the ruling party since mid-September, according to US Embassy reporting.

- ***Philippine*** Central Bank Governor Fernandez and Finance Secretary Jayme failed to reach an agreement earlier this month with commercial creditors on Manila's request for $1.7 billion in new loans and rescheduling of payments on existing debts. [redacted] (b)(3) (b)(1)

  Bankers speculated to the US Embassy that when discussions resume, probably next year, they would most likely agree to lend the Philippines new money, although substantially less than Manila is seeking. Reducing the foreign debt burden is assuming increasing importance in Manila and even Finance Secretary Jayme, generally considered a pragmatist on debt issues, announced this week that the Philippines cannot sustain its economic growth without meaningful debt relief. [redacted] (b)(3)

[redacted] (b)(3)

Briefs

Energy

Venezuela Buying US Refining and Marketing Assets

[redacted]

Venezuela's national oil company, PdVSA, is reportedly very close to reaching a joint-venture agreement with Unocal Corp. that would give PdVSA a 50-percent interest in Unocal's 151,000 b/d Illinois refinery and in its Midwest gasoline marketing network. The Unocal deal would be Venezuela's third US refining venture and would give PdVSA partial ownership for the first time of a chain of US gasoline stations. Last week, PdVSA announced it would acquire the remaining 50-percent interest of a 160,000 b/d refinery in Corpus Christi, Texas, from its joint-venture partner Champlin Petroleum Co. Venezuela's recent efforts to acquire additional stable, long-term outlets for its crude oil in the United States represent a significant step toward attaining the goal of owning 700,000 b/d of overseas refining capacity by 1990. The completion of the Unocal deal would increase PdVSA's US refining capacity by 70 percent to about 400,000 b/d and would allow PdVSA to place approximately 600,000 b/d of its crude in overseas refineries. The national oil company's latest moves—including its recently aborted attempt to acquire a Tenneco refinery in Louisiana—most likely have been accelerated by expectations that the probable winner of the country's 5 December presidential election will oppose further oil investments in foreign refineries. [redacted]

(b)(3)

(b)(3)

[redacted]

(b)(3)
(b)(1)
(b)(3)

New Congo Oil Discovery

[redacted]

A significant oil discovery in July will allow Congo to increase domestic investment spending despite the likely loss of "the least developed nation" status from Western creditors. [redacted]

(b)(3)
(b)(1)

~~Secret~~

[redacted] The find places Congo only behind Nigeria and Angola in oil reserves in Sub-Saharan Africa and could more than double Congolese output. Brazzaville announced, however, that the new find was flowing at only 3,000 barrels a day—half the actual figure—probably to obtain additional concessions from creditors and continue receiving international assistance. In addition, Congo recently received a $50 million loan from France, probably an attempt by Paris to maintain influence with Brazzaville in the wake of the oil discovery by a non-French firm. Brazzaville is likely to utilize the new revenue to resume projects previously canceled as part of an IMF-sponsored austerity program. [redacted] (b)(3) (b)(1) (b)(3)

Nigerian Oil Production Increasing

[redacted]

Nigeria recently increased oil production to about 1.5 million b/d, in excess of its OPEC quota of 1.3 million. Lagos also may soon replace Oil Minister Rilwanu Lukman, [redacted] who has served as President of OPEC since 1986 and who has insisted that Nigeria should adhere to its OPEC quota. Nigeria, which depends on petroleum exports for 95 percent of its foreign exchange, saw oil revenues drop last year to $6.7 billion—barely half its 1985 level—because of lower oil prices. The government clearly hopes to improve export revenues, but will be hard pressed to increase production much further because of technical problems. While in theory, productive capacity could theoretically reach 1.8 million b/d, major maintenance work would be required to produce at that level for a sustained period, according to US Embassy reporting. Notwithstanding increased oil production, Lagos will have to continue looking for alternative sources of income to replace declining oil revenues and improve its faltering economy. [redacted] (b)(3) (b)(3) (b)(3)

Abu Dhabi Oil Investments

[redacted]

Abu Dhabi's investment in foreign oil industries has not been deterred by the United Kingdom's recent decision to limit Kuwaiti participation in British Petroleum. An official of the Abu Dhabi Ministry of Finance has stated that the British decision should not cause the Gulf states to worry, although he did call for greater coordination of investment decisions between Gulf Cooperation Council states to strengthen their negotiating power with foreign governments. Moreover, Abu Dhabi will probably continue to seek profitable investments in those countries whose rules and regulations permit such participation, according to the US Embassy. The Abu Dhabi International Petroleum Investments Corporation purchased 10 percent of the Spanish petroleum company, CEPSA, earlier this year and reportedly is considering other investments in Western Europe, especially in the Italian oil sector. [redacted] (b)(3) (b)(3)

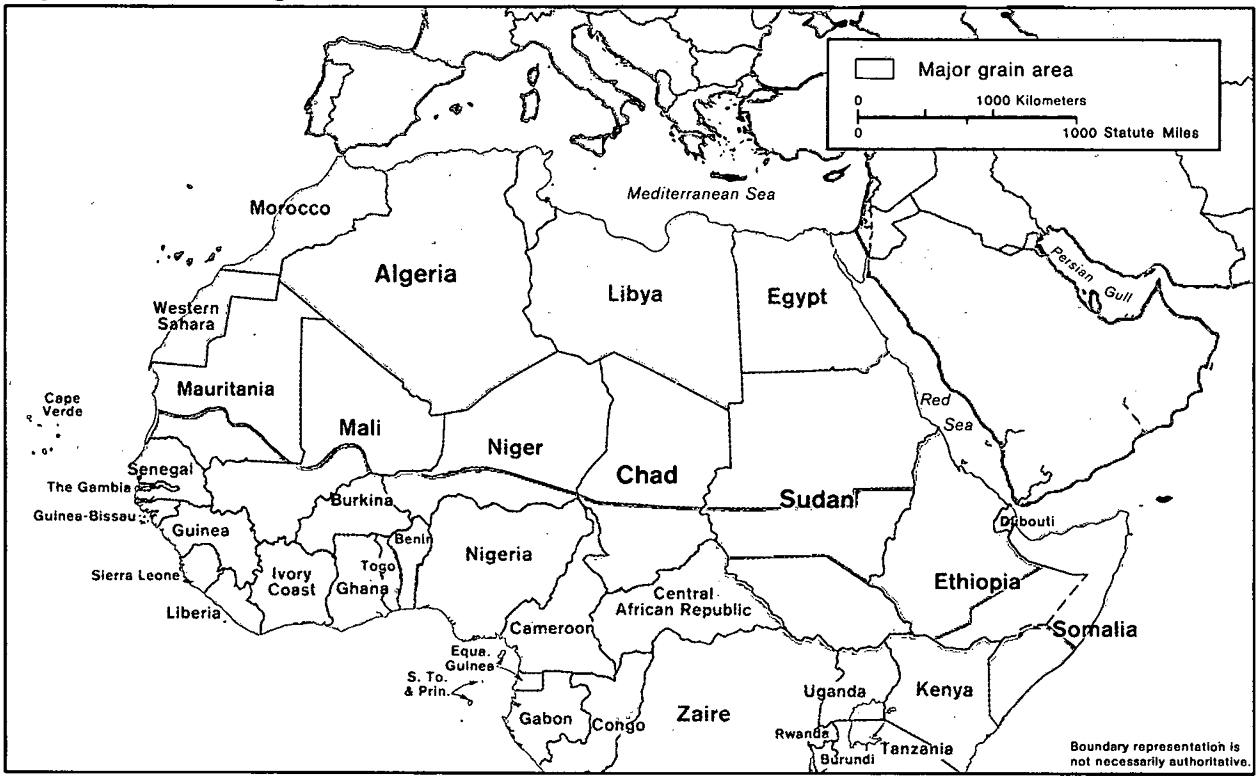
Global and Regional Developments

Grain Shortfalls Likely in the Sahel and the Horn

[redacted]

Grain production shortfalls are likely again this year for countries of the Sahel and the Horn of Africa. Near- or above-normal rainfall has occurred in most countries of the region, but heavy rains in August and September caused severe flooding in a (b)(3)

Major Grain-Producing Areas in the Sahel and the Horn of Africa



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band from Mali to Ethiopia; Sudan and Chad were hit hardest. Loss of life was extensive, homes were destroyed, and farmlands flooded. Additional crop damage is likely because concentrations of grasshoppers and desert locusts are the heaviest since the 1950s. According to reports from the UN Food and Agriculture Organization, crop loss from insects may reach 30 percent in some countries; requirements for insect control assistance may total $150 million. Precipitation patterns suggest regional grain production this year will amount to 15.3 million metric tons. Because carryover stocks are essentially nil, imports of 1.4 million tons will be necessary just to maintain per capita grain consumption at current low levels. Continuing food supply problems will encourage further migration to already overcrowded cities, placing more pressure on inadequate housing and food distribution systems. And, as land is abandoned, severe soil erosion and insect damage will hasten the decline of food production in years to come. (b)(3)

Australia and New Zealand Vie for Soviet Fishing Deal

Australia and New Zealand apparently are competing to forge trade deals with Moscow in return for providing the Soviet Union with a service facility for its South Pacific fishing fleet and Aeroflot landing rights to rotate fishing crews. Australia has already started negotiations with Moscow to link a service- and landing-rights agreement to a long-term trade deal, according to press reports. The agreement would provide for substantial Soviet purchases of Australian commodities, especially wool, wheat, and minerals. At present the Soviet Union is (b)(3)

Australia's 13th most important trade partner, buying about $600 million worth of commodities in 1987. Wellington, in the meantime, is scrambling to forge a similar arrangement with an eye on the $50-100 million and 2,000 new jobs that it estimates a ship-service facility would generate. Wellington has yet to set any financial conditions for the deal, but the US Embassy reports that Prime Minister Lange may limit any Soviet fishing operation to a relatively remote and easily monitored area of the country. We believe that Canberra is also mindful of the security risks and probably favors confining the Soviets to its smaller ports of Adelaide or Hobart. [redacted] (b)(3)

(b)(3)
(b)(1)

[redacted]

Japan Provides Export Insurance to Soviet Union

[redacted]

Tokyo's decision to provide insurance to Japanese firms investing in the Soviet Union will probably boost Japanese interest in participating in Soviet joint ventures. According to Embassy reporting, Trade Ministry officials recently approved the first application for insurance coverage of a Japanese-Soviet joint venture—a fish processing plant in Khaborovsk. The insurance—by covering losses due to war, expropriation, civil disturbance, and remittance problems—will reduce the risk of investing in the Soviet Union. In addition, Japanese firms will probably view the approval as Tokyo's consent to doing business with the Soviets. Despite Moscow's hope of garnering technology from prospective Japanese investors, however, we believe the insurance coverage will probably attract only small firms involved in resource exploitation. Japan's high-tech companies remain wary of investing in the Soviet Union, largely because of the lack of skilled workers, transportation bottlenecks, and technology transfer concerns, particularly in the wake of the Toshiba sanctions. [redacted]

(b)(3)
(b)(3)

Japan-China Synthetic Fuel Project

[redacted]

Japan and China have reportedly agreed to jointly develop and commercialize a low-pollution synthetic fuel made of coal powder, water, and additives. Under the agreement, Japanese firms will transfer coal-water mixture (CWM) technology to China and import the fuel into Japan. Plans for the joint venture include constructing a $23 million experimental plant next year in Shandong Province and, if that proves successful, building by 1993 the world's largest commercial CWM

(b)(3)

plant, capable of producing 5 million metric tons of fuel annually. Japan's MITI—which has funded CWM research since the 1970s—predicts domestic demand for CWM will grow rapidly in the 1990s, when many public utilities will replace existing boiler plants. For its part, Beijing will gain technology to produce an alternative to burning coal, currently accounting for about two-thirds of its total energy consumption and the major source of air pollution. Nevertheless, we believe the project will probably be delayed because of bureaucratic redtape, the need to train workers, and infrastructural inadequacies in China. [redacted] (b)(3)

Thai-Lao Trade Prospects Improving

[redacted]

Recent Thai Government statements, including Prime Minister Chatchai's remark that Indochina should be an economic market rather than a battlefield, are likely to stimulate sharp increases in trade with Laos. Bilateral trade—consisting primarily of Lao electricity in exchange for Thai consumer goods—increased 82 (b)(3) percent during the first half of 1988 to $27 million despite the border fighting at Ban Rom Klao. The Bank of Thailand predicts that second-half statistics could show even greater improvement. Pressure from ASEAN to honor the trade embargo imposed on Vietnam may have played a role in Chatchai's acceptance earlier this month of a Thai National Security Council recommendation to pursue trade with Laos and not Vietnam, [redacted] Bangkok (b)(3) apparently also hopes that its economic initiative will help move Laos away from Vietnam's political dominance. [redacted] (b)(3)

National Developments

Developed Countries

Renewed French Commitment to Rafale Fighter

[redacted]

President Mitterrand and the French Defense Minister recently stated that France will build the Rafale air superiority fighter even without foreign participation. Paris has been seeking partners—most notably Spain and Belgium—to help defray the program's estimated $5 billion development costs. France already has committed more than $2 billion for development of the Rafale. Although recent press articles have highlighted the growing cost of the fighter, the Defense Minister disclosed his draft 1989 budget last month that provided funds for continued development of the Rafale. In addition, Paris has made large and continuing investments into the French SNECMA M-88 engine for the Rafale, the only aircraft currently scheduled to use the M-88. The Rafale prototype aircraft first flew in 1986 and has made over 300 test flights. [redacted] (b)(3)

(b)(3)

Israel Trying To Save Major Company

[redacted]

Tel Aviv has offered $50 million to Koor Industries to head off a possible bankruptcy of the giant company, whose $3 billion in sales account for about 10 percent of Israel's GNP. The Israelis also will allow foreign creditors a greater role in overseeing the recovery of the financially troubled firm, according to the US Embassy. The crisis began when a US bank requested that an Israeli court liquidate Koor's assets because the company refused to repay $20 million in overdue loans. Koor owes the US bank $150 million and has outstanding debts to (b)(3) other creditors that total about $1.2 billion. Labor and the Likud Bloc set aside political differences to pull together the financial package—a reflection of Koor's enormous impact on the Israeli economy. Prime Minister Shamir said Koor cannot be abandoned because of the threat to Israel's own creditworthiness; Tel Aviv currently is in the process of restructuring about $4.8 billion of its debts to US creditors. The Israeli economy already is experiencing a sharp slowdown, and the government faces a growing budget deficit. Koor is closely affiliated with the Labor Party, and its difficulties may become a political liability before the 1 November national election. [redacted] (b)(3)

Newly Industrializing Economies

Brazilian New Wage and Price Freeze Possible

[redacted] (b)(3)

Brasilia may be planning another wage and price freeze to prevent inflation—now running at 24 percent per month—from spiraling further out of control. Inflation has exceeded Brazil's psychological barrier of 20 percent monthly since July, sharply eroding confidence in the currency; financial markets have been extremely volatile. The US Treasury attache reports that the Central Bank's decision on Thursday to set the interest rate on treasury bills at a record 50 percent per month may precipitate a freeze. The marked rise in interest rates this week was probably meant to attract buyers for government securities, but it added to the confusion by fueling speculation that high rates would impair Brasilia's ability to service its soaring domestic debt. [redacted] Brasilia is trying to secure congressional support for such a plan because the new constitution strips the President of his decree powers, and President Sarney's key political advisers favor a freeze. (b)(3) Although a price freeze would not reduce inflation for more than a couple of months, Sarney may believe he has no other option at this point. Finance Minister Nobrega opposes such a move and almost certainly will resign if a freeze is imposed, further disrupting financial markets. [redacted] (b)(3)

Asian NIEs Investing in ASEAN Countries Retaining GSP

[redacted] (b)(3)

South Korea, Singapore, and Taiwan, which were removed from the US Generalized System of Preferences (GSP) last January, are increasingly relocating segments of their manufacturing bases to Asian LDCs still covered by GSP. Preferential access to US markets—in addition to low wages and generally favorable exchange rates—is attracting Asian newly industrializing economy (NIE) investors to these countries, particularly in labor-intensive export enterprises such as textiles, footwear, electric appliances, and timber and rubber products. Thailand, Indonesia, Malaysia, and the Philippines, which receive special GSP privileges as members of ASEAN, are the primary beneficiaries of this investment, according to Embassy reporting. Unlike most other countries, which are required to have a 35-percent value-added content in GSP exports to the United States, ASEAN countries are accorded duty-free entry if two or more countries of the group account for 35 percent of the value added. For their part, according to Embassy reports, both Malaysia and Indonesia are relaxing foreign investment regulations and are making special efforts to allay investors' uncertainties as to the future course of government economic policies. Jakarta, for example, announced major financial measures to be implemented next month to increase banking efficiency and reduce transaction costs. [redacted] (b)(3)

South Korea's Hyundai Moving Upmarket

[redacted]

Design engineers at Hyundai Motor Company have indicated that they are drawing on the design of the Ford Taurus to develop an automobile capable of competing against the Japanese in the profitable US midsize automobile market. (b)(3)
[redacted] the engineers were uncertain about when the new model would be introduced; they claimed, however, that it takes Hyundai only 26 to 30 months to go from new model design to production, and implied that manufacturing could begin by the fall of 1990. According to industry forecasts, more than 40 percent of Hyundai's car production is expected to go to the United States during the next few years. Hyundai officials are probably concerned about sustaining their US market share—12 percent of total imports to the United States in 1987—if they stay exclusively in the compact market. Last year Canadian sales of their compact car, the Excel, fell by about 30 percent. Consequently, we believe Hyundai is trying to diversify into the higher profit midsize US car market by using proven designs capable of competing against popular Japanese models. [redacted] (b)(3)

(b)(3)

Hong Kong Confirms Rise in Emigration

[redacted]

The Hong Kong Governor announced in his State of the Territory address that an estimated 45,000 people are expected to leave the territory in 1988, according to US Consulate and local press reporting. This emigration—the result of uncertainty surrounding Chinese rule in 1997 and the relaxation of immigration regulations by Australia, Canada, and the United States—is 50 percent higher than the 1987 level and is, we believe, a realistic prediction. The Governor reiterated that Hong Kong will not restrict emigration but, instead, will adopt measures to entice Hong Kong expatriates to return to the territory—including the establishment of more international schools in Hong Kong and public relations efforts in overseas Hong Kong communities. Although the Governor acknowledged emigration as a continuing cause for concern, he discounted its negative economic implications by emphasizing that only one-quarter of those emigrating are professional or technical personnel. Our analysis, however, indicates that the number of departing professionals—which has significantly raised the costs and inefficiencies in Hong Kong business, particularly in the financial sector—is reaching an alarming level.
[redacted] (b)(3)

(b)(3)

Less Developed Countries

Upsurge in Protests in Egypt

[redacted]

There has been a noticeable increase in small, apparently spontaneous demonstrations throughout Egypt in the past several weeks. Last week several thousand investors in the Al-Rayan Company—one of the largest of the so-called Islamic investment companies, and rumored to be bankrupt—demanded the return of their deposits during demonstrations at the company's headquarters, the governor's office in Giza, and, for the first time, the presidential palace. In addition, members of the radical Islamic Gama'at led about 500 people through downtown Cairo and lower-class neighborhoods to criticize the government for raising prices and for its treatment of Muslim activists. Although these protests—as well as demonstrations last month by textile workers in Alexandria against bonus cuts—occurred without

(b)(3)

warning, they were not violent. We believe larger demonstrations are possible, which would certainly focus on Egypt's weak economy and on the perceived inability of the government to improve it. Cairo is under increasing pressure from international creditors to implement austerity measures, and demonstrators may increasingly blame Mubarak for Egypt's problems. [redacted] (b)(3)

Refugees Tax Rwandan Economy

[redacted]

Heavy rains and limited resources are likely to prompt Kigali to request additional Western assistance to meet the need of more than 62,000 refugees who have fled ethnic violence in neighboring Burundi since August. The US Embassy in Kigali reports the local Rwandan population—after an initial outpouring of goodwill—is becoming less hospitable toward the refugees, who occupy potentially productive land in an area where competition for arable land is fierce. The refugees' presence is also driving up local food prices and taxing Rwanda's rudimentary social services. For example, many refugees are ailing because of injuries sustained while fleeing Burundi, placing additional strains on Rwanda's limited medical resources. Despite Kigali's desire to repatriate the refugees, most will probably remain in Rwanda for some months because they fear reprisals by the Burundi military. [redacted]

(b)(3) (b)(3)

Violence Stymies Burundi Economy

[redacted]

Although ethnic clashes in August and September caused only minor direct economic losses, we believe the fighting will slow Bujumbura's ability to carry out economic reforms. Because the fighting occurred after this year's coffee harvest—a crop that accounts for 90 percent of Burundi's foreign exchange earnings—the country avoided significant losses. However, Burundi's agriculturally rich northern provinces are largely deserted, following the violence, and the belligerents burned most grain stocks and many coffee trees, according to the US Embassy. In addition, more than 62,000 refugees fled to Rwanda and are not likely to return within six months, leaving an inadequate work force to harvest next year's coffee crop. Moreover, bilateral and multilateral donors are reassessing their aid programs to Burundi in the wake of the ethnic violence. The World Bank has already delayed disbursement of funds needed to continue Burundi's structural adjustment program, according to the US Embassy. The Bank believes emergency security measures implemented by Bujumbura—limited freedom of movement, a curfew, and additional weapons expenditures—inhibit the successful continuation of Burundi's reform program. European assistance to Burundi continues, but the EC reportedly will not release aid until it is assured that Bujumbura is seeking ethnic reconciliation. Moreover, relations with Brussels—Burundi's largest contributor—remain cool, possibly threatening further reductions in aid disbursements. [redacted]

(b)(3) (b)(3)

Syrian Grain Output Rises, but Not Enough

[redacted]

Despite a bumper 1988 grain and pulse harvest, Syria must still import more than $100 million in wheat and flour during the next year, according to the US Embassy in Damascus. The government procured about 900,000 metric tons of the local wheat crop this year, up 55 percent from 1987. The improvement is attributable to above-average rainfall and higher procurement prices for farmers.

(b)(3)

With consumption projected at more than 1.6 million tons, Syria needs 400,000 to 500,000 tons of wheat and 300 to 400 tons of wheat flour to meet demand. Higher output of lentils, barley, chickpeas, and cotton will give Syria an exportable surplus that will defray the cost of grain imports. Syrian President Assad has already formally requested Saudi Arabia provide a grant of 300,000 tons of wheat. [redacted] (b)(3) (b)(1)

Bangladesh GDP Growth Target Revised Downward

[redacted]

In the wake of extensive damage from September's floods, Dhaka has revised its GDP growth target for fiscal year 1989—which began in July—to 2.9 percent, down from its original projection of 6.1 percent. Floods last year were partly responsible for slowing the rate of GDP growth from the 5.1-percent target rate to 2.6 percent last fiscal year, but this year's flood damage is probably more extensive. Lost agricultural production, however, may be partially offset if farmers are able to plant fall wheat and corn crops on damaged rice croplands. The impact on industrial production will depend on the length of time needed to restore transportation and communication links and on the level of congestion created at Bangladesh's ports by increased food imports. The actual rate of economic growth achieved will also depend to a large extent on the activities of the political opposition in the aftermath of the floods. Flood damage last year was compounded by the disruption to the economy caused by protest strikes called by political parties opposed to President Ershad. We judge that any political agitation this year will probably be less disruptive because the opposition is more divided and less able to organize an effective civil disobedience campaign. [redacted] (b)(3)

(b)(3)

Pakistani Businessmen Hedging Their Bets on Election Outcome

[redacted]

Although businessmen in Punjab Province still hope the Pakistan Muslim League (PML)—which controlled the dissolved National Assembly—will win the elections scheduled for 16 November, they are also providing financial support to the opposition Pakistan People's Party (PPP) to buy influence in the event of a PPP victory. According to the US Consulate, the business community has begun to prepare for the possibility of a PPP victory because of strong support for the party in industrial areas of Punjab. The business community in Pakistan has long been suspicious of the PPP because of its history of large-scale nationalizations during its rule in the 1970s. In an effort to reassure businessmen, the PPP announced a new manifesto on 13 October that ruled out further nationalizations, encouraged private investment and development of small businesses and industry, and promised deregulation. As a result, businessmen now claim they could live with a PPP victory, although they continue to view the PML as more probusiness. In our view, whatever party comes to power will need to implement the reform measures necessary to obtain an IMF Structural Adjustment Facility loan, which is necessary to address the country's relatively large amount of short-term debt.
[redacted] (b)(3)

(b)(3)

Successful Afghan Pledging Conference

[redacted]

UN efforts to solicit additional assistance for its Afghan relief program have raised nearly $800 million of the $1.2 billion sought for refugee resettlement at a donors' pledging conference last week. According to the US Embassy in Kabul, the Soviet Union pledged an unexpected 400 million rubles (about $600 million) aid— (b)(3) the largest contribution since an appeal for donations went out in June. Press reports also indicate significant contributions were made by Japan, West Germany, and Sweden. Although the terms of the offer are yet to be announced, we believe part of the Soviet pledge will consist of transport services that will give Moscow some control over the distribution of relief aid—by moving goods across the USSR—and divert it to the Kabul regime. In our view, Moscow's pledge is almost certainly a repackaging of bilateral assistance promised to Afghanistan last year for use in its reconciliation program and will probably be disbursed directly to Kabul. The UN will probably continue to insist that all Soviet aid in kind be given to the UN at the Soviet border for distribution in Afghanistan. Some Western donors fear that the large Soviet contribution will entice the UN to work more closely with the Kabul regime. [redacted] (b)(3)

Falling Oil Prices Pressure Indonesia

[redacted]

New declines in oil prices are increasing strains on Jakarta's already austere budget, which depends on oil taxes for roughly 40 percent of government revenues. If low oil prices persist, as industry experts expect, the country's oil export (b)(3) earnings could reportedly fall as much as $1.5 billion this fiscal year, offsetting impressive gains in nonoil exports. Indonesia is reportedly selling its crude oil at about $13 a barrel, 25 percent below its official selling price and nearly $3 a barrel below prices assumed by the Finance Ministry when it prepared this year's budget. Finance Minister Sumarlin recently told the press that lower tax revenues might force Jakarta to cut back spending on capital projects. [redacted] (b)(3)

Indonesia Sending Mixed Signals to Rice Farmers

[redacted]

Indonesia recently announced a 19-percent jump in the minimum price that its National Logistics Agency (BULOG)—an agency Jakarta mechanism uses to stabilize rice prices—pays farmers for rice. Although guised as a means to raise farmers' incomes, we believe the real motivation is to replenish low BULOG (b)(3) stocks, which have been substantially drawn down to cover shortfalls resulting from last year's drought. Though farmers will benefit from increased rice prices, they will be hurt by Jakarta's simultaneous decision to reduce subsidies on pesticides and to raise the prices of some fertilizers. This action will probably decrease the utilization of fertilizers and pesticides, causing lower yields at a time when Indonesia is struggling to maintain self-sufficiency in rice. As a result, Jakarta may be forced to import rice for the first time since 1983. [redacted] (b)(3)

Omani Stock Market Opening Rescheduled

[redacted]

At the behest of Sultan Qaboos, the Omani Government has intensified its efforts to open a domestic stock exchange. According to the US Embassy in Muscat, the new exchange could open later this year or in early 1989—at least a year ahead of (b)(3) the previous schedule. [redacted] (b)(3) (b)(1) Many government officials have become concerned over the slowdown in Oman's economy—partially caused by the inefficiency of the domestic capital markets. Oman's move to open an exchange follows similar efforts in the other GCC states and could improve Muscat's access to financial resources in these states. Nevertheless, few Omani firms are likely to meet the reporting and size requirements of the new exchange. As a result, Oman's stock exchange will probably offer only small relief to the depressed economy. [redacted] (b)(3)

UAE Budget Process Stalled

[redacted]

Disagreement within the UAE over spending levels and financing of the budget deficit have precluded settlement of the 1988 Federal and emirate budgets and has delayed the preparation of the 1989 budgets. The Embassy believes, however, that the combined emirate budget deficit for 1988 will closely match the 1987 level of $3.8 billion. The deficit will almost certainly be financed by Abu Dhabi from its own financial resources rather than through a bond issue or by contributions from the smaller emirates. The government of Dubayy and several influential officials in Abu Dhabi oppose government borrowing to cover current expenditures. The smaller emirates, on the other hand, already depend on Abu Dhabi and Dubayy for financial support. Despite the seeming intractable financing problems, the emirates—primarily Abu Dhabi and Dubayy—hold as much as $60 billion in foreign assets that can be used to finance expenditures. [redacted] (b)(3)

(b)(3)

Haiti's Financial Problems Provoking Military Unrest

[redacted]

Haitian President Avril's month-old government is under increasing pressure to improve conditions for the lower military ranks. [redacted] The US Embassy reports the mayor of Port-au-Prince refused to pay city employees last week, claiming her predecessor—now under investigation for numerous crimes—had pillaged the treasury. The noncommissioned officers who staged last month's coup are primarily concerned with their own welfare and may remove Avril unless he demonstrates progress toward meeting their demands. Junior officers, in close contact with the enlisted men, also may try to rally troops and overthrow the regime. Disgruntled civilian workers and retired officers may carry out protests and individual acts of violence in coming weeks, adding to Avril's concerns while he is still trying to placate the military. [redacted] (b)(3)

(b)(3)
(b)(1)
(b)(3)

Communist

Gorbachev Addresses Farm Conference

[redacted]

In a recent speech to farm officials, Gorbachev vigorously pushed for the rapid expansion of long-term leasing of land and equipment to families and other small groups. While admitting the need for additional machinery and other inputs, he emphasized economic incentives as the solution to agricultural problems and pointed to lease contracts and cooperative arrangements as the way to promote such incentives. Ligachev, named chairman of the newly formed Central Committee Agriculture Commission last month, was not among the large number of officials attending the meeting. Soviet officials confirmed that Ligachev is on vacation, but the decision to hold the agricultural conference in his absence would

(b)(3)

appear to undercut his authority and allow Gorbachev to put his own stamp on long-term agrarian policy, which is to be discussed at a Central Committee plenum, now definitely set for February. Ligachev has been somewhat ambivalent in his public support of lease contracts and, according to an Embassy source, believes the major problem in agriculture is lack of appropriate modern machinery. [redacted]

(b)(3)

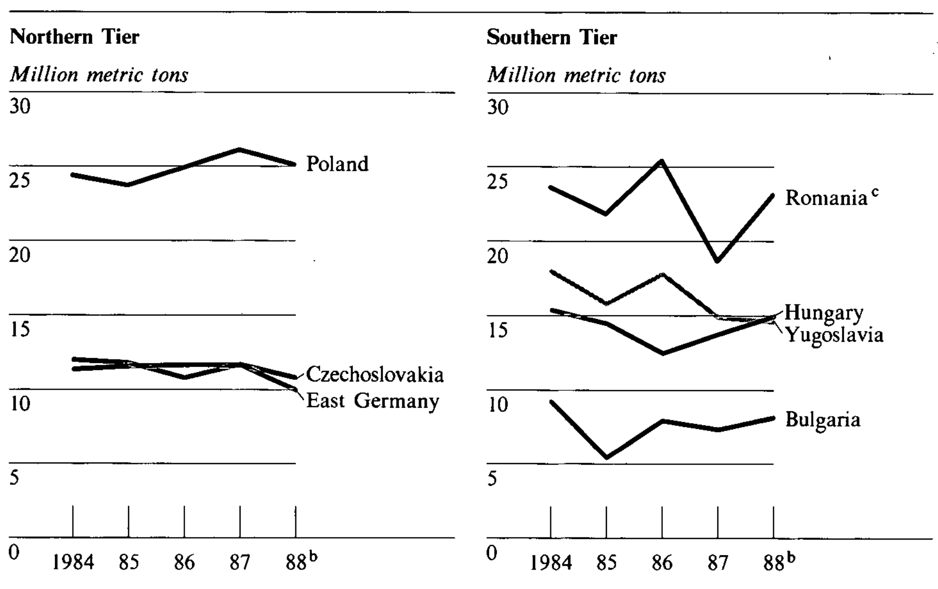
Mixed East European Harvest

[redacted]

(b)(3)

The economic and trade performance of most East European countries will benefit only slightly from this year's harvest. The grain harvest was about average, but some countries suffered significant crop losses because of drought. Although mild winter weather helped Hungary, Romania, and Yugoslavia record above-average winter wheat crops, a dry summer offset these gains by reducing output of corn and other crops. Yugoslavia and, to a lesser degree, Czechoslovakia and East Germany were most affected by the drought. Most of the countries with above-average wheat harvests will export small quantities of wheat, but the extra income may be offset by their need to import corn. Yugoslavia, normally the major corn

Eastern Europe: Grain Production, 1984-88 [a]



[a] USDA and CIA estimates.
[b] Estimated.
[c] Official Romanian estimates probably inflated.

[redacted] 319196 10-88

(b)(3)

exporter in Eastern Europe, will probably suffer the largest hard currency losses because of import needs. Czechoslovakia and East Germany also will have to import more grain to sustain bread quality and feed supplies. Overall consumer supplies in Eastern Europe will probably be sufficient in the coming year, but spot shortages of sugar, rice, vegetable oil, and some other staples will occur. The improved harvest in Romania will do little to ease the lot of consumers because the regime will direct most of the increased production to hard currency exports. [redacted] (b)(3)

China Jockeying for Grain Supplies

[redacted]

China, facing growing grain consumption and a disappointing harvest, appears to be preparing to import more grain. Beijing estimates this year's harvest at 388 million metric tons (MMT), 22 MMT below target. If grain imports continue to match with those of last year—10 MMT through September—the 1988 total could reach 16 MMT. However, China will devote an even larger proportion of imports to wheat to make up for rice shortfalls and to use as feed for livestock. Indeed, imports of US wheat through September are five times the 1987 level, and by yearend could be more than 6.6 MMT. In addition, Embassy reporting indicates that China may buy up to 1 MMT from France. Nevertheless, Commerce Minister Hu Ping last week told Chinese reporters that China's grain market should be stable this year because of substantial reserves. His remarks, however, were probably formulated to calm inflation-wary domestic consumers as well as to keep international prices from rising in anticipation of major Chinese purchases. [redacted] (b)(3) (b)(3)

(b)(3)
(b)(1)