

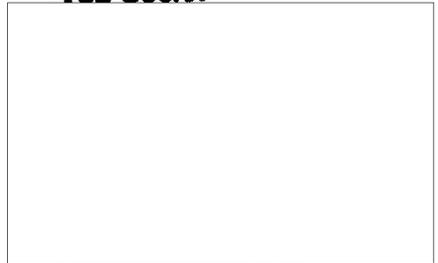
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Director of
Central
Intelligence

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Contents

USSR-US: Failure To Fulfill Grain Agreement 1

[Redacted] 2
[Redacted] 3
[Redacted] 4

Notes

[Redacted] 5
[Redacted] 5

France-New Caledonia: More Violence Likely 6

[Redacted] 6

Italy: Cabinet Introduces 1986 Budget 7

[Redacted] 7
[Redacted] 8
[Redacted] 8

In Brief 9

Special Analysis

OPEC: New Pressure on Oil Ministers 10

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1 October 1985



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USSR-US:

Failure To Fulfill Grain Agreement

Moscow has not purchased the remaining 1.1 million tons of US wheat called for in the second year of the US-Soviet long-term grain agreement.

The Soviets are required to make annual minimum purchases of 4 million tons each of wheat and corn under the agreement—which went into effect for five years beginning 1 October 1983. Soviet officials are dissatisfied with their exclusion from the US Export Subsidy Program and want a discount similar to the \$22 per ton recently offered Egypt. Moscow now considers the discounted US wheat price as the figure at which it will purchase US wheat.

Comment: Despite assurances in August that the remaining wheat would be purchased, it appears that the Soviets have balked over US preferential pricing to selected customers. Further wheat sales could be stalled until the issue of export subsidy qualifications is resolved. Competitors are offering wheat to the USSR at \$30-40 per ton less than US prices of about \$135 per ton, making it likely that US wheat prices—already at their lowest level in eight years—will be forced down further.

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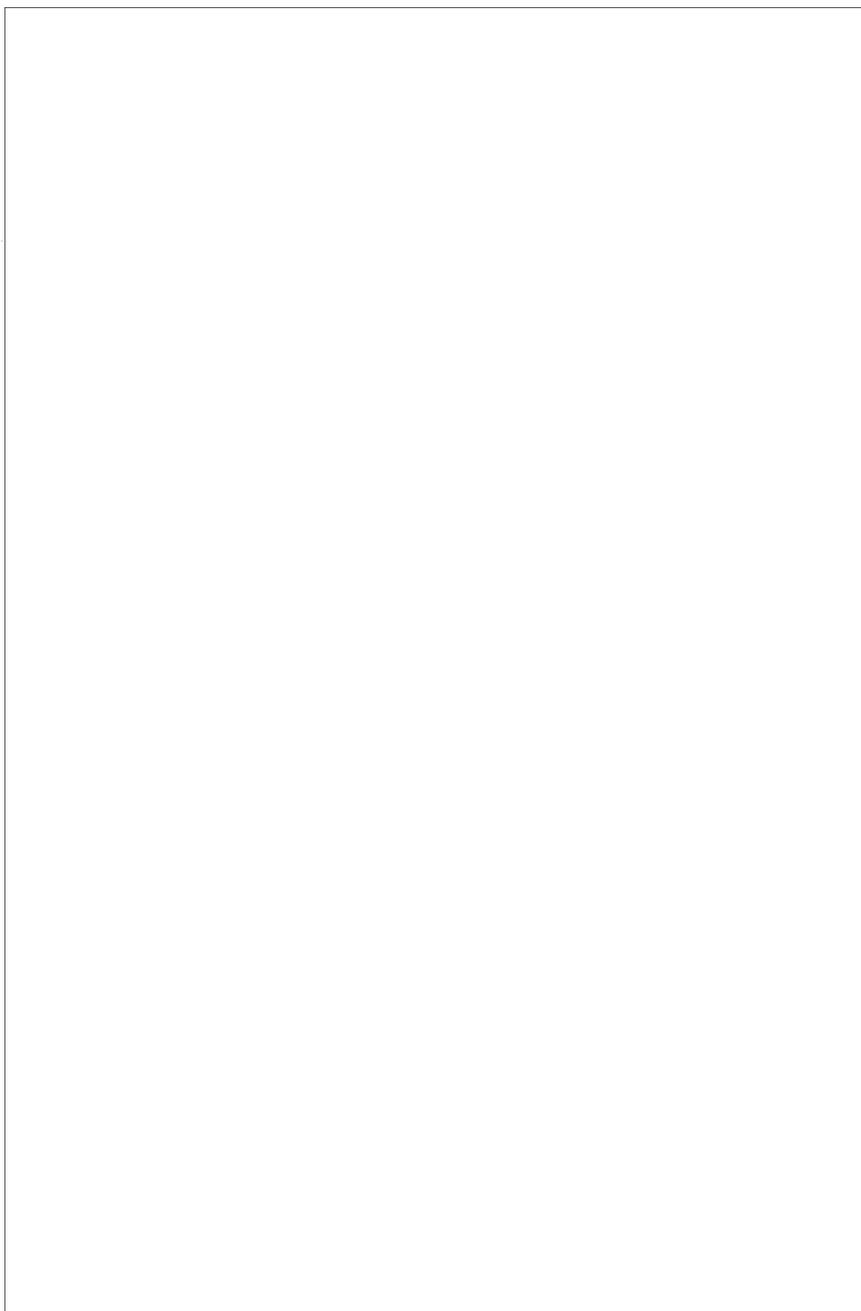
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FRANCE-NEW CALEDONIA: More Violence Likely

New Caledonian antiseperatists, composed of West European and Asian settlers, apparently will control the islands' new congress following elections Sunday. Separatist Melanesian parties, however, won hefty majorities in three out of four regional councils.

Comment: Although the respective powers of the congress and the councils are still ill-defined, the congress will probably gain the upper hand in both local and external affairs. The election results counter French Government claims that a majority of New Caledonians favor independence and give proponents of continued unity with France increased leverage to halt autonomy plans until after the French legislative election next spring. Separatists, however, will try to use the regional councils to press Paris for independence and to organize protests against the congress, virtually assuring more violence.

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ITALY: Cabinet Introduces 1986 Budget

After a month of sometimes contentious debate, the Italian Cabinet has agreed on a budget proposal for 1986 that would stem the growth of Italy's massive public-sector deficit, now 15.7 percent of GDP. The plan presented to Parliament yesterday calls for slightly lower income taxes to be offset by a \$4.4 billion cut in social spending. Italians will be required to pay more of their medical and transportation costs and contribute more toward social security to prevent the deficit from rising above the projected \$55.4 billion, or 14.5 percent of estimated GDP.

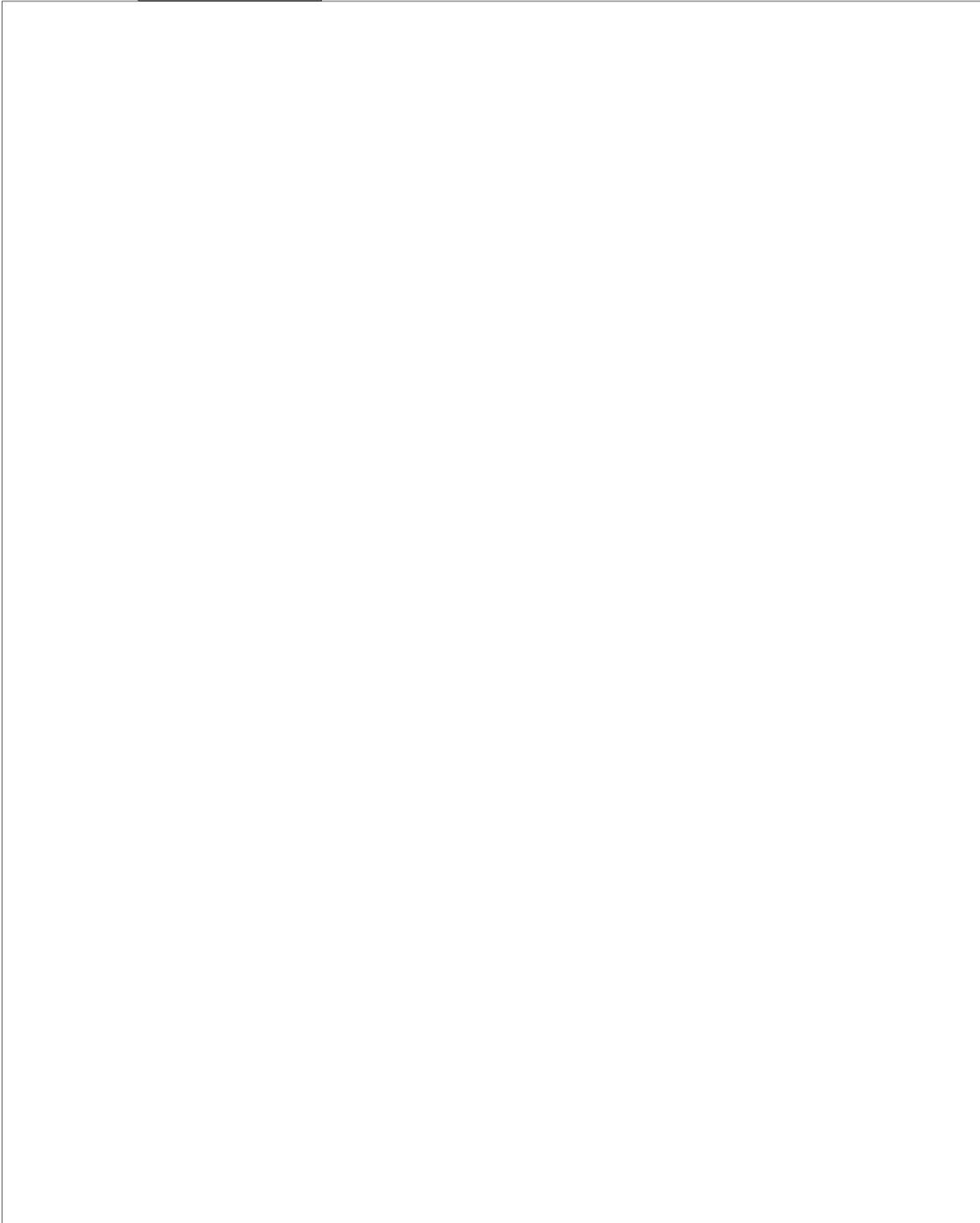
Comment: As presented, the 1986 budget is a politically strong step toward addressing Italy's budget problems. Winning agreement from the five parties in the Cabinet was not easy. In Parliament the Communist Party will strongly oppose the spending cuts and is likely to pick up enough support from sympathetic leftist members of the coalition to force the government to backpedal. In his two years in office, Prime Minister Craxi has been unable to reduce the budget deficit; another failure will undermine confidence in his ability to direct Italy's economic policy.

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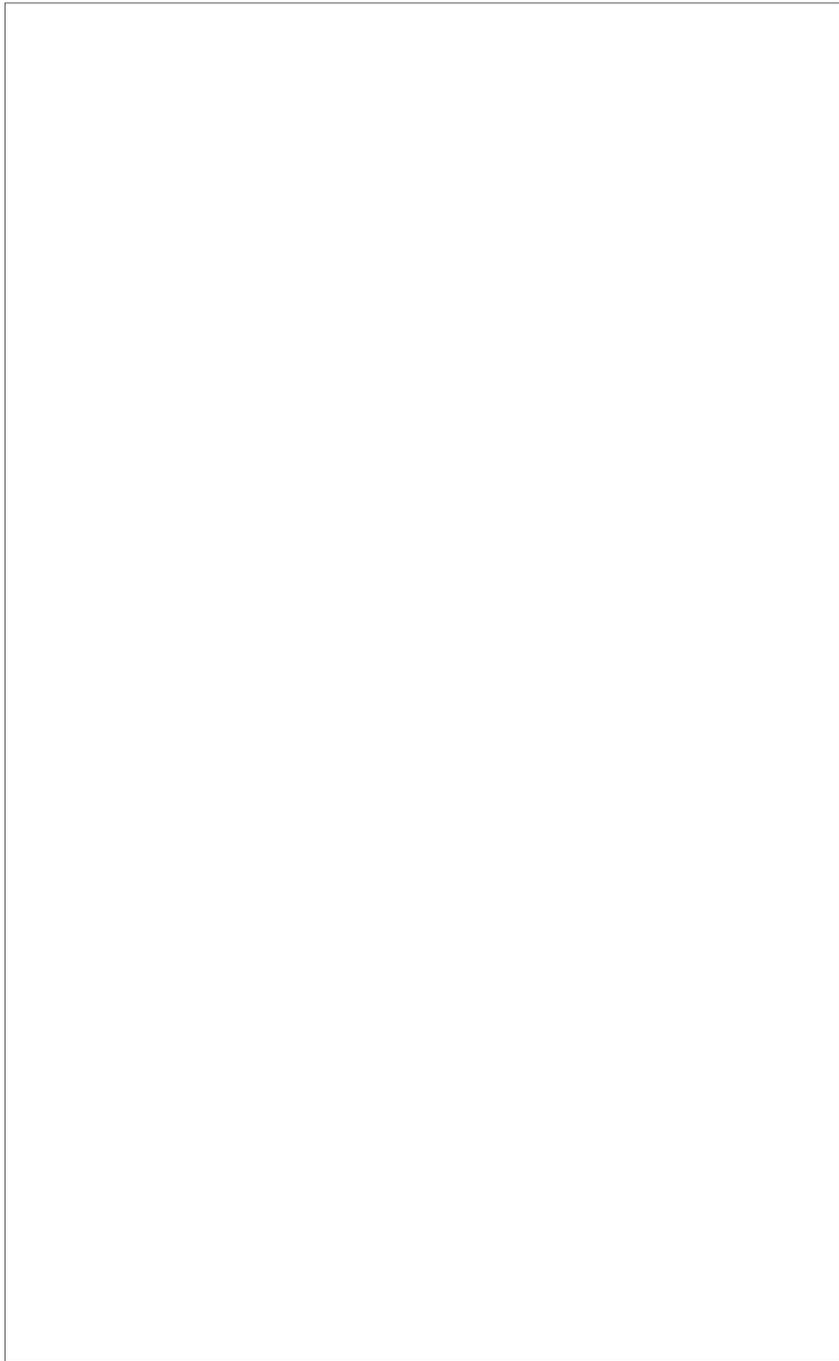
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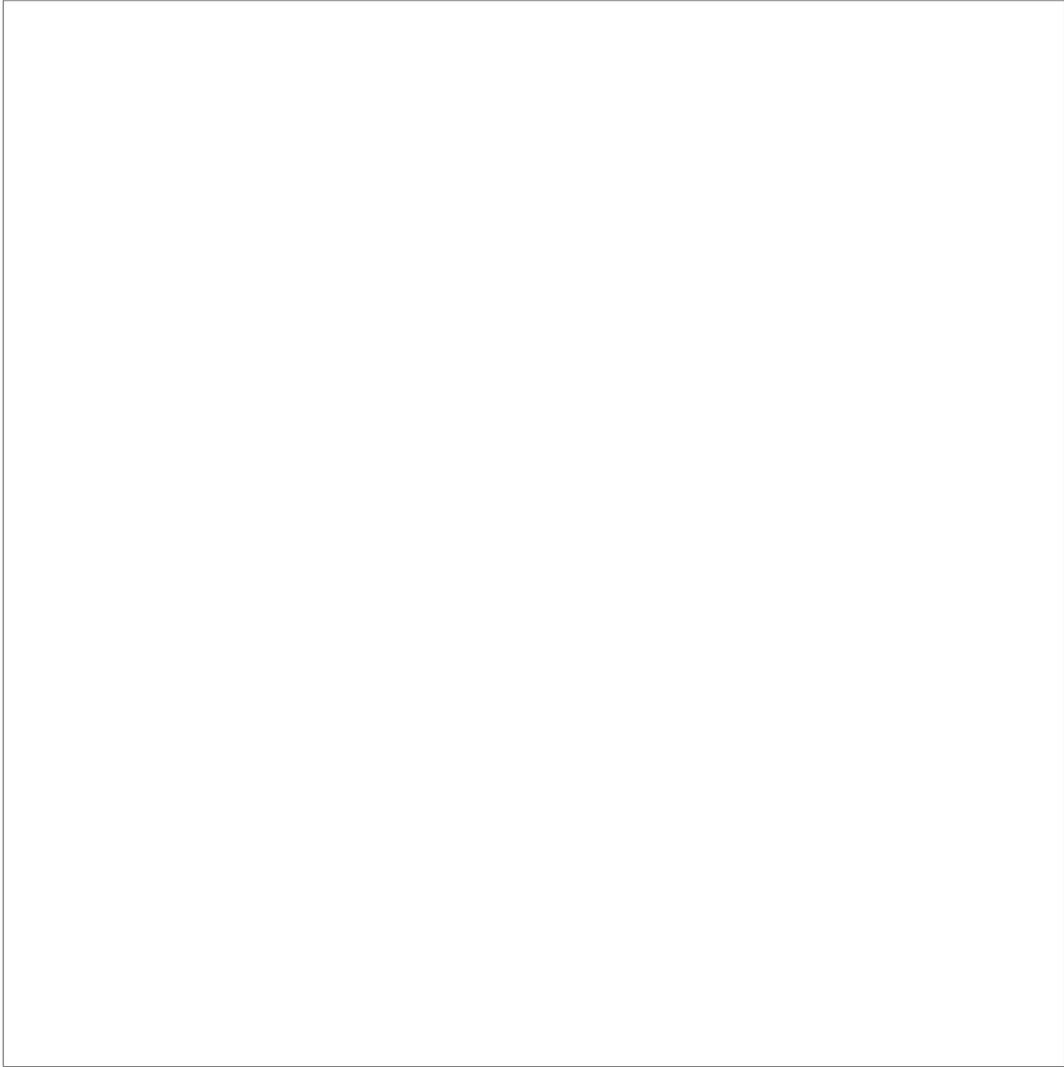


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In Brief

Middle East

— **Soviet Embassy in Lebanon** says three Soviet diplomats, one physician kidnaped in West Beirut . . . Islamic Jihad threatened to kill them unless attacks against fundamentalists in Tripoli cease . . . Moscow likely to ask Syria to work out release.

— **Ayatollah Khomeini** has sent letter to Iranian parliament advising retention of Prime Minister Musavi . . . probably worried Musavi's removal would imply government had failed . . . decision nevertheless victory for radicals.

Africa

— **Angola** claims South African aircraft yesterday attacked Mavinga area for second time . . . unconfirmed, but report of earlier South African airstrike accurate . . . Angolan or Soviet reaction uncertain at this time.

Europe

— **West German Social Democrats, East Germans** to start talks next month on nuclear-weapons-free zone . . . reached model chemical weapons agreement earlier . . . Kohl government probably will increase attacks on opposition's parallel foreign policy.

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[Redacted]

OPEC: Crude Oil Production

Million barrels/day
20



12

8

4

Saudi Arabia

0 Jan Feb Mar Apr May Jun Jul Aug Sep
1985 est.

• Does not include Saudi share of Neutral Zone production.

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Special Analysis

OPEC: New Pressure on Oil Ministers

OPEC ministers again will face seemingly intractable problems, compounded by a new Saudi marketing strategy, when they meet in Vienna on Thursday to discuss production quotas. Another round of price cuts is possible unless the Iran-Iraq war intensifies.

Demand for OPEC oil remains weak and has run more than 1 million barrels per day below the group's ceiling of 16 million b/d since the organization met in July. While most members have shown adequate restraint in production to keep prices from dropping, Saudi Arabia has still borne the brunt of production cutbacks. The most ominous development for OPEC is Riyadh's unwillingness to shoulder this burden alone and its intention to use price discounting to raise its output.

Saudi Challenge

Winter heating needs are expected to push demand for OPEC oil up about 1.5 million b/d during the fourth quarter. The Saudis have made it clear that they intend to capture the lion's share of this increase.

King Fahd also publicly asserted the right to set Saudi prices unilaterally as long as Riyadh remains within its OPEC quota.

Domestic pressures resulting from declining oil revenues led Riyadh to renounce its role as the swing producer in OPEC and forced the Saudis to abandon their previous strict adherence to OPEC's pricing guidelines. Riyadh's liquid international financial assets stand at \$90 billion, down roughly a third in three years. While this amount provides a cushion against further oil revenue losses, the Saudi budget deficit probably will run about \$20 billion this year. Moreover, Riyadh is loath to make further spending cuts, which would bite into programs that directly affect Saudi citizens and could weaken domestic political support.

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The Battle Within OPEC

The OPEC session could be all the more contentious because Iraq's new pipeline link to Saudi Arabia has become operational. Iraq already has stated its intention to run the pipeline at capacity—an estimated 500,000 b/d—and to ask for a commensurate increase in its quota. This, plus the planned increases in Saudi output, would cover nearly all the expected growth in oil demand. [redacted]

Several other members also could upset OPEC's tenuous balance. Nigeria's new President has decreed that oil policy will be based on national interest and, despite verbal support for OPEC, he is allowing Nigerian production to climb significantly. Severe revenue pressures in Indonesia and Ecuador will make them unlikely to restrain production voluntarily. Many countries believe they have already made major sacrifices to prop up prices, and their production restraint rests on the presumption that they would share in the general rise in winter exports. [redacted]

The Iran-Iraq war has polarized OPEC at a time when cohesion is essential to deal with an oil market that no longer takes the organization's actions seriously. Iran has threatened to match any increase in Iraqi exports, but the recent attacks on Khark Island have seriously affected Iran's capacity to boost exports. Another successful attack could knock out virtually all of Iran's exports for an extended period and prompt Iran to retaliate against other Persian Gulf oil shipments. [redacted]

Outlook

Because production quotas apparently will be the primary item on the agenda, the ministers will not be able to sidestep the contentious issue of quota increases. Given Saudi and Iraqi intentions, however, there is little room for compromise. Failure to reach an agreement that the major producers can live with could touch off another round of price cuts, notwithstanding higher winter demand. Should competition for market share intensify, prices could decline sharply—perhaps below \$20 per barrel. [redacted]

Continued Iranian oil export losses near the recent level of about 1 million b/d could enable others to increase output without adding to downward price pressures but would significantly raise the risk of a wider disruption of Persian Gulf supplies. Such an event could radically alter the prospect of a further weakening in oil prices. Furthermore, downward price pressures on OPEC could abate somewhat if the USSR's cuts in fourth-quarter oil exports to the West are substantial. [redacted]

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