Directorate of
Intelligence

~~Secret~~

(b)(3)

International Economic & Energy Weekly (U)

27 March 1987

~~Secret~~

DI IEEW 87-013
27 March 1987

Copy 856

Warning Notice	Intelligence Sources or Methods Involved (WNINTEL)
National Security Information	Unauthorized Disclosure Subject to Criminal Sanctions

Dissemination Control Abbreviations		
	NOFORN (NF)	Not releasable to foreign nationals
	NOCONTRACT (NC)	Not releasable to contractors or contractor/consultants
	PROPIN (PR)	Caution—proprietary information involved
	ORCON (OC)	Dissemination and extraction of information controlled by originator
	REL...	This information has been authorized for release to...
	FGI	Foreign government information
	WN	WNINTEL—Intelligence sources or methods involved

A microfiche copy of this document is available from OCR/DLB [redacted]; printed copies from CPAS/IMC [redacted] Regular receipt of DDI reports in either microfiche or printed form can also be arranged through CPAS/IMC.

[redacted]

(b)(3)

(b)(3)

(b)(3)

All material on this page is Unclassified.

~~Secret~~
[redacted] (b)(3)

International Economic & Energy Weekly (U)

27 March 1987

Synopsis

(b)(3)

[redacted]

(b)(3) *Comments and queries regarding this publication are welcome. They may be directed t*[redacted] *Directorate of Intelligence, telephone* [redacted] (b)(3)

~~Secret~~
DI IEEW 87-013
27 March 1987

(b)(3)

~~Secret~~

[redacted]

International Economic & Energy Weekly (U)

Synopsis

1 **Perspective—Global Agricultural Issues: The Context for Negotiations** [redacted] (b)(3)

As agricultural surpluses have piled up over the past year, agricultural policies have become a more prominent international economic issue. The agricultural trade situation has become so bleak, however, that some reform—albeit delayed until after key elections—seems inevitable. [redacted] (b)(3)

3 **International Financial Situation: Update on LDC Debt** [redacted] (b)(3)

7 **Summit Issues: Agriculture in the GATT Round** [redacted] (b)(3)

The biggest roadblock for US objectives for agricultural trade liberalization in the Uruguay Round will be French and West German reluctance to open the EC's Common Agricultural Policy to negotiation. On the positive side, newly emerging Cairns group of nonsubsidizers and support from the resurrected Morges group of farm exporters probably will provide the necessary leverage to press Paris, Bonn, and Tokyo for agricultural reforms. [redacted] (b)(3)

11 **Global Grain Glut: Pervasive Trade Impacts** [redacted] (b)(3)

World grain production is likely to reach a record 1.4 billion metric tons this year while global grain trade will remain at the depressed level of last year. With grain stocks more than double global grain trade, we see little chance the glut will diminish over the rest of the decade without major progress in agricultural policy reform and in multilateral negotiations on agricultural trade. [redacted] (b)(3)

15 **Argentina: Troubled Agricultural Sector** [redacted] (b)(3)

Argentina's farm sector—the world's second-largest exporter of agricultural products and the country's economic mainstay—is performing poorly, with grain production down for the second consecutive year. Although President Alfonsin is belatedly stepping up efforts to aid producers, we believe that persistent low world prices will cause continued hardship for the farm sector and for the Argentine balance of payments. [redacted] (b)(3)

19 **International Financial Situation: Delayed Lending Postpones Mexican Economic Growth** [redacted] (b)(3)

The delay in securing final approval of the commercial bank lending package has postponed President de la Madrid's economic plans and is already causing him to abandon fiscal and monetary prudence in favor of measures designed to bring quicker results. [redacted] (b)(3)

~~Secret~~

DI IEEW 87-013
27 March 1987

[redacted] (b)(3)

International Economic & Energy Weekly [redacted] (b)(3)

27 March 1987

Perspective

Global Agricultural Issues: The Context for Negotiations [redacted] (b)(3)

As agricultural surpluses have piled up over the past year agricultural policies have become a more prominent international economic issue. Moreover, bilateral disputes have become more contentious as the number of players has grown and the agricultural trade system has become more interconnected. At the same time, agricultural markets are facing unprecedented structural problems, and the pressures for reform have never been greater. [redacted] (b)(3)

Bilateral disputes have taken on an especially critical dimension this year. The lengthy EC accession dispute, changes in US rice and sugar policy, and recent proposals for an EC vegetable oil tax have sparked strong protests from trading partners. Agricultural trade issues increasingly have taken center stage as the stakes have become higher and rounds of retaliation threaten industrial as well as farm products. [redacted] (b)(3)

Market trends have also complicated the context for negotiations:

- ***Falling prices***—now at their lowest level in decades—have slashed export earnings for all agricultural exporters and especially burdened LDC exporters struggling to maintain debt payments. LDC agricultural export volume to the OECD, for example, was lower in 1985 than five years earlier, and some estimates indicate a further drop last year.

- To maintain export receipts in the current depressed markets, newly emerging Third World producers have in some cases ***doubled production levels***, further adding to glutted markets. Brazil, for example, has boosted soybean output by one-third in the past five years.

- Huge ***stock overhangs*** have created yearlong buffers that would limit commodity price rebounds—even in the event of a sizable crop disaster. Global wheat and coarse grain stocks, for example, stand at more than double world trade flows—in the late 1970s the excess was only 20 percent. [redacted] (b)(3)

Given these complicating factors and the existing political pressures, it will be difficult for the GATT to agree to an approach toward agricultural reform. Domestic farm groups in key GATT countries will continue to lobby stridently for sustained production supports and import barriers, fearing a collapse of their incomes if current world prices are allowed to prevail. These farm blocs are especially important in France, West Germany, and Japan—the countries vital to rapid success in GATT. Moreover, French Prime Minister Chirac is struggling to reverse his slumping popularity before the election scheduled for May 1988, and West German Chancellor Kohl—whose government faces five important state

(b)(3)

elections—will not jeopardize his party's chances by agreeing to reforms that reduce West Germans' farm income. Japanese Prime Minister Nakasone's chances of staying in office beyond the end of his present term in October are slim, and his Liberal Democratic Party successor may have difficulty securing farmers' acceptance of rapid or far-reaching reforms. (b)(3)

The agricultural trade situation has become so bleak, however, that some reform—albeit delayed until after key elections—seems inevitable. The growing fiscal burden of income support and export subsidy programs—both EC and US agricultural support programs will each cost more than $25 billion this year—is bringing a political consensus on the imperative for reform. Though there is little hope for rapid progress in GATT agriculture negotiations, most participants remain optimistic about the outlook for eventual agricultural trade reform through a phased reduction in subsidies and protectionism. (b)(3)

(b)(3)

International Financial Situation: Update on LDC Debt [redacted] (b)(3)

Major developments on the LDC debt situation this week focus on Brazil, Mexico, the Philippines, Venezuela, Chile, and a consortium of Japanese commercial banks:

- Press reports indicate that Brazil requested that the country's creditors extend short-term credit lines for another 60 days after they expire 31 March.

- Mexico signed the $7.7 billion commercial bank loan package last Friday with 99 percent of the total funds committed. According to press reports, more than 360 banks ratified the accord out of a total of about 400 banks named in the agreement; the remaining banks have the option of accepting the loan package within the next few weeks. The signing paves the way for a $3.5 billion disbursement, including $1 billion in cofinancing with the World Bank, probably by the end of April.

[redacted] (b)(3) (b)(1)

- Venezuela approved a series of foreign bond issues totaling nearly $900 million—the first government borrowing in foreign capital markets since 1982, according to press reporting. Caracas has not indicated when the bonds will be offered, however.

- Chile will meet its Paris Club creditors on 2 April to request $140 million in debt relief. Santiago will propose that 85 percent of payments due from 15 April 1987 to 31 December 1988 be postponed until late 1991 when payment in eight semiannual installments will begin. Another 10 percent will be paid at a date to be set in 1989. Technical difficulties may surface during the April talks. The Paris Club usually requires IMF performance targets to be in place throughout the rescheduling period, but Chile does not have set Fund targets for the period after 1987. Chile expects its official creditors to proceed with the rescheduling if Santiago agrees to a follow-on IMF program to cover late 1988 and a Paris Club review of IMF performance targets set for next year.

- Japanese commercial banks formed an offshore company—JBA Investments, Inc—that will buy bad loans from Japanese banks at a discount, presumably at rates prevalent in secondary markets. Payments the company receives from LDCs on the troubled loans will be passed along to its commercial bank

Key LDC Debtors:
Economic/Financial Indicators

	Total Debt [a]	International Reserves [b]	Other Indicators
Brazil	110	2.0 (Feb 87) 3.5 (Nov 86)	Trade surplus $260 million in February, double January's surplus; slow start to reaching 1987 target of $8 billion.
Mexico	104	6.3 (Dec 86) 4.0 (Jul 86)	Inflation rising, estimated 130% by yearend, up from 106% in 1986; money supply growth up.
Argentina	50	2.0 (Dec 86) 3.5 (Sep 86)	Inflation projected at 94 percent for 1987, up slightly from 82 percent in 1986.
Venezuela	36	5.0 (Jan 87) 6.1 (Oct 86)	Loss of $3.7 billion in reserves during 1986; inflation estimated at 20% for 1987.
Indonesia	40	8.1 (Dec 86) 9.6 (Sep 86)	GDP stagnant in 1986 after 2.0% rise in 1985; growth of less than 1% projected for this year.
Egypt	30	0.9 (Dec 86) 0.9 (Sep 86)	**Inflation running at annual rate of 30 percent up from 17 percent rate last year**
Philippines	28	2.6 (Jan 87) 1.9 (Oct 86)	1986 GDP growth 0.1%, first increase in three years; project 3.0% to 3.5% in 1987.
Chile	19	2.3 (Jan 87) 2.2 (Oct 86)	Trade surplus of $1.3 billion in 1986, 54% higher than 1985; inflation declined to 17% in 1986.
Nigeria	19	**0.5 (Mar 87)** **0.7 (Dec 86)**	Trade surplus deteriorated to $0.9 billion in 1986, steep drop from $4.4 billion 1985 surplus.
Peru	14	0.8 (Feb 87) 0.9 (Dec 86)	Inflation at 100% annual rate during January-February.

[a] Billion US $, yearend 1986.
[b] Billion US $.

(b)(3)

Boldface indicates change over the previous week

Status of Debtor-Creditor Relations	Domestic Political Scene
No formal date set for commercial bank talks; Brazil will seek multiyear rescheduling and $4 billion in new money.	Moratorium quieted some criticism, but Sarney's popularity remains low.
Signed $7.7 billion commercial bank package last week; disbursement of $3.5 billion available by end of April	Moderate GDP growth will limit political problems, helping to ensure a smooth PRI victory in 1988.
Bank talks began mid-February, now discussing terms; $1.8 billion IMF package approved in February.	Congressional and gubernatorial elections in September.
Bank agreement reached; interest rate spread reduced; saves Caracas $2 billion in payments over three years.	**Leftist protests raising concerns of economic and political pressures on Lusinchi government.**
Jakarta likely to reschedule if oil prices fall below $15 per barrel; still maintains limited access to commercial credit.	Parliamentary election in April; may determine timing of rescheduling or reforms.
IMF letter of intent signed, but many details remained to be completed in technical annex.	Mubarak unlikely to state reforms until after April election to reduce political risk.
Bank talks began 2 March; Manila seeking rescheduling and interest rate relief; **rejected bankers recent interest rate proposal.**	Preparing for May House and Senate elections.
Bank agreement concluded 24 February—no new lending, but lower rate spreads and single annual interest payment. Paris Club meeting 2 April.	Retiming could aid growth, but not enough to overcome political difficulties.
IMF standby approved in February; finalizing London Club package; **Paris Club bilateral talks under way.**	Babangida implementing economic reforms; discontent may rise if economy remains weak, however.
Bank negotiations in limbo; IMF owed $250 million in arrearages.	Garcia remains highly popular; worried about 1987 economic prospects.

"shareholders" as dividends. This scheme would provide the Japanese banks tax relief because the discount would be fully tax deductible. Moreover, these creditors will improve their capital adequacy by reducing the amount of loans they hold. For other creditors, this plan brings greater prominence to the issue of new mechanisms that could be employed in dealing with the LDC debt problem. [redacted] (b)(3)

Summit Issues: Agriculture in the GATT Round [redacted]

(b)(3)

The biggest roadblock for US objectives of agricultural trade liberalization in the Uruguay Round will be French and West German reluctance to open the EC's Common Agricultural Policy to negotiation. In particular, domestic political and economic constraints limit the ability of France, West Germany, and Japan to offer concessions. On the positive side, growing budgetary burdens have prompted these key GATT members to seriously consider agricultural reform. In addition, the newly emerging Cairns group of nonsubsidizers—led by Canada, Australia, and Argentina—and support from the resurrected Morges group of farm exporters probably will provide the necessary leverage to press Paris, Bonn, and Tokyo for agricultural reforms. [redacted]

The Cairns and Morges Groups

The Cairns group of 14 self-proclaimed nonsubsidizers joined forces in mid-1985 to develop a common negotiating strategy for agriculture in the new GATT Round. After having threatened to boycott the talks if agriculture was not negotiated, the group still demands top priority for domestic farm reform and market liberalization. The Morges group—originating in the Tokyo Round to discuss agricultural trade issues—consists of 10 major farm traders, including the United States and the EC[a] as well as many Cairns members.

(b)(3)

MORGES	*CAIRNS*
Argentina	*Argentina*
Australia	*Australia*
Brazil	*Brazil*
Canada	*Canada*
EC	*Chile*
India	*Colombia*
Japan	*Fiji*
New Zealand	*Hungary*
Nordic countries	*Indonesia*
United States	*Malaysia*
	New Zealand
	Philippines
	Thailand
	Uruguay

(b)(3)

[a] *Community representatives as opposed to the member states. Any final EC negotiating position must integrate member country views.* [redacted]

(b)(3)

[redacted]

(b)(3)

Negotiating Strategies

In our judgment, the EC, which negotiates as a single entity, wants to preserve the status quo—to maintain its present Common Agricultural Policy (CAP) based on flexible import levies and export subsidies. Given its priorities, the EC will probably continue to delay and attempt to narrow the negotiations. Nonetheless, there is substantial difficulty in reaching a common negotiating strategy on agriculture, since a considerable divergence of views exists among the member states on the future course of EC internal policy. France and West Germany hold the key to progress on agricultural reform. [redacted]

Overall, France will hold the frontline of resistance to rapid progress on agriculture. The basic French position, in our view, will be to wait until the United States reveals its strategy and then react to it. According to press reports [redacted] French GATT representatives will also continue to press for a grain exporters' cartel to buoy grain prices. They will argue that progress on agricultural reform is better achieved through the managed elimination of surplus stocks and cautious adjustments to present agricultural support systems. In the unlikely event that Paris agrees to speed the negotiations, Bonn will present a substantial second obstacle. The farm sector in West Germany—as in France—wields political influence out of proportion to its size and to a certain extent dictates the Kohl government's negotiating parameters. [redacted]

(b)(3)

(b)(3)

GATT Agriculture: Key Country Views

United States
Seeks to remove farm trade barriers and export subsidies across the board on a fast track—specifically, freeze on the current level of barriers and subsidies, and then phaseout existing ones . . . wants significant movement toward free trade through decoupling farm income supports from production decisions . . . wants greater international harmonization of food, plant, and animal health regulations and stronger dispute settlement.

European Community

France
Opposes fast track for agriculture in the new round . . . wants to confine farm discussions to the agriculture group and proceed at same pace as other issues . . . maintains the basic structure of the Common Agricultural Policy (CAP) should not be open to challenge in the Uruguay Round . . . pressing for a cartel of grain exporters to increase world prices . . . unwilling to make large concessions on agriculture . . . farm bloc politically important to Prime Minister Chirac.

West Germany
Unlikely to press for fundamental agricultural reform . . . defender of the CAP with France . . . farm groups still wield considerable political influence . . . prepared to cut surplus agricultural production with quotas . . . willing to support curtailing some export subsidies, but only if it receives assurances that it can support domestic farm income through state programs.

United Kingdom
Wants to ensure that all forms of agricultural support are covered in Uruguay Round negotiations . . . strong concern over the high cost of farm expenditures . . . agricultural sector has some influence with the Conservative Party, but less political pull than in any other EC country.

Japan
Internal discussion on agricultural reform has begun . . . in GATT, anxious to divert attention from domestic farm subsidies . . . especially protective of politically important rice and beef farmers . . . major concessions unlikely.

Cairns Group

Argentina
Hard line Cairns member . . . demands total elimination of agricultural export subsidies . . . willing to grant concessions on services in exchange for strong gains in agriculture . . . emphasizes harm to export earnings and debt-repayment prospects from export subsidies and falling commodity prices.

Australia
Wants GATT members to agree on the parameters of global agricultural trade reform within the next two years . . . seeks removal of import barriers and substantial reductions in farm subsidies during an early phasing out period.

Brazil
Wants firm commitments not to expand existing restrictions and to eliminate barriers to trade . . . moderate Cairns member . . . wants to preserve multilateral forum and to avoid bilateral solutions . . . does not want to show excessive hostility to CAP when the EC has helped forge a compromise on services.

Canada
Stresses urgent need to resolve the market-depressing effects of grain surpluses and export subsidies . . . prefers to pursue agricultural reform in the multilateral context of GATT, rather than in the US-Canada Free Trade Agreement talks.

Malaysia
As vocal ASEAN member, feels special treatment for LDCs must be strictly maintained . . . wants elimination of agricultural export subsidies . . . highest priorities include tropical products.

Thailand
Wants Cairns group to take lead in mapping out strategies for further collective action in pressing for agricultural trade reform . . . especially critical of US rice support program and proposed EC vegetable oil tax . . . wants to actively participate in all forums on agricultural reform—including Morges Group. (b)(3)

Key Countries: Agriculture Negotiating Stance, 1987

	Willing to discuss domestic subsidies	Negotiate export subsidies	Fast-track talks	Talks confined to one committee	Lower access barriers	Strengthened dispute settlement
United States	○	○	○		○	○
European Community						
France	○			○	○	○
West Germany	○			○	○	○
United Kingdom	○				○	○
Japan		○				
CAIRNS:						
Argentina	○	○	○		○	
Australia	○	○	○		○	○
Brazil	○	○	○		○	
Canada	○	○	○			○
Malaysia	○	○	○		○	
Thailand	○	○	○		○	

312266 3-87 (b)(3)

Japan's goal is a limited but strongly held one: to divert attention away from its domestic agricultural subsidies—especially those on rice and beef. Tokyo, for its part, will maintain that it is exempt from agricultural adjustment measures because Japan is not an exporting country. In our view, Tokyo may attempt to deflect US and EC pressure for reductions in Japanese domestic subsidies and rice liberalization by making limited concessions on oranges, walnuts, and to a lesser extent beef—the major farm trade irritants apart from rice. (b)(3)

The Cairns group of 14 agricultural exporters is pressing hard for early progress on agriculture—primarily a freeze on subsidy levels and rapid phase-out of current supports. To attain their goals of substantial changes in agricultural policy, the Cairns group will emphasize timing in its pursuit of rapid reform. Though GATT members have agreed on a broad timetable for negotiations, according to the US Embassy in Geneva, the Cairns group is still pressing for examination of proposals this year followed by substantive negotiations in 1988. The Morges group similarly wants to set specific deadlines for progress on agricultural reforms. Provided no drastic increases in export subsidies occur, we believe the Cairns and Morges groups will probably support US interests and provide the necessary leverage to eventually move French and German intransigents. (b)(3)

Implications for US Strategy

While there continues to be strong political resistance to substantive reform, we believe GATT members have become more realistic about the necessity for change as the costs of agricultural programs have escalated. Nevertheless, the biggest obstacles to successful negotiations will be keeping the French and Germans at the table. With Paris and Canberra holding the most divergent views on agriculture, the Cairns group will probably lend its support to a moderate position. In our view, while it will be difficult to prod Brasilia to play more than a marginal role in Cairns, the strength of Buenos Aires's and Canberra's commitment virtually guarantees the survival of the group. As a result, the primary challenge will be effectively utilizing Cairns pressure in accelerating the pace of EC reform by focusing on its most reluctant member—France. We believe, however, a direct attempt to force EC concessions in agriculture will force France to block such a strategy even at the expense of stalling the new round. [redacted] (b)(3)

In pursuing reform-oriented objectives, negotiators may realize benefits from directing GATT attention toward Japan. According to US Embassy reporting, Denmark believes success in opening the Japanese market would transform the agricultural reform debate from the current focus on negative aspects to an attractive proposition for politically influential US and EC farm sectors. Moreover, a brighter spotlight on Japan would encourage the French to participate in the new round by adding an issue—Japan's huge trade surplus with the EC—which greatly concerns Paris. [redacted] (b)(3)

[redacted] (b)(3)

Global Grain Glut: Pervasive Trade Impacts ([redacted]

(b)(3)

World grain production probably will reach a record 1.4 billion metric tons this year while global grain trade will remain at the depressed level of last year. The resulting stiffening competition and falling grain prices are likely to increase both domestic and international tensions over agricultural issues. One major beneficiary, the USSR, however, could save perhaps 30 percent from last year's grain import bill. In our view, without extremely aggressive marketing, it is unlikely that the US share of the world grain trade will significantly recover. With grain stocks more than double global grain trade, we see little chance the glut will diminish over the rest of the decade without major progress in agricultural policy reform and in multilateral negotiations on agricultural trade. [redacted]

(b)(3)

Major Exporters: Wheat and Coarse Grain Production and Exports, 1986-87 *Million metric tons*

	Production [a]		Exports [a]	
	1986	1987 [b]	1986	1987 [b]
United States	340.9	309.7	61.4	68.9
Canada	49.3	59.5	22.7	26.0
Australia	23.9	24.2	21.0	18.3
Argentina	25.6	24.4	15.8	12.5
European Community	160.0	152.7	47.2	48.3

[a] Data for the period ending 30 June of the stated year.
[b] Projected.

This table is Unclassified.

The Global Grain Glut

Global grain trade for market year 1987 [1] is likely to remain at a depressed level; USDA, for example, estimates global exports of 172 million tons. Not only are Soviet imports down, but non-Soviet grain trade also continues to be depressed. We believe the lackluster demand for imported grain reflects both the sluggish world economy and increased grain production by traditional grain importers:

- For the LDCs as a whole, USDA projects record production for MY 1987 of 272 million tons, up 20 percent over last year. Imports are likely to stagnate or rise at most 1 percent.
- In Africa, record production—72 million tons—is projected, up 36 percent since the drought levels of 1983/84. Imports are likely to be up only 1 percent above last year's level.
- OPEC countries are also recording record grain production and with oil prices depressed, grain imports probably will be at most 1 percent above last year's level.
- East European countries probably have achieved their second-highest level of grain production ever and may be able to cut back grain imports as much as 20 percent.

World grain production will probably hit a record 1.4 billion tons and push world grain stocks to peak levels. According to USDA estimates, global stocks at the end of MY 1987 will probably be 376 million tons, surpassing last year's level by 20 percent [redacted] (b)(3)

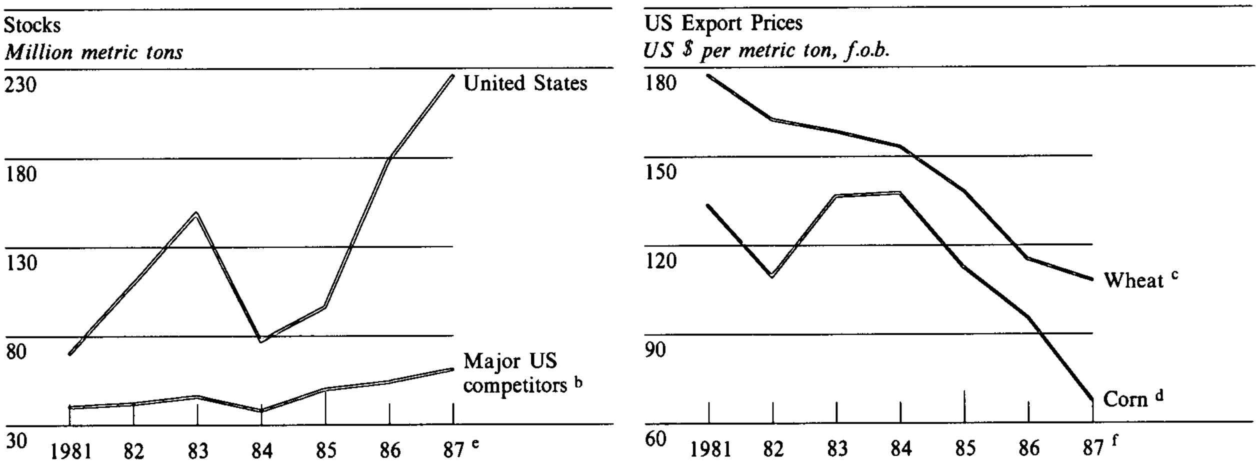
Benefits to the USSR

The USSR will reap significant benefits from this buyers' market—very attractive prices will greatly reduce Moscow's hard currency grain import bill. Combined with lower Soviet grain import requirements—probably down 10 percent from last year's level—we believe Moscow's grain import bill will be about 30 percent lower than last year. To date in MY

[1] 1 July 1986–30 June 1987. (U)

Comparison of Grain Stocks and US Export Prices, 1981-87 [a]

Note scale change



[a] Beginning stocks as of 1 July of the stated year.
[b] Canada, European Community, Australia, and Argentina.
[c] US Gulf No. 2 H.W.
[d] US Gulf No. 3 Yellow.
[e] Projected.
[f] January prices.

Unclassified 312289 3-87

1987 Moscow has lined up about 25 million tons of wheat and coarse grain. It has come to the United (b)(3) States for only 2.6 million tons of corn—preferring instead to purchase grain from US competitors for $20 to $30 per ton below US prices [redacted]
(b)(3)

Moscow reportedly is also well aware of the huge grain surplus facing the United States [redacted] The United States, with a projected 219 million tons of grain stock ending MY 1987—up (b)(3) nearly 50 million tons since last year—has enough wheat and coarse grain in reserve itself to cover all world trade for more than a year. [redacted]

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

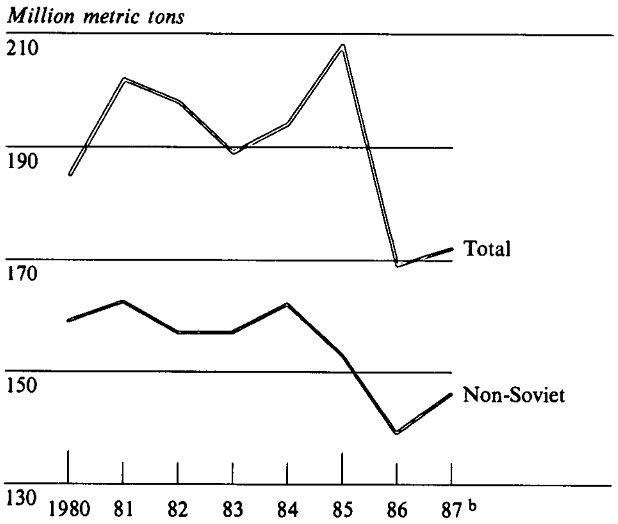
Aggravating Trade Tensions

US competitors are resorting to increased concessions and arm-twisting techniques to maintain or capture markets:

[redacted] (b)(3) (b)(1) (b)(3)

- According to US Embassy reports from Canberra, in the recent 2-million-ton sale to Egypt, the Australian Wheat Board was only able to strike a deal by selling wheat at $16 a ton under the guaranteed

Global Grain Trade, 1980-87 [a]



[a] Data for the marketing period ending on 30 June of the stated year. Grain refers to wheat and coarse grains.
[b] Projected.

Unclassified 312288 3-87

fixed price paid to its farmers, by extending three-year-credits to Cairo, and by donating a bonus of 50,000 tons of wheat. [redacted]

(b)(3)

As countries vie for one another's markets and prices remain low, US competitors in the short run are being forced to increase domestic subsidies to provide relief to their farmers. According to US Embassy reports from Canberra, Australia will probably pay wheat farmers $200 million in price supports this year to offset falling world prices of grain. In the recent sale to Egypt alone, the Australian Wheat Board will be forced to pay its farmers $30 million. Moreover, this past December, Ottawa was forced to initiate subsidies of $750 million to its grain farmers to offset falling world grain prices. [redacted]

Similarly, West European grain trade officials reportedly believe that the EC will not reduce its subsidies and will continue to match or undercut the US grain prices in the Export Enhancement Program (EEP).

Moscow's Changing Trade Strategy

The glut in the world grain market is, in our opinion, contributing to changes in Moscow's grain buying strategy. Moscow has a five-year Long-Term Grain Agreement with the United States; however, this is the third year that Moscow is failing to live up to its agreement, and the first year in a decade of purchasing under its LTAs with the United States, Moscow has waited five months to purchase its first million tons of US corn—the longest delay in a decade. Moscow's grain import needs most likely will be in the mid-to-upper 20 MMT range of grain this market year and Moscow clearly believes—and we agree—that US competitors can supply all of Moscow's needs as long as they remain in this range. [redacted] (b)(3)

Accordingly, Moscow's strategy seems clearly to make the United States its supplier of last resort. Should Moscow decide to come more heavily into the US grain market, we believe it most likely will only be for corn and in amounts less than called for by the LTA. Moscow [redacted] *is currently buying wheat from US competitors in the mid-$70 per ton range and feed wheat in the mid-$60 per ton range. Should the United States extend the Export Enhancement Program (EEP) to the USSR, Moscow may buy US wheat under the LTA.* [redacted] *Last year, however, when the EEP was offered, Moscow failed to make any wheat purchases under this US offer, claiming even with the subsidies they could purchase grain more cheaply from US competitors. In addition to economic reasons for not buying US grain, Moscow may be expressing its displeasure with the status of bilateral relations and indirectly be pressuring the United States to grant it most-favored-nation status.* [redacted]

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

The EC reportedly will not use an aggressive sales strategy to high credit risk countries, but will push for cash buyers or good credit risks. [redacted]

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

Last, Australian trade and industry ministers have recently attacked both the EC and the US subsidy policy and have spoken strongly for global agreements in GATT to alleviate the present agricultural trade situation. Canberra is spearheading the drive by the 14 Cairns member countries to ensure that the effects of subsidies and other agricultural issues are included within the scope of negotiations at the GATT. Australian Government officials reportedly view the round of the GATT currently under way as providing the opportunity to begin discussions for global agricultural agreements. [redacted]

Outlook

We believe that without concerted effort by major producers—both at the domestic and at the international level—to curtail production, it is likely that global grain production will continue to outstrip demand in MY 1987, in MY 1988, and quite possibly throughout the remainder of the decade. Moreover, the current world stock situation is so outbalanced that all world grain trade for the next two years could be met from existing stocks—even if moderate growth in world trade were to resume. Even an extreme scenario—where Moscow imports a record amount of grain of 56 million tons for MY 1988; all other importing countries increase grain imports 10 percent; and competitors suffer a bad crop forcing a 20-million ton drawdown in stocks—would only pull 90 million tons out of stocks. Without major agricultural policy reform by grain exporting countries, this would leave nearly 290 million tons of grain stocks on hand—still the third-highest stock level on record and enough to cover well over a year of global grain trade. Over the long run, however, we believe budgetary pressures associated with domestic grain price support programs are likely to exert pressure for agricultural reform. [redacted]

(b)(3)

In the near term competition for markets will further intensify, international grain prices probably will continue at their depressed low levels, or may even fall further, and domestic pressures for governments to provide relief to the hard-hit agricultural communities will mount. Under these circumstances, it is our judgment that both domestic policy initiatives and multilateral negotiations in the current GATT round will be paramount to management of what amounts to a potential global grain crisis. [redacted]

(b)(3)

The implication of this situation for US exports in our view is particularly bleak. Even if a modest recovery in international grain demand in response to lower world prices were to occur, we believe that without extremely aggressive marketing, it is unlikely that the US share of the world grain market will significantly recover. In our opinion, the US market share will be kept at its presently depressed level by the aggressive strategies of US competitor nations, particularly the EC whose heavy subsidies permit it to continue to undercut US wheat sales, and by relatively low-priced feed wheat from Canada and Australia, which is cutting into traditional US coarse grain markets. [redacted]

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

[redacted]

Argentina: Troubled Agricultural Sector [redacted]

(b)(3)

Argentina's farm sector—the world's third-largest exporter of grains and oilseeds in 1985 and an economic mainstay—is performing poorly, with grain production down for the second consecutive year. Low grain prices, competitors' export subsidies, and Buenos Aires's own policies have hurt agricultural export earnings, in turn causing higher current account deficits and increased borrowing needs. Although President Alfonsin is belatedly stepping up efforts to aid producers, we believe that persistent low world prices will cause continued hardship for the farm sector and for the Argentine balance of payments. [redacted]

(b)(3)

Farmer Woes

Argentine agriculture, which provides 75 percent of export earnings and roughly 17 percent of federal revenue, is experiencing serious difficulties. The current global grain glut has caused commodity prices to plummet; 1986 wheat prices were only 54 percent of 1982 levels. While Argentina itself has contributed to the current overproduction, it is also hurt by US and EC agricultural policies. Argentines blame EC export subsidies for lower Soviet purchases—only about 500,000 metric tons of grain last year instead of the 4.5 million tons specified in the Soviet-Argentine long-term grain agreement. Buenos Aires was further upset when Washington offered to subsidize agricultural sales to Moscow, according to the press. As a result, Buenos Aires has become a vocal member of the Cairns Group of 14 nonsubsidizers pushing for agricultural trade reform in the new GATT round. [redacted]

Although severe flooding last year had a major impact on output, Argentina's own agricultural policy has also harmed farm production. The Argentine farmer receives only about 50 percent of the f.o.b. export price, versus 75 percent for US producers, according to the USDA. Export taxes account for one-fifth of the export price of corn and one-fourth of the price of soybeans, according to a private Argentine study published last spring. Farm receipts are also diminished by a continually overvalued exchange rate vis-a-vis the dollar and by port costs that are among the highest in the world. In addition, high real interest rates—they equaled up to 60 percent at an annual rate during the latter part of 1986—make credit in the loan-dependent agricultural sector prohibitively expensive. [redacted] (b)(3)

Because of these factors, production of major grains and oilseeds decreased from a record 41 million tons in crop year [1] 1984 to 38 million tons in 1985, and a further drop to 35 million tons is projected for 1986, according to the USDA. Cereal and oilseed export revenue fell 25 percent from $3.6 billion to $2.7 billion, and will drop to $2.6 billion this year, according to IMF estimates. The revenue loss led directly to a worsening of Argentina's current account deficit, from nearly $1 billion in 1985 to $2.6 billion in 1986, and will contribute to a current account shortfall—and financing need—of about $2.4 billion this year. [redacted] (b)(3)

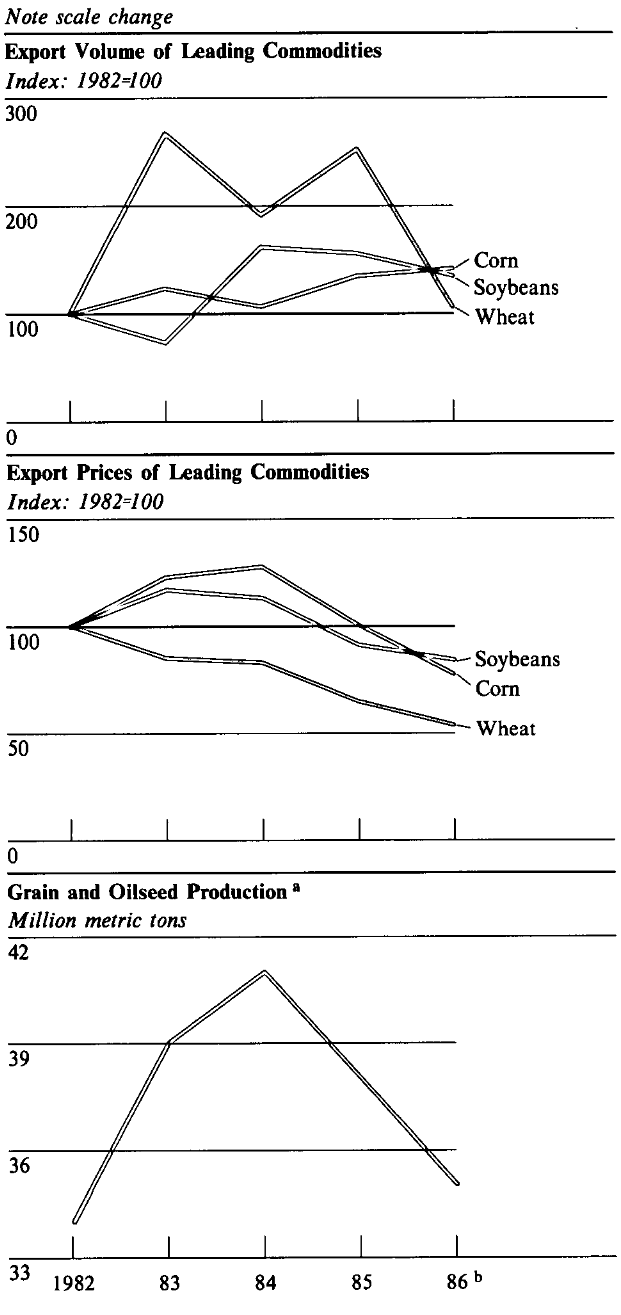
President Alfonsin's Response

Last year, Buenos Aires worked to diversify trade partners—the Soviet market accounted for 50 percent of Argentine wheat sales in 1985. Argentina increased marketing efforts in Japan and Iran, as well as among intraregional partners such as Mexico and Venezuela. The 1986 economic integration agreement between Brazil and Argentina established specific purchase goals for wheat, corn, and rice, but Brazil will almost certainly have to cut back on imports this year (b)(3)
because of its debt problems. [redacted] (b)(3)

In an effort to boost farm income, Buenos Aires also reduced export taxes to 5 percent for wheat and an average of 15 percent on other major grains, foregoing $420 million in revenue, according to government

[1] June-May [redacted] (b)(3)

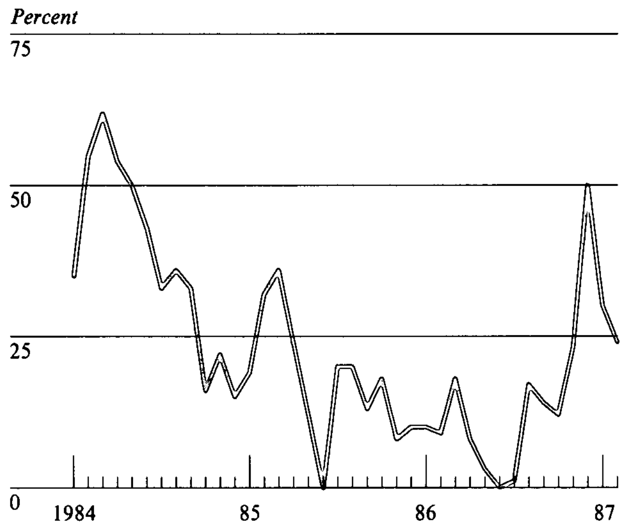
Argentina: Selected Economic Indicators, 1982-86



[a] Data for planting period beginning June of the stated year. Includes wheat, corn, sorghum, soybeans, sunflowers, and flaxseed.
[b] Estimated.

Unclassified 312267 3-87

Argentina: Difference Between Parallel and Official Market Rates for the US Dollar, 1984-87

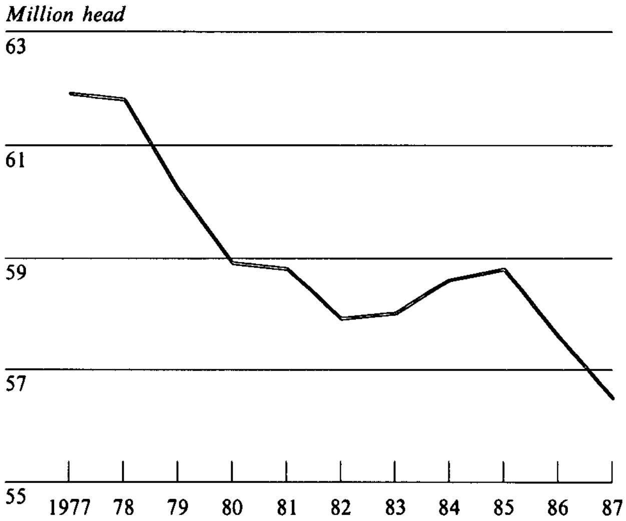


Unclassified 312268 3-87

statistics. It obtained $350 million from the World Bank to switch from the export tax to a land tax designed to encourage the most productive use of land. However, the land tax bill—opposed by farmers who already pay local land taxes—is currently languishing in Congress. [redacted] (b)(3)

With congressional and gubernatorial elections scheduled for September, Alfonsin has stepped up efforts to address farmers' concerns this year. He recently replaced an agricultural secretary seen by many as indifferent toward the farm sector with an experienced farmer and politician, Ernesto Figueras, who instituted support prices—albeit at symbolic, low levels—for corn and sorghum soon after taking office. In addition, Alfonsin halved interest rates and devalued the austral by 7 percent in late February. Moreover, he recently approved a major rescheduling of farm debt owed to official banks and created a new 90-day bond to finance planting. He also appears to

Argentina: Cattle Inventory, 1977-87 [a]



[a] As of 1 January of the stated year.

Unclassified 312287 3-87

support some efforts to decrease transportation and port costs, such as making the state-owned railroads more efficient and allowing privately run port elevators, and is considering the elimination of most export taxes, according to press reports. Nevertheless, we believe Alfonsin opposes expensive farm programs that serve to boost production regardless of market forces [redacted] (b)(3)

Outlook and Implications for the United States

Over the short term, Alfonsin's actions are likely to undercut a nascent farmer movement to halt farm debt payments, while serving to increase farmer share of the export price and decrease the cost of credit. Given the Argentine Government's track record of taxing agriculture to support industry, however, farmers may wait to see if Alfonsin's profarm policy continues beyond the election before they change production strategy. Over the longer term, a switch back to livestock spurred by current high meat prices, and an increase in fruit and vegetable production—many Argentines are impressed by Chile's success—could aid some producers. We believe, however, that persistent low world prices will cause continued difficulties for the vast majority of farmers and for the Argentine foreign payments position [redacted] (b)(3)

Although US farmers may marginally benefit from a drop in production on the part of a major competitor, an increased emphasis on intraregional trade could make US sales to traditional Latin partners more difficult. In addition, unless Argentina can significantly boost industrial exports, US bankers, among others, will probably be called upon to finance current account deficits for some time to come. Moreover, even if export taxes on soybean meal and oil were eliminated, a small tax on soybeans could remain. This would allow Buenos Aires to continue its indirect subsidy to the oilseed crushing industry, something the United States opposes [redacted] (b)(3)

[redacted] (b)(3)

Approved for Release: 2018/08/22 C05743492

International Financial Situation: Delayed Lending Postpones Mexican Economic Growth [redacted] (b)(3)

The delay in securing final approval of the commercial bank lending package has postponed President de la Madrid's economic plans and is already causing him to abandon fiscal and monetary prudence in favor of measures designed to bring quicker results. Mexico's goal during negotiations with creditors last summer was to obtain financing for an economic recovery sufficient to ensure a resounding victory for the ruling Institutional Revolutionary Party (PRI) in the 1988 national election. De la Madrid's negotiators were successful, but the reluctance of European and smaller US regional commercial banks resulted in a nine-month lag between the banks' agreement in principle to lend $7.7 billion [1] and finalization of the package on 20 March. [redacted]

Current Economic Situation

The Mexican economy currently is sputtering along awaiting the infusion of foreign lending, and the delay has been costly to de la Madrid's economic growth goals. [redacted] According to press and US Embassy reporting, to achieve a turnaround from last year's GDP decline of 3 to 4 percent:

- De la Madrid planned to use foreign loans to finance a 15-percent real increase in government investment in such labor-intensive areas as housing, infrastructure, and other public works.
- Indirectly, he further expected the injection of foreign lending would relieve the liquidity squeeze that gripped private businessmen last year and, combined with a new tax law, stimulate a 10-percent increase in private investment. [redacted] (b)(3)

Compensating for Lost Oil Revenues

Mexico was able to meet its external obligations last year despite an $8.5 billion drop in oil revenues and an absence of new net commercial bank lending. Given these setbacks, yearend current account results came as a surprise to most observers:

- *Capital flight was reversed as an estimated $1.5 billion was repatriated last year.*
- *Nonoil exports grew 34 percent over 1985 levels. At the same time, imports were reduced by 15 percent.*
- *These trade figures combined with lower than expected interest payments to limit the current account deficit to only $1.1 billion, after initial* (b)(3)
  projections of up to a $3 billion gap [redacted] (b)(3)

Mexico achieved these results largely through its aggressive devaluation of the peso, extremely tight monetary policy, and the slowing of domestic demand. On the monetary side, tight government credit policies—necessary to finance the budget deficit— (b)(3)
forced Mexican businessmen to return their assets (b)(1)
from abroad to keep business afloat. [redacted] (b)(3)

This year, oil revenues will again be well below 1985 levels. However, the measures that proved effective last year in limiting the current account deficit will not be repeated again this year, we believe, because the economic recovery de la Madrid has promised will require cheap imports and easy credit. Although Mexico was able to adjust to lost oil revenues largely on its own last year, this year's political realities demand that 1986's unpopular policies be replaced by relatively painless foreign borrowing. [redacted] (b)(3)

---

[1] Mexico's total financial package amounted to $13.7 billion. The $7.7 billion commercial bank portion is in three parts: $6 billion is direct lending, while $1.2 billion and $500 million are contingent on Mexican oil export prices and manufacturing growth, respectively. Although Mexico will qualify for the $500 million loan, lending under the oil contingency only is made available if prices fall below $9 per barrel. [redacted] (b)(3)

Mexican Balance of Payments, 1984-88

Million US $

	1984	1985	1986 [a]	1987 [b]	1988 [b]
Current account	4,238	541	−1,127	−3,093	−3,133
Trade balance	12,942	8,405	4,377	3,552	4,126
Exports, f.o.b.	24,196	21,866	15,760	17,652	19,644
Oil	16,601	14,767	6,259	7,391 [c]	8,870 [d]
Other	7,595	7,099	9,501	10,261	10,774
Imports, f.o.b.	11,254	13,461	11,383	14,100	15,518
Public sector	4,790	4,354	3,216	4,800	5,520
Private sector	6,465	9,106	8,167	9,300	9,998
Services and transfers balance	−8,704	−7,865	−5,504	−6,645	−7,259
Interest payments	−11,716	−9,917	−8,734	−9,695	−10,520
Public	−9,337	−8,012	−6,894	−7,557	−8,259
Private	−2,379	−1,905	−1,840	−2,138	−2,261
Maquila	1,155	1,282	1,305	1,462	1,608
Net tourism	1,304	1,052	1,171	1,288	1,352
Other	553	−281	754	300	300
Capital account	39	−1,276	1,662	6,144	5,088
Long term	3,617	295	348	7,214	5,132
Liabilities	3,913	530	548	7,414	5,332
Public	3,136	471	−672	5,800	3,402
Gross borrowing	3,353	1,997	3,076	8,109	5,580
Amortizations	−1,691	−2,006	−3,748	−2,309	−2,178
Other net income	1,474	480	0	0	0
Private	777	59	1,220	1,614	1,930
Foreign investment	391	490	1,042	1,225	1,480
Other liabilities	386	−431	178	389	450
Assets	−296	−235	−200	−200	−200
Short term	−3,578	−1,571	1,314	−1,070	−44
Liabilities	−1,972	−712	−211	−180	310
Public sector	175	88	20	10	10
Private sector	−2,147	−800	−231	−190	300
Assets	−1,606	−859	1,525	−890	−354
Errors and omissions	−924	−1,688	−263	−1,500	−2,500
Change in net reserves	3,353	−2,423	272	1,551	−545

[a] Estimated.
[b] Projected.
[c] Oil assumption: export price of US $ 15 per barrel and exports of 1.35 million b/d
[d] Oil assumption: export price of US $ 18 per barrel and exports of 1.35 million b/d.

(b)(3)

To expedite economic recovery, Mexico now is turning to looser monetary policies and a slower devaluation of the peso, a reversal of the strategy that last year allowed the country to meet its external obligations while weathering an $8.5 billion loss in oil revenues. Until new bank loans are disbursed at the end of April, Mexico City will continue relying on domestic resources to finance its budget deficit. This approach has resulted in monetary growth of nearly 70 percent and an annual inflation rate of 125 percent last month, according to the US Embassy. Despite rising inflation, [redacted] the head of Mexico's central bank is under pressure to reduce interest rates. [redacted]

Politics Shaping Economic Policy

Next year's election is clearly the driving force behind economic policy, in our view. Following Mexican tradition, de la Madrid will name the PRI's presidential candidate, most likely next fall, and he will be elected in September 1988. Until the successor is named, three current contenders—Salinas; Alfredo del Mazo, the Secretary of Energy, Mines, and Parastatal Industries; and Manuel Bartlett, the Interior Secretary—will support populist policies in an effort to make themselves acceptable to key interest groups within the ruling party. Salinas in particular is mindful that his political stock will rise or fall with the economy and, as a result, is bucking the conservative Bank of Mexico to continue along the expansionary monetary path. [redacted]

Among the groups backing the ruling party, organized labor is the most powerful, and we believe the Mexican leadership will reward it for its support. Labor has sacrificed the most as a result of de la Madrid's austerity program, which, in retrospect, has done little to improve the economy. Workers now are looking for a restoration of living standards, which have fallen 40 percent since de la Madrid took office. Recent developments demonstrate its influence:

- Last October an unprecedented third wage hike was granted in addition to the traditional midyear and end-of-year increases.
- The cost-conscious, anticorruption head of Mexico's state-owned oil company was replaced [redacted] (b)(3) (b)(1)

The additional concessions we expect labor to achieve as the election nears—quarterly wage increases and additional jobs, for example—will come at the expense of reducing inflation and the massive federal budget deficit [redacted] (b)(3)

Outlook

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

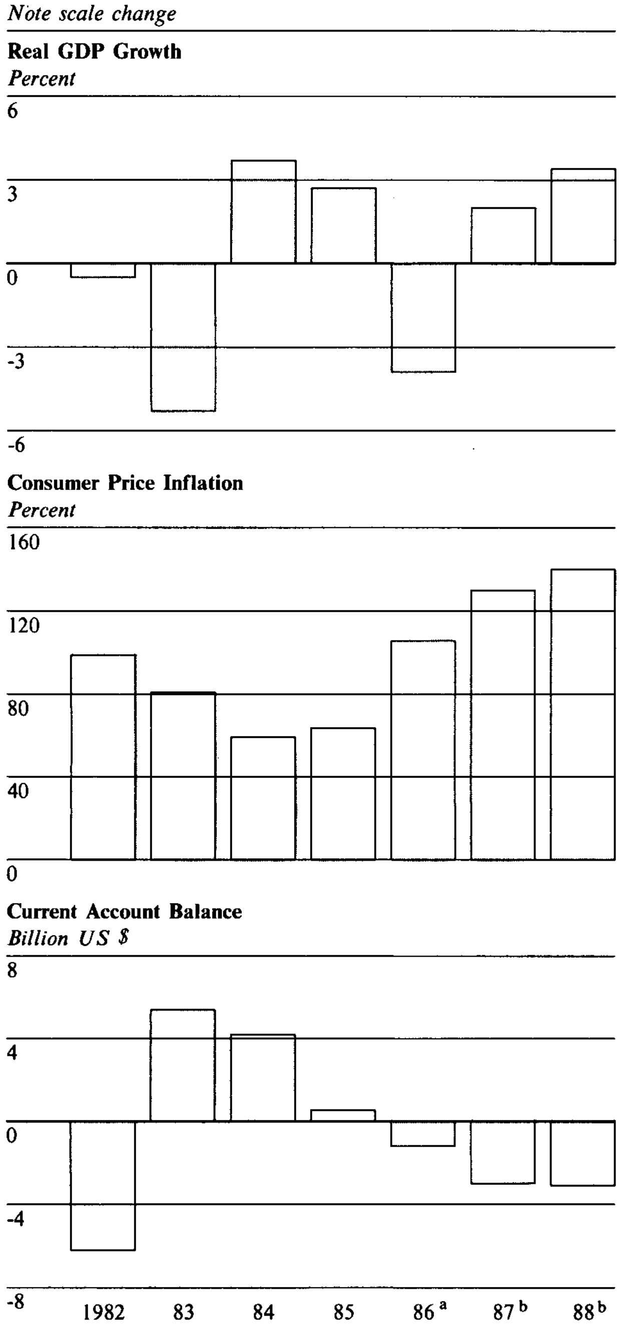
The next 18 months will be crucial for the PRI with the approach of the presidential election and lagging support for the party. New lending, expansive government policies, and an appreciation of the peso probably will produce a modest economic recovery this year and somewhat better performance in 1988. Nevertheless, this growth will come with some painful trade-offs, particularly in terms of higher inflation. On the basis of our econometric forecasts, we project:

- Real GDP growth of 2 percent this year and 3 to 4 percent in 1988.
- Private consumption rising 1 to 2 percent this year and 2 to 3 percent next year, after a 4.4-percent decline in 1986.
- Only modest increases in private investment of 3 to 4 percent and 2 to 3 percent in 1987 and 1988, respectively.
- Despite job creation efforts, the rapidly expanding labor force will drive unemployment 2 to 3 percentage points higher before de la Madrid leaves office. (b)(3)

[redacted] (b)(3)

Although the results we project are far from spectacular, we believe they will be sufficient to satisfy the party's political objectives. However, by late 1988, we foresee financial problems again for Mexico. We believe foreign bank lending and a healthy level of foreign exchange reserves will allow Mexico City to finance its current account deficit this year, but in 1988 it will take another large infusion of capital if

Mexico: Selected Economic Indicators, 1982-88



[a] Estimated for GDP only.
[b] Projected.

[redacted] 312293 3-87 (b)(3)

the country is to remain solvent. Because Mexico is unlikely to make tough economic adjustments between now and the 1988 election, we think it likely that de la Madrid's successor will face a financial crisis soon after he takes office. The difficulty in arranging the latest financial bailout, however, does not bode well for continued lending, in our view. [redacted] (b)(3)

[redacted] (b)(3)

France: Privatization Going Well [redacted] (b)(3)

The privatization of a large number of nationalized French companies—one of the key aspects of Prime Minister Chirac's economic "revolution"—has proved less controversial than expected and is one of the most successful of the government's economic initiatives. Although denationalization has gotten off to a slow start, the first public offerings were carried out relatively smoothly and were popularly received. As a result, the government has decided to try to speed up the program. If completed as planned, the scheme will return 65 banking, insurance, and industrial companies, worth an estimated $35 billion, to the private sector by March 1991 and reduce direct government ownership in the economy from an estimated 28 percent to about 10 percent. The government has stated that it will use the money generated to reduce the national debt or to financially strengthen remaining public corporations. [redacted] (b)(3)

A Pillar of the Economic Revolution

Inaugurated in March 1986, the Chirac administration aimed to transform an economy dependent upon government intervention into one based on free market principles. The government's economic plan, guided primarily by Economics Minister Balladur, included: privatization of nationalized firms; decontrol/reform of prices, exchange rates, and financial markets; tax cuts and tax reform; and measures to increase labor market flexibility. Most of these policies had been tried to some extent in previous—even Socialist—administrations. Privatization, however, was solely a Chirac government initiative [redacted] (b)(3)

The privatization plan was the first issue to cause a "cohabitation" confrontation between the conservative Chirac and Socialist President Mitterrand. In July 1986, when the government sought authorization for denationalization by decree without prior parliamentary debate and Mitterrand refused, the Chirac government then moved quickly, using deft parliamentary maneuvering to get the bill passed in two weeks. Implementation of the plan was slow and cautious, however, as the government wanted to ensure success and to avoid selling off public assets at "bargain basement prices"—a charge that the Socialist opposition was already leveling. [redacted] (b)(3)

As a result the first three companies [1] earmarked for privatization were profitable, financially sound, and attractive to private and institutional investors. At the same time, the government appointed a seven-member commission to advise it on the valuation of these companies. The Economics Ministry also began hiring outside auditors to prepare financial reports on the companies and to solicit bids from financial institutions that wished to act as advisers and/or market makers for each privatization. [redacted] (b)(3)

[redacted] (b)(3) (b)(1)

[1] Saint Gobain, a glass and packaging manufacturer; Paribas, an investment bank; and Assurances Generales de France, an insurance firm. [redacted] (b)(3)

The Government's "Golden" Share

The privatization law stipulates that the government may—at the discretion of the Minister of Economy, Finance, and Privatization—retain a golden or special share in companies being sold for up to five years. This rule is to counter criticism that the privatization plan would lead to foreign domination of French companies and to keep the government's hand in some business. Use of a special share allows the Minister to approve or disapprove ownership of more than 10 percent of the privatized company by any domestic or foreign firm. French officials point out that, unlike the British golden share, the law does not give the government the right to intervene in management decisions. French officials also have said the government would use its share option sparingly and only in special cases. The government did invoke this privilege for the early limited sale of stock in the oil company Elf Aquitaine and has stated that it will apply to the sale of the Havas advertising agency and the computer company Bull. The special share will probably also be invoked for defense-related companies such as Matra and Thomson. [redacted] (b)(3)

The privatization law also imposes a 20-percent limitation on the amount of company equity that can be sold to foreign interests during the initial offering, and the Economics Minister has the right to lower this limit. There is, however, no statutory limit as to how much equity foreigners may purchase on the secondary markets once the company is privatized. The only exception is that the Economics Minister still must approve foreign investment over 5 percent in companies whose activities involve national security, public health, or public order. Nonetheless, [redacted] the Treasury does plan to closely monitor the secondary markets to ascertain the aggregate amount of shares held by foreigners in a company. [redacted] (b)(3) (b)(3)

Every Frenchman a Capitalist

The Chirac government, hoping that its privatization scheme will promote "popular capitalism" in France, has tried to ensure that denationalized shares are as widely held as possible. The government's aim was not only to assure public acceptance of the plan, but also to make it more difficult for a subsequent government to renationalize the companies. Toward this end, 10 percent of the shares are offered to the firms' employees at a 5-percent discount and purchasers receive a bonus rebate for holding their shares more than 18 months. The government also financed extensive publicity campaigns—extolling the benefits of share ownership—prior to the initial offerings. The shares were sold through France's 17,000 post offices as well as banks and stockbrokers. Other bonus schemes included fractional shares for small private shareholders who keep their stock over 18 months. Last, the government has sold the shares at attractive prices, although not so low as to validate Socialist Party criticism about giving away government assets. [redacted] (b)(3)

All of these moves have paid off. The government kicked off its program last September by selling 11 percent of its holdings in Elf Aquitaine. These shares, which were priced about 10 percent below market levels at the time, were quickly grabbed up. The offering was oversubscribed sixfold and attracted 390,000 buyers of 10 shares or less. The first full-scale denationalization occurred in November with the sale of St. Gobain. This offering proved to be an even greater success. The sale was 14 times oversubscribed and the original 20-percent allotment for foreign buyers had to be cut to 18 to satisfy domestic demand. The sale of Paribas was 40 times oversubscribed and shares were sold to more than 3.8 million investors. As a result the allocation of shares to investors had to be cut considerably with individual French buyers being given a maximum of four shares each. As before, the overseas allocation had to be cut to meet internal needs. [redacted] (b)(3)

The government now plans to accelerate the privatization schedule. It recently announced that Societe Generale—France's fourth-largest bank—will be sold in the second half of this year along with four smaller banks. This sale will be especially significant in political and psychological terms because it will mark the first time a company nationalized in the wholesale takeovers of 1945 has been totally returned to the private sector. In addition, the government is selling the Havas advertising agency and, in "off-market" (b)(3) (b)(3) (b)(1) sales to investor groups, France's premier television station TF-1 and the telecommunications switch supplier Compagnie Generale des Constructions Telephoniques. The CGCT sale has been delayed in the past and has become controversial because of stiff competition for the 20 percent of the company to be sold to foreigners. The next market privatization, expected in May, will be the giant electrical engineering and telecommunications group Compagnie Generale d'Electricite. [redacted] (b)(3)

Chirac's Major Success

The French privatization program will probably be Chirac's most popular and lasting legacy. Most of the government's social initiatives have been abandoned in the face of opposition from students, workers, and other interest groups. The government's other economic initiatives—while important—had their roots in past regimes and seem to pale in the public mind in comparison to the radical about-face in French economic policy embodied in privatization. [redacted] (b)(3)

If privatization follows its planned four-year course, 65 firms including nine major manufacturing companies and 42 banks and finance companies will be returned to private ownership. The total value of shares quoted on French stock markets will have increased by 40 percent and millions of Frenchmen will have become shareholders. The number of investors who purchased Paribas stock alone is more than double the estimated 1.5 million stockholders in France before privatization began. [redacted] (b)(3)

The sales will have returned $35 billion or more to the French Treasury, and the government's direct ownership in the economy will be cut from an estimated 28 percent to 10 percent. It is impossible to predict at this point whether or to what extent a new government—probably elected in 1988—will proceed with further privatizations. The success of the program suggests, however, that denationalized companies—with the probable exception of TF-1—will be left in the private sector and that even the Socialists—if they took over the government—might be tempted to carry out a few more selective privatizations. [redacted] (b)(3)

[redacted] (b)(3)

Approved for Release: 2018/08/22 C05743492

Smaller Gulf States: Mixed Economic Performance and Prospects [redacted] (b)(3)

Bahrain, Qatar, and the United Arab Emirates all have limited prospects for economic growth in the near term. The still substantial financial resources of all three states, however, will allow ruling regimes to shield their nationals from the continuing recession in the Middle East and to cover current financial shortfalls. Nonetheless, the recession increases pressure on ruling families to broaden political and economic opportunities. Failure to accommodate or co-opt growing discontent among youth, the economically disadvantaged, religious fundamentalists, or the large foreign labor forces probably will create the potential for internal instability or external meddling over the long term. [redacted]

Coping With Lower Oil Revenues

The economies of Bahrain, Qatar, and the United Arab Emirates (UAE) differ sharply in structure and scope from their larger neighbors, but share a dependence on crude oil. The differences in these economies produced a mixed response to the contraction in oil prices over the past year. The UAE and Qatar, which depend on oil for about 45 percent of GDP, increased petroleum exports by 200,000 b/d and 30,000 b/d, respectively, to compensate for lower prices. The UAE's greater production capacity helped contain the drop in real GDP to about 3 percent for the year compared with a 9.6-percent decline in Qatar. Bahrain's greater economic diversification—only 20 percent of GDP comes from crude oil—helped hold the decline in GDP to 4 percent. [redacted] (b)(3)

Within these countries, the burden of austerity has not been evenly shared. For the most part, the large expatriate communities have borne the brunt of falling oil revenues. Nonetheless, the departure of many foreigners has not opened jobs suitable for domestic workers' ambitions and skills, which has contributed to a small, but growing unemployment problem. In Bahrain, slow economic growth has exacerbated government neglect of the underprivileged Shia majority—about 70 percent of the population. Qatar has progressively trimmed its extensive welfare system and curtailed plans to build additional housing and medical care facilities. Lower oil prices led Abu Dhabi and Dubai to reduce aid to the five smaller emirates while heightening competition between the two larger emirates for remaining oil customers. [redacted] (b)(3)

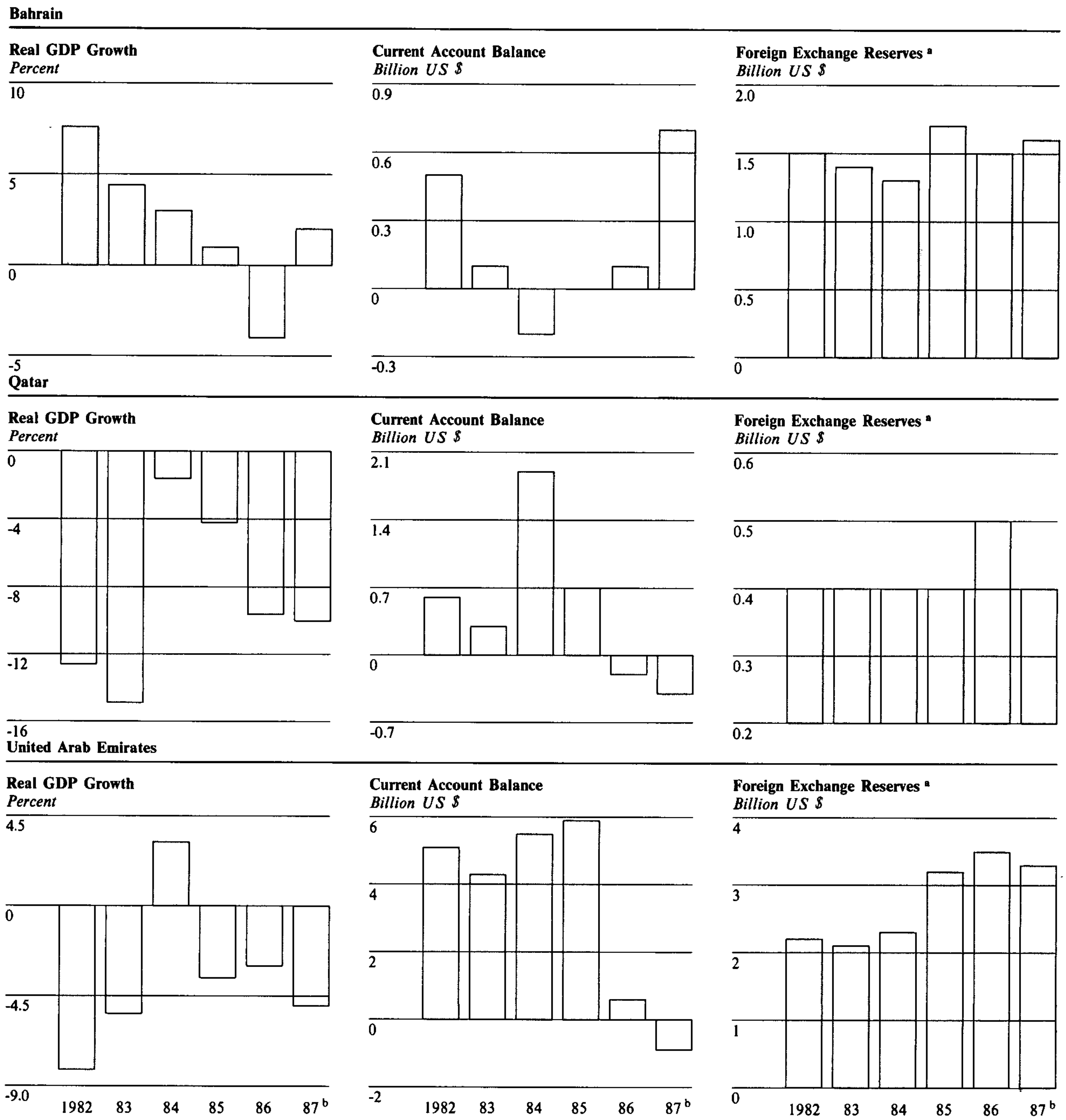
Trade and budget positions also have suffered since 1985. Imports in all three states were trimmed by as much as 17 percent last year to slow the deterioration of their trade surpluses. The real impact of the cuts is even greater, however, because all three states peg their currencies to the US dollar, which has eroded vis-a-vis the currencies of their trading partners. At the same time, sharply lower revenues forced all three states to slash planned expenditures by 15 to 18 percent in 1986 and to scramble for new sources of financing, according to US Embassy reporting. Despite minimal debt burdens, the small Gulf states have refrained from borrowing and moved instead to raise taxes, user fees, and trim subsidies to cover widening budget deficits. [redacted] (b)(3)

Revenue constraints and import cuts have slowed the pace of development programs to a crawl. Lower prices for petrochemicals, aluminum, cement, and agricultural goods have stifled growth of some promising sectors. More important, the downturn in Gulf economic activity has taken a serious toll on the booming financial services sectors. Bahrain, which has the largest banking services industry, has been hardest hit with many institutions burdened by nonperforming loans or facing bankruptcy [redacted] (b)(3) [redacted] Governments have been slow to deal (b)(3) with the problem to avoid confronting influential investors with their debt obligations [redacted] (b)(3)

Bahrain, Qatar, and the UAE all face sharply higher defense costs because of growing security concerns. Territorial problems between Bahrain and Qatar over the Fasht ad Dibal Reef and the Hawar Islands have

Small Persian Gulf States: Selected Economic Indicators, 1982-87

Note scale change



[a] Yearend data. Excluding gold.
[b] Projected.

312265 3-87

(b)(3)

brought the two states to the brink of hostilities. As a result, Manama has requested F-16 fighters and other equipment from the United States at a cost that would exceed $1 billion. Saudi Arabia probably will pick up much of the cost, but the package will still burden Bahrain's small economy. Qatar has planned a more modest air defense modernization program that could cost several hundred million dollars. The growing proximity of the Iran-Iraq war was brought home to the UAE last November by the attack—probably by Iran—on an oil production platform in Abu Dhabi waters. The government is seeking perhaps $1 billion in US aircraft and other air defense equipment. [redacted]

Political Dynamics

The downturn in small Gulf state economies is fueling already well-entrenched disgruntlement over the lack of political and economic opportunity, over corruption and greed in the ruling families, and over generational differences. The wealth disparity in Bahrain is one of the most pronounced in the Gulf. The military is increasingly resentful of the privileges granted expatriate personnel who predominate in Bahrain's military. [redacted] Nonetheless, calls for a return to representative government are largely ignored and the Amir and the government rely instead on traditional family ties and the security services to remain in control. [redacted]

Qatar has similar problems. The Amir rules as a tribal autocrat in conjunction with the extensive Al Thani family, leading merchant families, and the religious establishment. Poverty is not an issue in Qatar, but competition for important and prestigious positions by young, foreign educated Qataris could spark resentment against Al Thani family domination of domestic business, especially if the economic recession continues. Moreover, the regime depends on the still large foreign work force—two-thirds of the population—to operate much of the economy. Although currently quiescent, expatriates may cause problems for the regime if faced with large-scale job loss or nonpayment of contracts. The high standard of living, substantial proved oil and gas reserves, and an effective security force, however, reduce the chances for serious opposition to the Amir's authority. [redacted] (b)(3)

Limited oil revenue prospects are a threat to the stability of the loose federation of seven emirates, which comprise the UAE. Abu Dhabi's predominant oil wealth has enabled it to control federation politics since independence in 1971, but the increasingly educated populace and the growing economic independence in the northern emirates has brought calls for a greater say in federation politics. In addition, Abu Dhabi's small and lesser educated population limits its ability to retain control. Like Bahrain and Qatar, the UAE depends on a large foreign work force—including a sizable number of Iranians—whose allegiance is suspect. The power struggle and personal rivalry between Abu Dhabi and Dubai complicate the issue of federation leadership. Growing public disillusionment with the federation increases prospects for internal instability and external meddling. [redacted] (b)(3) (b)(3)

Outlook

The near-term prospects for economic growth in Bahrain, Qatar, and the UAE are limited. Real GDP probably will decline again in Qatar and the UAE if they stick to their new OPEC quotas. Trade surpluses in these two states also are projected to decline to their lowest levels of the decade. Bahrain's economy may grow slightly if oil prices remain near current levels. Nevertheless, all three states have substantial foreign investments and borrowing capacity at their disposal to maintain their relatively high living standards and cover current financial shortfalls. [redacted] (b)(3) (b)(3)

The smaller Gulf states' growing economic and political problems leave all three vulnerable to external meddling or subversion. Even so, the likely continuation of substantial Saudi payments and a loyal security force probably will be sufficient to keep Bahrain's economic concerns from posing a significant threat to domestic stability. Likewise, Qatar's substantial oil wealth and security apparatus should keep economic issues from boiling over. The disparity in wealth among the United Arab Emirates and the security concerns of the individual emirates probably will be enough to keep them together and even strengthen the federation. [redacted] (b)(3) (b)(3)

[redacted] (b)(3)

Briefs

Energy

Saudi Pipeline Construction Problems Persist

Mechanical problems are restricting the capacity of Saudi Arabia's East-West Petroline to some 2.6 million b/d rather than the planned 3.2 million b/d. [redacted] (b)(3) (b)(1) Riyadh this month has increased Baghdad's oil exports through the Iraqi spur line to about 500,000 b/d, raising concern among the Petroline's operators that a poorly designed connection between the two lines could lead to a significant disruption if the Petroline is forced to shut down quickly while Iraqi crude continues to flow. The capacity restriction will limit the Petroline's role as the only alternative outlet for Persian Gulf oil normally shipped through the Strait of Hormuz. When Saudi refinery deliveries are considered, only about 2 million b/d of Gulf crude will be able to move through the line. Even if the mechanical problems are solved, loading limitations at Yanbu, the Saudis' Red Sea terminal, will restrict exports to some 2.5 million b/d. [redacted] (b)(3)

New Brunei Oil Production Target

Brunei, a non-OPEC producer, plans to stabilize oil output at about 155,000 b/d for several years, down slightly from last year's nearly 167,000 b/d, according to US Embassy reporting. Although it might oblige neighboring Indonesia by claiming the cut is in support of OPEC goals, we believe Brunei's decision reflects the need to slow production to maximize output from the country's aging fields. There is little incentive for financially secure Brunei to mount an extensive effort to find new fields at current, relatively low crude oil prices. The low level of exploration underway now is more likely to turn up additional natural gas deposits, [redacted] (b)(3)

More Philippine Electrical Problems

Drought and maintenance problems may result in major electrical shortages in the Philippines' industrial heartland of Luzon, hurting production and the investment climate. According to the US Embassy, rainfall in many areas has dropped below 50 percent of normal levels, threatening hydropower production that accounts for roughly 15 percent of the island's power supply. A similar drought in 1986 contributed to brownouts and blackouts that upset Manila's business community. Moreover, [redacted] five (b)(3) major nonhydropower plants—accounting for more than 25 percent of Luzon's total capacity—were shut down in mid-March for equipment failures, fires, or scheduled maintenance. At least two of these plants will be out of commission through midsummer, during peak demand on nonhydropower sources, and several others need substantial maintenance. President Aquino recently took several steps—such as obtaining Japanese financing for a new coal-fired plant—to reduce Luzon's electrical woes by the 1990s. Little immediate relief can be expected, however, until hydropower reservoirs begin refilling with the late summer onset of the rainy season [redacted] (b)(3)

International Finance

Indonesia Finds Japan a Willing Lender

Japanese banks are prepared to provide Indonesia with a $328 million 10-year general purpose loan. The continued willingness of Japanese banks to commit sizable amounts to Indonesia, despite its faltering international credit rating, apparently reflects their belief that world oil prices are stabilizing. Moreover, Tokyo is sensitive to the long-term economic importance of Indonesia as a relatively secure source of strategic resources—especially oil and natural gas. We believe Tokyo views Indonesia's current economic crisis as an opportunity to strengthen the bilateral economic relationship and establish a firm foothold in the potentially lucrative Indonesian market. [redacted] (b)(3)

Zambia and the IMF Agree on New Auction

The Bank of Zambia has announced a new two-tier foreign exchange auction system scheduled to begin 28 March. The previous system was halted for two months because of the rapid decline of the kwacha and riots over IMF-recommended food price hikes last December, according to US Embassy reporting. Under the new auction system sanctioned by the IMF, foreign exchange will be allocated at both an official exchange rate of 11 cents per kwacha—a significant appreciation from the final auction rate of 7 cents under the former system—and an auction rate set by bidders—primarily importers—competing for a share of the weekly allotment of foreign exchange. The weekly allottment, not to exceed $9 million, depends heavily on foreign assistance, which will be in jeopardy until an IMF standby agreement can be reached. US and World Bank funding under existing programs, however, will probably ensure a smooth start up of the auction system. The viability of the system will depend on private-sector willingness to pay the premium auction rate. [redacted] (b)(3)

International Trade

(b)(3)

EC To Possibly Limit Japanese Auto Imports

The European Commission will most likely impose an annual 1.1-million unit import quota on Japanese passenger cars by the fall of 1987, [redacted] Recent Japanese press reports (b)(3) state that Japanese automakers plan to cut exports to Western Europe this April following warnings from MITI that exports to the EC were increasing too rapidly. Japanese car sales to Western Europe rose by a record 19 percent in 1986 to take a record market share of 10.7 percent; January sales were up 38 percent over January 1986. [redacted] (b)(3)

Global and Regional Developments

Spanish Interest in the European Monetary System

Prime Minister Gonzalez's goal of joining the European Monetary System (EMS) in 1989 or 1990 will most likely be met, despite some internal and external opposition. The EC Commission is wary, however, because of the instability a potentially weak currency could add to the EMS—just when the system is gaining credibility. In addition, some Spanish economic officials argue that EMS membership would mean less domestic control over fiscal and monetary policies. Nevertheless, membership has strong support in business circles, as well as from the Bank of Spain and the Economics Ministry—which believe that Britain's possible EMS entry in 1988 could pave the way for the peseta. Before joining, Madrid probably would seek a wider fluctuation band for the peseta—similar to that for the Italian lira—because of its concern about Spain's inflation rate vis-a-vis its EC partners. Madrid has already demonstrated its intention to keep inflation near its 5-percent target for 1987, and we expect it to take other steps to ensure the stability of the peseta. [redacted] (b)(3)

Intra-German Electric Power Proposal

East German leader Honecker, whose country faces serious electric power shortages, last week proposed linking the East German and West German power grids. Honecker's proposal, according to the press, calls for East Germany to buy power from West Germany and to deliver electricity to West Berlin. The East Germans would in turn use the proceeds from this arrangement to purchase much-needed air pollution control equipment. The deal would help East Germany with chronic winter power shortages, currently aggravated by a major power plant accident. Bonn appears interested, but any agreement involving West Berlin's electricity supply would have to satisfy longstanding Allied and West German concerns about the security of the city. West Germany has excess generating capacity and might eventually use such a link to supply other CEMA countries. [redacted] (b)(3)

South American Exchange Rate Misalignment

Several key South American debtors backpedaled from aggressive devaluation strategies last year. Free market exchange rates in Brazil, Argentina, Venezuela, Peru, and Paraguay traded at an average 60-percent premium over the official rates in 1986. In these countries exchange rates were fixed for most of the year or adjusted behind the pace of prevailing inflation, leading to a public perception that export competitiveness was eroding—we estimate the trade surplus for this group of key debtors fell by approximately $8 billion last year. In contrast, Colombia, Chile, Uruguay, Ecuador, and Bolivia, whose policies are to doggedly keep official exchange rates near free market levels, boosted their aggregate trade surplus by about $1 billion. In response to weakening trade accounts, many South American countries are moving to bolster export competitiveness. Brazil is increasing the frequency and size of its minidevaluations, while Argentina recently announced a large devaluation in an attempt to keep pace with rising prices and close the spreads between official and free market exchange rates. Caracas and Asuncion devalued in December, but the free market rates still exceed the official rates by 70 and 95 percent, respectively. Responding to rapidly accelerating inflation, Lima reduced the share of exports transacted at the official exchange rate and, since January, adopted monthly devaluations. Nevertheless, the perception that these currencies remained overvalued will continue to undermine export efforts. [redacted] (b)(3)

Thailand Concerned About Vietnamese Trade Ties to Japan

Bangkok is worried that Hanoi's efforts to obtain credits and technology from developed countries, particularly Japan, will ease pressure on Vietnam to withdraw its forces from Cambodia. [redacted] the Thai Foreign Ministry is seeking support from ASEAN members to condemn the increasing business activities in Vietnam of the Japanese trading company Nissho Iwai. Bangkok wants Tokyo to restrict the firm's activities, but we believe the Japanese Government will almost certainly reiterate that it has little control over the private sector. We believe other Japanese companies and a few West German firms are interested in establishing trade ties to Hanoi and probably will watch the new leadership's progress on economic reform to pace their efforts. The public probing these companies are likely to make over the next year is almost certain to provoke additional Thai, and possibly ASEAN, demarches as well as requests that Washington lobby Tokyo and Bonn. [redacted] (b)(3) (b)(3)

[redacted] (b)(1)

National Developments

Developed Countries

Japan Considers Public Works Spending

According to press reports, Tokyo is considering the unusual step of including $12 billion of public works spending in the $59 billion provisional budget designed to tide the government over—for 50 days beginning on April 1—while the Diet impasse on next year's budget is resolved. Provisional budgets generally cover only essential operating expenses. The Nakasone government probably believes that putting off public works projects at this time, however, could slow the already struggling economy, which grew by only 2.5 percent last year. Although the public works spending in this provisional budget represents about twice the amount that would be spent in 50 days under the full budget if expenditures were spread evenly throughout the year, it does not signify a change in the Nakasone government's austere fiscal policy. Indeed, Tokyo had already planned to push forward many of the programs originally scheduled for later in the year. In any event, Nakasone probably hopes that such public works spending will help defuse Diet criticism of his fiscal policies. [redacted] (b)(3)

(b)(3)

Strong Mark Hurting West German Trade

Preliminary data indicate West Germany's seasonally adjusted trade balance dropped 20 percent in real terms in fourth quarter 1986. This is the sharpest fall in three years and the sixth consecutive quarterly decline—the longest downturn in at least 10 years. Moreover, because trade volumes react with a lag to exchange rate changes, the surplus is likely to weaken further. The decline in net foreign demand lowered GNP growth in the fourth quarter by 1.5 percentage points. In addition, by threatening a loss of West German market share, the downturn may also be adversely affecting investment decisions and hence medium-term growth potential. The worsening trade performance comes at an inauspicious time for Chancellor Kohl, whose Christian Democrats face five state elections by early fall. [redacted]

[redacted] (b)(1)

Italy Lowers Discount Rate

The Bank of Italy has reduced the official discount rate by one-half percentage point to 11.5 percent while imposing a 25-percent reserve requirement on the foreign exchange liabilities of commercial banks. Both measures reflect the effort of Italian monetary authorities to curb increases in foreign borrowing. The decrease in the discount rate, although smaller than expected, will narrow the still large interest rate differential between Italy and other major industrial countries. Moreover, according to unofficial estimates, the new reserve requirement could raise the cost of foreign borrowing by 1 percentage point. The measures are significant because they represent a break with the use of direct controls—such as a ceiling on foreign indebtness—toward more market-oriented solutions. [redacted] (b)(3)

[redacted] (b)(1)

[redacted] (b)(1)

Spain Plans Massive Railway Improvements

As part of its economic modernization program, Madrid has announced plans to spend $22 billion during 1987-2000 to renovate Renfe, the troubled state-owned railway system. Transportation Minister Caballero has indicated that the bulk of expenditure—one-third from the central government and two-thirds from Renfe—will occur by 1992 to prepare for the Olympic Games and the fifth centenary celebration of Columbus's discovery of America. Major features include the expansion of single-lane tracks, the improvement of suburban services, a new line to Andalucia, and the use of modern, high-speed trains on heavily traveled routes. While these ambitious improvements would make Spain's railways comparable to some of the best in the EC, we think they will be difficult to achieve—particularly in the early years of the program. Renfe is likely to be hard pressed to come up with the necessary funds—annual losses are currently $1.5 billion and total debt is estimated at $4.7 billion. [redacted] (b)(3)

Less Developed Countries

Brazil's Economic Slide Continues

Brasilia's current policy of allowing rapid price increases is politically risky for President Sarney. Economic growth is almost certain to slow to about 3 percent this year—sharply lower than the 8-percent annual rates since 1985—and inflation will probably top 300 percent for the year. Increased unemployment and lower real wages will probably further erode Sarney's standing with the public, the governing coalition, and the Congress. Preliminary data indicate that rising prices are cooling consumer demand and new investment. Press reports say that industrial production also is slipping because of a squeeze on imports, constraints on capacity, and strikes. The lack of a coherent economic plan is fueling financial speculation and rising inflation, according to the Embassy. Estimates by private industry indicate the monthly rise in prices was close to 20 percent in February, and Brasilia is reindexing the economy to blunt the impact on living standards. Nevertheless, strikes are increasing as workers seek new wage hikes. [redacted] (b)(3)

A senior Finance Ministry official told the US Embassy last week that a new economic plan will be ready by the end of the month. The program will have to be approved by the National Congress, however, and Central Bank President Gros told foreign creditors that it will not be implemented until June. Finance Minister Funaro told the press last week that the new plan will continue to emphasize growth. [redacted] (b)(3) (b)(1) The government's continued unwillingness to implement strong stabilization measures risks runaway price increases—possibly triggering widespread social unrest and calls to cut short Sarney's term of office. [redacted] (b)(3)

Guerrilla-Labor Links to Colombian Oil Industry

(b)(3)

Guerrilla ties to labor are an increasing threat to foreign oil investors and to Ecopetrol, the state-owned oil company. Since the Cano Limon–Covenas oil pipeline in northeastern Colombia was completed last March, the National Liberation Army and other guerrilla have increased their attacks on oil facilities and have begun to mobilize labor support for their activities. [redacted] the guerrillas have organized a determined campaign to recruit oil workers (b)(3) and that their efforts have been particularly successful with employees whose pipeline construction jobs are being phased out. We believe guerrilla influence over organized labor, particularly among oil workers, is likely to grow and could seriously jeopardize the Colombian oil industry. [redacted] (b)(3)

Ecuador's Battle Over Domestic Interest Rates

Ecuador's highest judicial body—the Constitutional Guarantees Tribunal (TGC)—has declared unconstitutional a floating interest rate system that President Febres-Cordero implemented last August as part of an economic reform package. According to US Embassy sources, the TGC claims the measure gave commercial banks too much control over interest rates violating a constitutional provision that prohibits favoritism for any economic group. Commercial banks are charging 36 percent interest on business loans, compared with 22 percent before the reforms were enacted. During the same period inflation has risen only 6 percentage points to 25.5 percent, raising real interest rates to 10.5 percent. The ruling is the latest example of efforts by the leftist-controlled TGC and other opposition groups to discredit administration economic reforms. Febres-Cordero says he will ignore the ruling, and the Tribunal lacks an enforcement mechanism. [redacted] (b)(3)

Zambia Diverts Copper Exports

[redacted] Zambia over (b)(3) the past year has gradually ceased shipping its copper exports through South African ports. As a result, nearly one-fourth of Zambia's total copper exports—about 10,000 metric tons per month—are currently being shipped from the ports of Beira, and Dar es Salaam. Copper exports, which totaled about 460,000 tons in 1986, account for approximately 90 percent of Zambia's export earnings. In addition, the government has directed the mining parastatal not to purchase South African equipment on spares if available elsewhere. Zambia's inventory of South African mining equipment and its technical equality, however, will probably frustrate efforts to shift to other suppliers. Although rerouting of the copper reduces Zambian dependence on South Africa, the relatively disruption-prone alternate transport routes and less reliable ports in Tanzania and Mozambique are likely to result in reduced export earnings. Moreover, Lusaka still relies on the South African route for essential imports and exports such as coffee, tea, and tobacco. [redacted] (b)(3)

New Philippine Land Reform Program

The Aquino government has approved a six-year, $3 billion land reform program that it hopes to get under way before the plan becomes bogged down in congressional politics when the newly elected legislature convenes in July. In the first phase, 2.2 million hectares—about one-fourth of all farmland—will be distributed to tenant farmers over the next three years, at a cost of $1.7 billion, with more land to be distributed later. Funding will be a major problem, however. In a move to raise at least $1.4 billion, President Aquino early this month directed that all proceeds from the sale of government corporations and assets sequestered from associates of the former Marcos government, and from non-performing loans held by government financial institutions, be devoted to the land reform plan. Finance Secretary Ongpin is seeking an additional $500 million from bilateral and multilateral aid donors, who will consider Manila's request at a special meeting in Tokyo next month. [redacted] (b)(3)

New Thai Trademark Bill Likely

Prime Minister Prem's government probably will submit a new trademark bill when the National Assembly reconvenes next week, according to the US Embassy. The government's aim is to step up protection of intellectual property rights and hopefully remove a source of bilateral friction with the United States. Bangkok last year agreed to improve its trademark law to bolster its chances of retaining trade benefits under the US Generalized System of Preferences, but the bill is almost certain to face a tough fight. Several small but vocal opposition parties—and probably some dissident members of Prem's coalition—probably will attempt to head off the legislation because of potential losses by politically powerful business groups and because of growing dissatisfaction with US trade policy. With the National Assembly preoccupied with a number of serious financial scandals, we believe the government may be unable to ensure passage during this parliamentary session, which runs until July. [redacted] (b)(3)

Indonesian Devaluation Cuts Real Wages

Jakarta's overall resistance to across-the-board pay increases since the 31-percent devaluation last September has left the majority of Indonesian workers worse off, according to the US Embassy. Indonesian labor economists estimate that higher prices triggered by the devaluation, coupled with increased public transport fares, have reduced workers' purchasing power by more than one-fourth. Jakarta, however, seems determined to avoid wage hikes that would raise the costs of manufactured exports and undermine a key objective of the devaluation. The government has convened a committee of government, labor, and business leaders to study the wage issue, and permitted some selective wage settlements—moves aimed at defusing a potentially explosive issue on the eve of next month's parliamentary election. [redacted] (b)(3)

Communist

Poor Soviet Economic Performance Continues

Last month, for the second straight month, the Soviet machinery sector failed to meet the goals of General Secretary Gorbachev's ambitious revitalization campaign, thereby threatening the attainment of this year's economic growth targets and posing a further challenge to Gorbachev's program. Although industrial performance improved somewhat from January to February, it was down by more than 1 percent when compared with the first two months of last year, according to our calculations. The machinery sector, which accounts for most of the decline in overall industrial production, continues to suffer from the effort to modernize plants while increasing production and improving quality. Stringent enforcement of more rigorous quality control standards is the dominant factor in holding down growth. The lackluster performance opening the year implies that Soviet industry will have to grow at more than 5 percent for the remaining months to meet this year's targets. Moscow has yet to indicate, however, that it will compromise any of Gorbachev's ambitious plans to ease the burdens on industry. [redacted] (b)(3)

Slow Progress on Soviet Joint Ventures

[redacted] (b)(3) (b)(1) Many details about joint ventures remain vague, casting doubt on their profitability. Western firms are interested in projects involving goods that will sell in the large Soviet domestic market, but Moscow's main objective is to expand hard currency earnings. Additional deals are likely to be signed over the next few months because some Western firms may be willing to risk small investments for the sake of gaining entry to the Soviet market. [redacted] (b)(3)

Tactics on Polish Price Hikes

The Jaruzelski regime reportedly hopes to blunt protest against price hikes planned for this spring by introducing the increases gradually and instilling a sense of public resignation. [redacted] (b)(3) (b)(1) Nonetheless, union leader and Politburo member Miodowicz last week called the planned price increases economically pointless and socially risky, and union leaders threatened to use their legal right to strike if the regime goes through with the price hikes. The government argues that real income is up, and price hikes are needed to avert a reduction in market supplies. Poland needs to limit subsidies and raise prices to impress its creditors and the IMF with its resolve in order to gain access to Western credits. Pressure from the increasingly outspoken unions will probably force Jaruzelski to accommodate demands for offsetting wage hikes, however, and such a compromise would largely cancel the positive effect on consumer demand and market supplies. [redacted] (b)(3)

Yugoslav Public Pressure Forces Price Freeze

Belgrade last week broadened price controls following nearly 70 strikes and widespread criticism of recent wage restraints. The decision rolls back prices for many food items, consumer goods, and other products and freezes them for 90 days. Workers, union leaders, and regional politicians had attacked wage restraints imposed last month as devastating to living standards at a time of triple-digit inflation. Premier Mikulic is trying to end the furor without backing down on his wage controls—even at the risk of a major confrontation with Western creditors. The decision to move only weeks before pivotal debt rescheduling negotiations with Western creditors suggests that the government is increasingly desperate. Belgrade almost certainly realizes creditors will view this as a retreat from Yugoslavia's commitment to economic reform and will now demand tighter external supervision—a condition Belgrade rejects—in exchange for further reschedulings. Mikulic, however, may try to turn weakness into strength by citing his problems as grounds for greater Western understanding. [redacted] (b)(3)

China Reorganizing Auto Industry

Beijing is scrapping its China National Automotive Industry Corporation (CNAIC)—established in 1982 to centrally direct the industry—in order to give greater decisionmaking powers to independent companies and local governments. A new China National Automotive and Motorcycle Industrial Federation is to serve as consultants and coordinators. [redacted] (b)(3) (b)(1) The 15.6-percent drop in vehicle output last year probably contributed heavily to the decision. Apparently at least three major independent manufacturers will be formed directly under China's State Council, but details will not be finalized for some time. The reorganization, and especially the delay in implementing it, will create confusion among Western investors and will raise new concerns about the validity of pending deals, adding to the problems already encountered by foreign carmakers in China. [redacted] (b)(3)

China Opens Door to Western Researchers

The Chinese Academy of Sciences recently announced that the first four Western scientists will carry out postdoctoral studies in Chinese laboratories. The scientists—from the United States, Sweden, France, and Canada—will study systems science, biochemistry, optics, and metallurgy. China announced last year that its institutes in the basic sciences would be opened to foreign researchers. Beijing is eager to showcase laboratories that have been upgraded with Western equipment, and to learn from resident foreign scientists. The numbers will probably remain small, however. Beijing will most likely limit the program to topics and institutes in which Chinese capabilities are exceptionally strong, and will have difficulty attracting Western scientists, who are generally skeptical about the research value of study in China. In contrast, China has sent more than 20,000 scholars abroad since 1978, and the number sent each year will probably increase. [redacted] (b)(3)

Record Low Cuban Sugar Harvest

Cuba's current sugar crop may be the lowest in eight years, according to US Interests Section estimates [redacted] Drought followed (b)(3)
by harvest rains could reduce the harvest to 6.5 million metric tons. The poor

harvest has already shut down sugar mills and caused delivery delays and could mean as much as a 10-percent fall in Havana's sugar exports. This would worsen already poor prospects for economic recovery and raise the cost to Moscow of supporting the Cuban economy. [redacted] (b)(3) (b)(1)

Approved for Release: 2018/08/22 C05743492

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

Approved for Release: 2018/08/22 C05743492

(b)(3)

Approved for Release: 2018/08/22 C05743492

~~Secret~~

~~Secret~~