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Trade between India and Western Europe has increased dramatically over the last decade in part as a result of Prime Minister Gandhi's economic liberalization program. The recent trade expansion probably will strengthen India's productive base, but the widening trade gap could prompt Gandhi to reinstitute import restrictions.

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Some articles in the Near East and South Asia Review *are preliminary views of a subject or speculative, but the contents normally will be coordinated as appropriate with other offices within CIA. Occasionally an article will represent the view of a single analyst; an item like this will be designated as a noncoordinated view.*

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Near East and South Asia Review [redacted] 25X1

Articles

The Soviet Union and the Libyan Succession: Limited Influence [redacted] 25X1

Over the past 10 to 15 years Libya has become increasingly dependent on the Soviet Union. This is particularly true in the sphere of military assistance. Although this dependence may give Moscow some influence over domestic political events in Libya or a succession, we do not believe it is sufficient to ensure the installation of a pro-Soviet regime there. [redacted]

In our judgment, Qadhafi's removal by assassination or coup would result in an intense—and possibly bloody—power struggle among several competing factions. These include:

- Qadhafi's relatives and tribesmen, who hold most key military and security posts but represent a small tribe requiring allies to retain power.
- Nationalists in the armed forces, who have domestic prestige and popularity but have so far been checked by Qadhafa control of the instruments of power.
- Exiled dissidents, who have been unable to establish much of a following in Libya, but whose long opposition to the regime and ties to the middle class may allow them to influence the succession.
- Radicals in the revolutionary committees, who are most committed to Qadhafi's ideology but are riven with tribal and personal rivalries and despised by most of the population—including the Army—for their abuse of power. [redacted]

Libya's dependence on the Soviet Union makes it unlikely that a successor government dominated by any of these groups—or, more likely, a coalition of two or more—would try to break ties to Moscow in the near term. If a post-Qadhafi regime hostile to the Soviets should emerge in Libya, we do not believe the Soviet investment there is so great that Moscow would try to remain by force, nor is the Soviet presence so pervasive that they could easily do so. The longstanding Soviet ties to Libya, however, especially with the military, may provide Moscow with avenues to influence a succession struggle or to attempt to subvert a hostile successor. [redacted] 25X1

Soviet Relations With Libya
The US Embassy in Moscow reports that the Kremlin views Qadhafi as erratic and unpredictable. It has resisted signing a friendship treaty with Libya and rebuffed Qadhafi's requests to join the Warsaw Pact. Perhaps indicative of the Soviet attitude is the remark of a Soviet official in 1981 who was reported by the press to have said "one should not forget that Colonel Qadhafi is a Muslim fanatic, with all that implies." [redacted] 25X1

It is not clear how seriously the Soviets take Libya's geostrategic position. They have avoided investing much political or economic capital in Libya compared to South Yemen or Syria. We believe, however, that Moscow harbors a desire for secure access to Mediterranean ports—the US Embassy in Moscow reports that the Soviets value the Libyan port calls made by their ships—and Libya could offer more extensive access to the Soviets. When under US pressure, Qadhafi has publicly threatened to offer such access, but he has failed to follow through. [redacted] 25X1
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At the same time, the Soviet Union has sought economic links to Libya that may also provide Moscow some influence. [redacted] 25X1
nonmilitary economic links between Libya and the

Soviet Union and its allies increased during Qadhafi's second decade in power, primarily due to the decline in world oil prices. [redacted] economic and trade ties between Libya and the Soviet Union were growing closer. In addition, Libya is a profitable source of oil and hard currency for the Soviets, according to the US Embassy. [redacted]

The Soviet Presence

We estimate that about 1,500 to 2,000 Soviet advisers and technicians provide essential instructional, planning, and maintenance assistance to Libya's military establishment. They are found in the Army and Air Defense Force down to the battalion level, in Libya's military schools, with many Navy and Air Force squadrons, and with the major staffs. [redacted]

The Soviets have had a profound influence on Libya's military planning. For example, [redacted] the Libyan Army has reorganized along Soviet lines, with battalions and brigades similar in size and composition to their Soviet counterparts. A Libyan contingency plan to attack US AWACS aircraft over Egypt, [redacted] appeared similar to Soviet contingency plans to deal with AWACS over Europe. [redacted]

In 1986 the Soviets were especially active in the Libyan Air Defense Force. Early in the year [redacted] the Soviets built Libya's first SA-5 surface-to-air missile complex to defend the Gulf of Sidra. Following the US airstrikes on Tripoli and Banghazi in April 1986, Soviet technicians repaired the missile defenses that had been damaged in the raids. Since then we believe the Soviets have assisted the Libyans in improving their control of their present air defenses, but they have not provided Tripoli with new weapon systems. [redacted]

Soviet naval units were also present in Tripoli before and after the US raids in a limited show of support for Libya. At the same time other Soviet naval units were involved in intelligence collection on the US and NATO fleets in the Mediterranean. Soviet IL-38 antisubmarine warfare and reconnaissance aircraft have periodically deployed on a temporary basis to Libya to collect against the US Sixth Fleet. The Soviets probably share some of this intelligence with the Libyans. [redacted]

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Despite the significant impact the Soviets have had on Libya's military readiness, strategy, and tactics, we believe they do not have a significant role in Tripoli's decisions regarding when and where to employ its forces. In our view, Colonel Qadhafi tries to protect his independence of action from Moscow and takes care not to be seen as a Soviet puppet. Early in 1986 the Soviets recommended that the Libyans not engage US aircraft in the Gulf of Sidra with the new SA-5s—advice that was ignored two months later. Moreover, the Libyan intervention in Chad almost certainly was mounted without heeding Moscow's preferences. [redacted]

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We believe the nonmilitary Soviet presence in Libya is too small and restricted to play an important role in influencing a Libyan succession struggle. [redacted] the number of Soviet military and civilian advisers in Libya is only 2,500, which suggests Soviet nonmilitary advisers amount to about 500. [redacted] the civilian Soviet presence is not concentrated in key areas. [redacted] most Soviets and East European civilian personnel in Libya are working in medical functions. [redacted]

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Soviet Capabilities

Soviet capability to influence a Libyan succession would depend on which groups came to the fore in the struggle to replace Qadhafi. In our judgment, a successor regime dominated by radicals from the revolutionary committees might prove resistent to Soviet influence. Qadhafi's ideological canon, the "Green Book," is openly hostile to Communism, and we believe many members of the revolutionary committees share this hostility. For example, senior

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revolutionary Musa Kusa has privately criticized the Soviets for their lack of militancy. Some of the more radical members of the Qadhafa tribe, such as Military Revolutionary Committee chief Muhammad Majdhub, may harbor similar contempt toward the Soviets.

Similarly, most of the Libyan exiles are conservative nationalists or Islamic activists and would be unlikely to turn to Moscow for support. Their lack of serious support in Libya probably would make them unattractive to the Soviets in any event.

Moscow's extensive and longstanding training of Libyan military personnel and its military advisory contingent in Libya suggest it may have some influence among regular armed forces officers and some Qadhafa tribesmen. Although the Libyan Army is likely to play an important, if not decisive role in a succession struggle, we believe Soviet advisers are too few and scattered to take control of the Libyan military and swing it into action. In addition, some Libyan soldiers may well resent the Soviet presence in Libya for political or cultural reasons. The execution in February 1987 of several Libyan soldiers for, among other offenses, plotting to attack Soviet personnel underscores the extent to which some Libyans are motivated by antipathy to the Russians.

Nonetheless, the Soviets at a minimum probably have used their military contacts to identify Libyan officers likely to assume key political positions in a post-Qadhafi regime. Moscow probably also has acquired potentially valuable information on these officers' views, leadership skills, and lifestyles to use in developing a pro-Soviet faction in the military. Such information, combined with intelligence obtained from agents the Soviets almost certainly have in place, could help them exploit the uncertainties resulting from Qadhafi's removal. Moscow could also use its access to Libyan military personnel to warn the regime of a coup if the Soviets believed a change in regime was against their interests. The apparent inability of the Soviets to detect preparations for the coup in South Yemen in 1986, however, underscores the limits of Soviet intelligence capabilities, and it is quite possible the Soviets could be similarly surprised in Libya.

Possible Soviet Actions

Moscow's willingness to use its assets in Libya is a key unknown. The Soviets might adopt a wait-and-see approach, believing their interests would be preserved by continued Libyan dependence on Soviet military assistance. A new government, however, might have 25X1 reduced enthusiasm for more arms purchases or greater opportunity to obtain weapons from Western suppliers, thus forcing the Soviets to choose between a more active effort to court the successor regime or accepting diminished influence. 25X1 25X1

We cannot rule out a more active Soviet response to Qadhafi's ouster, particularly if Moscow believed a pro-Western regime was about to take power. In that case, Soviet advisers could signal their interest in supporting pro-Soviet elements within the Libyan military, hoping to improve the position of their friends in the political infighting that almost certainly would follow Qadhafi's removal. Libyan revolutionaries, despite their ideological dislike of Communism, also might turn to Moscow for protection against less radical elements. 25X1

In the event a new regime, for whatever reason, decides to order out the Soviet advisers, it is unlikely that the Soviets would choose to stay by force. The Soviet Union's cautious military response to the US airstrikes on Libya and the collapse of the Libyan 25X1 campaign in Chad suggest that Moscow is unwilling to commit its own combat forces to defend Libya. We doubt that Soviet willingness would increase significantly in the case of an internal coup. Nonetheless, as noted above, the Soviets could seek to call on their allies and agents in the Libyan Government to prevent a new regime ousting them or to subvert it if it did order them out. 25X1

Almost any regime that succeeds Qadhafi is not likely to order a Soviet withdrawal from Libya. We cannot identify any important elements within the Libyan armed forces, the Qadhafa tribe, or the revolutionary committees that are more friendly to the West than they are to Moscow. The growing Libyan dependence on the Soviet Union, particularly in the area of

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military assistance, probably would ensure that any successor would maintain good relations with Moscow, at least until it could broaden its sources of supply for military equipment and training. Moreover, because the initial post-Qadhafi period in Libya is likely to be marked by political infighting and instability, a new regime probably would not be inclined to create problems with the Soviet Union at the same time that it is trying to assert political control in Libya.

Implications for the United States

Clearly, the absence of a large US official or nonofficial presence in Libya diminishes US capabilities to affect a Libyan succession struggle, especially in comparison to the assets available to Moscow. Nonetheless, the limits of Soviet influence in Libya should provide Washington at least some room for maneuver in the event Qadhafi dies or is ousted. In particular the dearth of effective Soviet economic assistance to Libya—particularly in the petroleum sector—may provide avenues by which Washington could establish a relationship with a new Libyan regime. In our judgment, almost any successor government in Tripoli will be eager to garner popular support by reversing Qadhafi's austerity policy and providing more consumer goods. 25X1

At the same time, Qadhafi's removal is not likely to lead to a sudden reversal of Soviet fortunes in Libya. A successor regime could reverse the trend of growing Libyan dependence on the Soviet Union, but it would be unlikely to end the military dependence in the near term. Although the worst-case scenario—the emergence of a pro-Soviet Marxist regime in Libya—is unlikely, we believe Moscow will retain considerable influence in Libya even in a post-Qadhafi period. 25X1

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Moroccan Arms Buyers Get a Green Light [redacted] 25X1

In 1985, Morocco's King Hassan publicly pledged to spend $1 billion in five years on military modernization. The need for modernization is real. Morocco's forces in Western Sahara must be substantially refurbished to sustain their mobility and firepower and avoid a substantial increase in Moroccan combat casualties. When he made his promise, the King did not appear to have the funds to carry out the program. Since June 1986, however, Morocco has signed about $400 million dollars worth of agreements for arms and military equipment. Deliveries already made based on these new contracts will, in our view, do much to relieve Morocco's most urgent needs in the Western Sahara war. [redacted]

Preferring the Work Horse to the Race Horse

[redacted] Rabat has long pursued a contract for two squadrons of modern jet fighters—US-built F-16s or French-built Mirage 2000s. Such an acquisition could go far to redress the imbalance between Morocco's and Algeria's air forces as well as enhance Morocco's prestige as a potent regional power. Rather than choosing this $550 million item, however, Rabat has signed more than a dozen smaller contracts for trucks, light artillery, armored vehicles, and the like, totaling about $400 million. [redacted]

Rabat's decision to buy more mundane force sustainment items before the glamorous fighter aircraft stems from several factors:

- It was easier to finance several smaller purchases than a single massive fighter contract, even though the total price tags were similar. Indeed, we believe a few of the agreements, such as the Spanish upgrading of the Casablanca naval base, were signed because financing was available.

- The efficiency of operations in Western Sahara would be at risk, in our view, if Morocco did not replace or repair many of the vehicles there that are nearing the end of their useful lives. Operations to defend the berm—the 1,300 kilometer earthen wall that Morocco uses to control four-fifths of Western Sahara—depend upon the Army's use of trucks, land rovers, and armored personnel carriers to rapidly reinforce points being attacked by the Polisario Front. Should such tactics falter because of equipment unavailability, the Polisario could score successes that would embarrass Rabat and hurt Moroccan military morale.

- It was probably easy for Rabat to put aside its plans to acquire fighter aircraft for a short time in the absence of an immediate Algerian threat. Rabat probably also calculated that, even if a conflict with Algeria were to break out tomorrow, F-16s or Mirage 2000s would not be sufficient, by themselves, to turn the fight in Morocco's favor. Furthermore, as much as two years will be required between contract signature and operational employment of these aircraft in the Moroccan Air Force. [redacted]

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Why Is the Military So Blessed?

The magnitude of Morocco's arms purchases over the last year almost certainly makes it the largest element of Rabat's capital expenditures for 1987.[1] That the King would put such a high priority on the military at a time of general cuts in other budget areas reflects his sensitivity to the potential threat from a dissatisfied military as well as his interest in using the military to relieve some of his country's most pressing economic and foreign policy concerns. [redacted]

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Modernizing and refurbishing Morocco's armed forces are ways to avoid significant disaffection of his officers, which we believe is among King Hassan's highest priorities. The military was the source of the

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two most serious coup attempts of his 26-year reign (in 1971 and 1972) and remains the organization most able to dethrone him. Since 1972 the King has prevented a repetition of these attempts by combining effective security measures with a program to co-opt the military. He has striven to satisfy military leaders that he has earnestly prosecuted the 11-year-old Western Sahara war and faithfully tended to the country's defense needs in the face of the perceived long-term Algerian threat.

Many of the new military contracts Rabat has signed, including those for vehicles, night vision devices, artillery, ordnance, and surveillance gear, are intended to help avoid tactical setbacks in Western Sahara. Rabat has publicly claimed victory, dismissing the Polisario Front as little more than a nuisance. Any large Polisario victory on the battlefield would humiliate Rabat and gain the guerrillas adherents as they demonstrate their military viability, even though the guerrillas have little chance of shaking Morocco's military grip on the disputed territory. The materiel acquisitions also are intended indirectly to bolster morale among Moroccan troops by helping to keep down their casualties at the front.

Rabat also has needed to make military purchases to support the expansion of the Moroccan armed forces, ordered by the King in November 1985. [redacted] the military is being bolstered by 30,000 men. The expansion probably is intended in part to man the 450 kilometer extension of the berm in Western Sahara, completed last April. We believe it also is intended to reduce Morocco's burgeoning unemployment, getting 30,000 men off the streets. [redacted]

A few of the new agreements almost certainly are viewed in Rabat as economic investments. Morocco's purchase of Spanish and probably Danish patrol boats—in the absence of a real maritime threat—probably is intended to police Morocco's fertile fishing grounds more effectively. This, in turn, could increase revenue for Rabat by compelling more foreign fleets to buy licenses to fish the waters and more violators to pay fines. In another example, a $1.4 million contract for US aircraft arresting gear may be intended to attract use of two northern airfields by US or other NATO forces, according to the [redacted] Morocco's own aircraft land there without arresting gear. Rabat's likely intent is to offer occasional foreign use of the fields in return for foreign funding for their maintenance and improvement. [redacted]

Where Is the Money Coming From? Alternative Views

[redacted] Financing for most of the agreements has been provided by European and Arab banks and consortiums, according to Moroccan and Spanish publications, but we lack details on how Morocco plans to repay these firms. There are two strong possibilities, in our view—Gulf donations (from Saudi Arabia, the United Arab Emirates, or both) or the shifting of funds within Morocco's already tight budget. These sources are not mutually exclusive. [redacted]

Gulf Donations. Saudi Arabia and the United Arab Emirates have been sources of significant revenue for Rabat over the years. Riyadh, for example, funded Rabat's purchase of F-5 jet fighters and OV-10 reconnaissance aircraft in 1980. The UAE has paid Rabat at least $50 million annually for the services of over 3,000 Moroccan soldiers, according to the US Embassy in Morocco. Fresh contributions from the Saudis and the UAE appear to have been agreed to in June 1986, although the amounts involved remain unclear. We believe that it is no coincidence that the first large contracts under Morocco's new military modernization program were signed less than two weeks after visits to Rabat by the Saudi Crown Prince and the deputy commander of the UAE armed forces. [redacted]

King Hassan agreed in the summer of 1986 to train UAE airmen and technicians on Mirage F-1s in the United Arab Emirates and Morocco, [redacted] This deal almost certainly involved a sizable financial commitment to Rabat, although it is not clear whether rumors are true that Morocco will receive some two dozen Mirage 2000s for the service. An indication of the importance of the relationship to Rabat was received last May, when a [redacted] pilot trainees are getting F-1 flights in Morocco ahead of some Moroccan trainees because of a severe shortage of operational aircraft. [redacted]

New funding from the Saudis almost certainly also has been received, although its magnitude again is unclear. [redacted] Morocco has agreed in principle to form a strategic reserve force for Saudi Arabia, probably in response to Riyadh's fear of the Iranian threat. The Saudis in turn agreed to provide economic development assistance, oil, and funding for Moroccan military modernization (excluding F-16s and Mirage 2000s), [redacted]

[redacted]

[redacted]

Although the tap may have been opened on Gulf donations to Morocco's military modernization program, there are indications that the amounts are either much lower than Rabat received in the salad days of the late 1970s or are earmarked for contracts that remain unsigned. Between 1977 and 1982 the Saudis gave the Moroccan military as much as $350 million per year. Were the influx of funds to Rabat even close to that now, we would anticipate that it would have already signed an F-16 contract. Widespread critical parts shortages—[redacted] for example, that 16 of 21 Air Force Agusta Bell 206 helicopters are unflyable for want of parts—almost certainly would have been resolved if foreign funds were so extensive. [redacted]

Juggling the Moroccan Budget. If Gulf donors have not been generous, Rabat's new military purchases could have been made by shifting funds from other parts of the Moroccan budget. This would have been made palatable in part by attractive financing provided for the purchases from Spain, which account for over three-fourths of the contracts signed since June 1986.[2] The King may have been willing to move forward with modernization if his agents could negotiate repayments of $100 million or so per year for the contracts signed so far. We believe he would regard that sum as justifiable in view of his interest in satisfying his military leaders and preventing tactical setbacks in Western Sahara. Indeed, even $200 million per year may not seem excessively burdensome next to Rabat's existing $15 billion debt. [redacted]

[2] As part of a 1983 deal giving Spain fishing rights off Morocco, Rabat received a five-year loan of $550 million. [redacted] It seems likely that the loan period has been extended, since most of it was untouched until 1986. [redacted]

More Purchases in the Cards

We believe the trend of the last year will continue, with Rabat making careful use of increased—but still limited—funds for military modernization. Satisfying the military's most basic equipment needs will remain a prime concern for the King, impelling him to spend another $550 million to meet his $1 billion target by 1990. Rabat can ease the pace set in the last year and still meet the goal. If, as appears likely, Saudi Arabia and the United Arab Emirates contribute $100-200 million annually to this effort, purchases almost certainly will include a new generation fighter aircraft. [redacted]

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Army. Although the Moroccan Army has received the lion's share of the purchases made in the last year—$286 million out of $432 million—it is not likely to match this rate over the next three years unless it comes under serious pressure in the Western Sahara war. Another $200 million in purchases through 1990 would be adequate, in our view, to ensure the Army's transport and firepower needs for sustaining its dominance of Western Sahara without increasing the Moroccan casualty rate.[3] [redacted]

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Officials of the US Embassy in Rabat note that some Moroccans have already expressed dissatisfaction with the quality of the Army's new Spanish trucks. It appears that they may not be up to the rigors of service in Western Sahara and may have to be replaced by 1990. Whether or not an expensive truck replacement is needed, it does not appear likely that Rabat will have the funds to meet the Army's desire for two battalions of new US-built M60A3 tanks—total cost $345 million—under this five-year plan. They probably can afford, however, a much cheaper acquisition of older M48A5 tanks—a request for 100 was made to the Pentagon recently. [redacted]

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Air Force. Major Air Force purchases are likely. The Air Force accounted for only 7 percent of the purchases since June 1986, a rate that General

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[3] This sum is for military modernization only and does not include such expenses as upkeep, military pay, ammunition replacement, and fuel. [redacted]

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Kabbaj, the influential Air Force chief, will not long tolerate. Kabbaj may have implemented strict austerity in Air Force purchases to amass the backing for an F-16 purchase, realizing that, once that package is signed, there will be little funds left for anything else.[4] Of all Morocco's military leaders, we believe only Kabbaj has enough influence with King Hassan to obtain such a big-ticket item as F-16s and then ask for supplemental funding to cover more mundane Air Force requirements. Among the latter are spares for Mirage F-1 and F-5 aircraft and for the Agusta Bell helicopters, at least a few new C-130 transports, and stand-off radar surveillance planes, [redacted] If there is no breakthrough on the purchase of F-16s or Mirage 2000s, the list of these second-echelon items almost certainly will be expanded and approved, and they are likely to account for at least $300 million in purchases through 1990. [redacted]

Navy. We anticipate few additional purchases by the Moroccan Navy in the next few years. The contracts signed in the last year address Rabat's interest in better control of its fishing grounds for economic reasons. Before Rabat signs contracts for many more patrol boats, it probably will want to see a return on its investment. In addition, King Hassan is not likely to approve contracts for larger warships when Morocco faces only a slight naval threat. Most new contracts for the Navy probably will relate to ship upkeep and additional improvements of the infrastructure ashore, perhaps totaling less than $100 million by the end of 1990. [redacted]

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[4] Kabbaj is widely reported to strongly favor the F-16 over the Mirage 2000, although he has publicly claimed that the Moroccan Air Force will some day fly both [redacted]

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Israel: Jewish-Arab Relations Flounder

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The Israeli Cabinet recently overturned its highly controversial decision to impose discriminatory university tuition fees in response to public and Labor Party pressures. The original decision, enacted to ease severe financial problems at Israel's universities, imposed a tuition fee of $1,050 per year for students who have served in the armed forces, who are almost exclusively Jewish, and $1,550 per year for students who have not served, predominantly Arabs. The two-tier policy generated a political backlash probably unexpected by its Likud initiators and ultimately led the Cabinet to rescind its decision. Instead one fee of $1,200 for all students was set for the 1987-88 school year. In the wake of the controversy, Israeli Arab discontent with the Israeli Government has been aroused, the financial outlook for Israel's universities is clouded, and Likud's image may have been damaged.

The two-tier policy outraged Israeli Arabs, Labor Party officials, and Labor-affiliated Jewish student leaders, who attacked it for discriminating against Israel's Arab citizens. Arabs are barred by government policy laid down in the early 1950s from serving in the Israel Defense Forces because of security reasons and humanitarian regard for Arabs who might have to serve against Arab brethren. About 3,700 Israeli Arab students would have been affected by the unequal fee structure—4 percent of Israel's 75,000 university students. Government officials expressed surprise when both Israeli Arab and Jewish students protested in mid-May against the discriminatory policy on the campuses of Ben Gurion, Haifa, Hebrew, and Tel Aviv universities.

Israeli university administrators supported the Israeli Arab students when the Committee of University Heads threatened to defy government attempts to impose a two-tier fee structure. Rather than impose higher fees for Arab students, the Committee declared it would increase fees to $1,680 for all students unless the government increased its higher education subsidies. Israeli universities have the right to set their own tuition fees, but in recent years their growing dependence on state aid has given the government a leading role in this area. Education Ministry and university officials declared that the two-tier structure would not produce sufficient income to allow universities to continue operating and, without additional funds from the education budget, would undermine the higher education system.

The government's ruling setting fees at $1,200 for every student seems to have appeased university concerns about discrimination, but the amount may not be enough to ease the universities' financial problems. The Cabinet's reversal does not address how the system will survive with student fees that are $480 per student less than the university recommendation and $180 per student below last year's level.

Hebrew University Ferment Over Tuition Fees

On several occasions in March, April, and May, Hebrew University students in Jerusalem protested, at times in violent confrontations with police, any attempt by the government to increase tuition fees. The demonstrators, who at times totaled 4,000 Arab and Jewish students, contended that the 10-15 percent of the university budget they must contribute through tuition fees was caused by the university's financial mismanagement and government cutbacks, and they called for a reduction in fees to $800 per year. The revised program setting fees at $1,200 seems to have mollified student fears about tuition increases, although, with universities out of session for the summer, reactions are difficult to monitor.

The widespread campus disapproval of the Israeli Government's unfair treatment of Israeli Arab students suggests surprisingly evenhanded attitudes among large numbers of Jewish students. Many of the

Jewish students who had decried proposals to increase tuition in March and April came out again in late May to protest the unequal treatment of fellow Arab students even though Jewish student fees would have been reduced by $230.

In addition, Hebrew University students voted in record numbers in late May to elect Labor-affiliated student union leaders. With a voter turnout of 48 percent—up 25 percent from 1986—the Ofek list backed by Labor and allied parties won 60 percent of the vote, while the Gilead list backed by Likud gained 17 percent. According to the US Embassy, the massive Labor victory at Israel's most hawkish university—after a 10 percent drop in Labor votes there in the 1986 student union election—underlined the students' emotionally charged repudiation of the Likud-sponsored two-tier fee structure.

Labor Party leaders were quick to point out that the results signaled a continuing drift of Sephardic Jewish students from Likud to Labor. Likud-affiliated students had maintained control of student councils throughout the country until about two years ago when Labor-backed lists began to win university student union elections. Although the student population does not always reflect the national electorate and roughly half did not vote, we believe the outcome this year suggests broader political trends. This year's high turnout and Labor's clear victory appear to confirm increasing support for Labor among young, university-educated Israeli voters.

Labor Maneuvering

By exploiting student criticism of Likud's ethnic bias, Labor may have gained new leverage nationally. With Likud forced to back down on this issue, Labor's position could increase its support within the Israeli Arab community—a sector of the electorate Labor has courted assiduously in recent years.

Labor, moreover, has seized high moral ground by posing as a defender of human rights and higher education—a position likely to appeal to both moderate and left-of-center Jewish voters. Labor leaders may try to exploit Likud's record on minorities—particularly, the Israeli Arab community—as part of their campaign for the next national election, now scheduled for November 1988.

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North Africa–Middle East: Battling the Soft World Phosphate Market [1]

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Slack demand and low international prices have forced the phosphate industries of North Africa and the Middle East to implement austerity measures to reduce production costs. The phosphate industries in the region, however, are also expanding mining capacity, upgrading equipment and processing facilities, and pursuing aggressive marketing strategies to survive in an increasingly competitive world market, earn foreign exchange, and maintain domestic employment. Despite these measures, governments in the region will be hard pressed to maintain sales because world phosphate demand is unlikely to increase in the near future.

Background

Morocco, Jordan, Tunisia, Israel, and Syria are the largest producers of phosphates in North Africa and the Middle East and also rank high among world phosphate producers. Algeria, Egypt, and Iraq also produce small quantities of low-grade phosphates—about 1 million metric tons per year each—mostly for domestic use.

High phosphate prices in the mid-1970s led many Western countries to reduce their demand. As demand continued to fall in the early 1980s, phosphate prices fell from $42 per metric ton in 1982 to $34 in 1986. Prices probably will remain depressed, declining by about $1.50 per metric ton this year, according to phosphate experts. The relatively lower prices, however, have done little to stimulate demand. World demand for phosphate rock fell to about 87 million metric tons in 1986—about 3 percent lower than in 1985 and almost 7 percent lower than in 1984.

The downturn has been steepest in Western Europe and the United States—key markets that have a long history of phosphate fertilizer application but have built up large reserves of phosphates in their soil, according to experts on the phosphate market. Some Western agricultural experts believe that the phosphate level in the soil is high enough to permit phosphate fertilization to be reduced. Western consumers also appear to be increasingly conscious of the negative impact of phosphate products on the environment and are substituting other chemicals for them.

Phosphate rock and derivatives represent over 40 percent of merchandise exports in Morocco and Jordan, according to US Embassy reporting. We estimate that about 80 percent of Middle Eastern phosphate sales currently go toward manufacturing fertilizers. The balance is used to make animal feed additives, detergents, and a range of phosphate compounds with industrial applications.

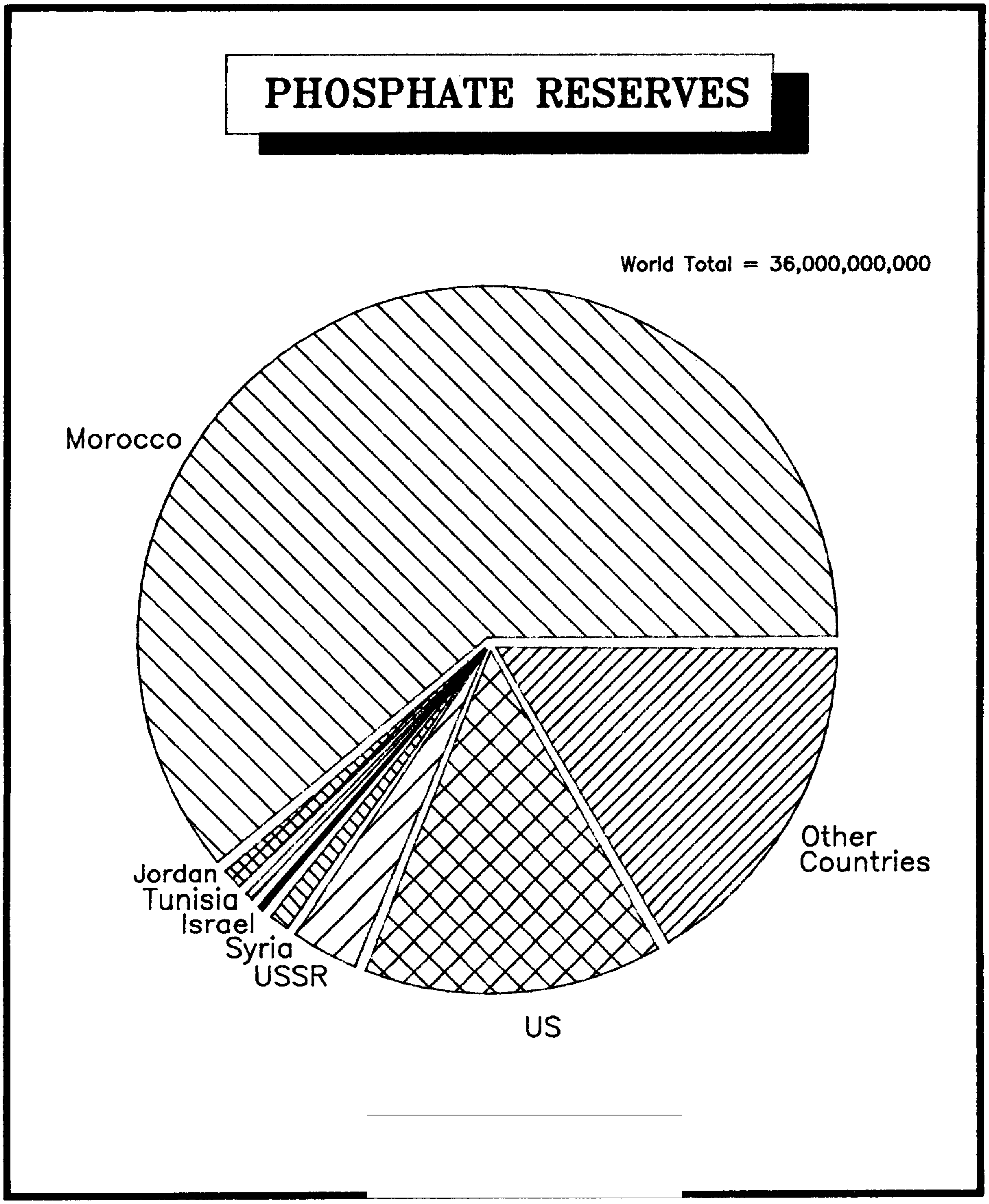
Regional Trends

***Retrenchment*.** The weak demand for phosphate rock has forced Middle Eastern and North African producers to address problems in their phosphate industries, including mismanagement and large debts. Phosphate companies in the region are beginning to introduce new methods to increase productivity and reduce operating costs. Strategies include:

- Replacing conventional, expensive equipment with more efficient excavating machines.
- Closing mines and delaying some new projects.
- Introducing washing equipment to remove contaminants—such as calcium carbonate—to produce high-grade phosphate concentrate.
- Switching from expensive underground mining methods to open pit mining, which is significantly less labor-intensive.

Overstaffing and high labor costs are problems in the phosphate industry. As many as half of the workers in the industry throughout the region are unnecessary or underqualified, according to diplomatic reporting.

[1] The phrase "phosphate market" refers largely to the market for phosphate rock. Phosphate rock describes minerals occurring naturally with high concentrations of calcium phosphate, usually mixed with other compounds such as calcium carbonate. The phosphate market also includes the products made from phosphate rock.


PHOSPHATE RESERVES
World Total = 36,000,000,000
Morocco
Other Countries
Jordan
Tunisia
Israel
Syria
USSR
US

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Companies keep employees on, however, because of strong union pressure and government policies to reduce unemployment. For example, workers at a closed mine in Jordan remain on the payroll, and most have refused to transfer to other mines, according to the US Embassy in Amman. To reduce costs, Tunisia will try to cut employment over the next two years at the Gafsa mine by offering 2,500 workers pensions and disability payments.

Modest Expansion of Mining and Downstream Activities.[2] Despite depressed world prices and demand, phosphate producers in North Africa and the Middle East continue to expand their operations—in contrast to the United States, where many phosphate projects have been postponed. They are increasing mining capacity and pursuing downstream activities to improve market share and to achieve self-sufficiency in domestic phosphate supply. We believe downstream activities will be particularly important for producers in the region to remain competitive in the world market. Some producers are expanding production capacity because they assume that the phosphate market has bottomed out and that prices will soon rise. If the market for phosphates remains weak, however, producers will be faced with large debts and idle equipment.

The investment in downstream activities is risky. For instance, the manufacture of phosphoric acid requires significant quantities of sulfur, the cost of which varies widely and can represent over half of phosphoric acid production costs. In addition, the price of certain end products, such as Jordan's diammonium phosphate, has dropped by nearly 50 percent in the past five years.

Morocco, the world's largest exporter of raw phosphate rock and the third largest producer of phosphate products after the United States and the Soviet Union, has invested heavily in downstream activities. According to trade journals, Morocco's long-term strategy is to convert 35 percent of its total phosphate rock output into higher value finished products by 1990 and to capture about one-third of the world's total phosphate exports. Morocco's state phosphate company—which mines, processes, and markets Morocco's high-grade phosphate rock and derivatives—opened a $1 billion phosphoric acid and fertilizer complex in Jorf Lasfar during 1986. The facility doubled the company's capacity to produce phosphate products. Morocco probably will be able to supply most commonly traded phosphate derivatives by the end of 1987. Morocco also is developing new mines in Khouribga, Youssoufia, and Western Sahara.

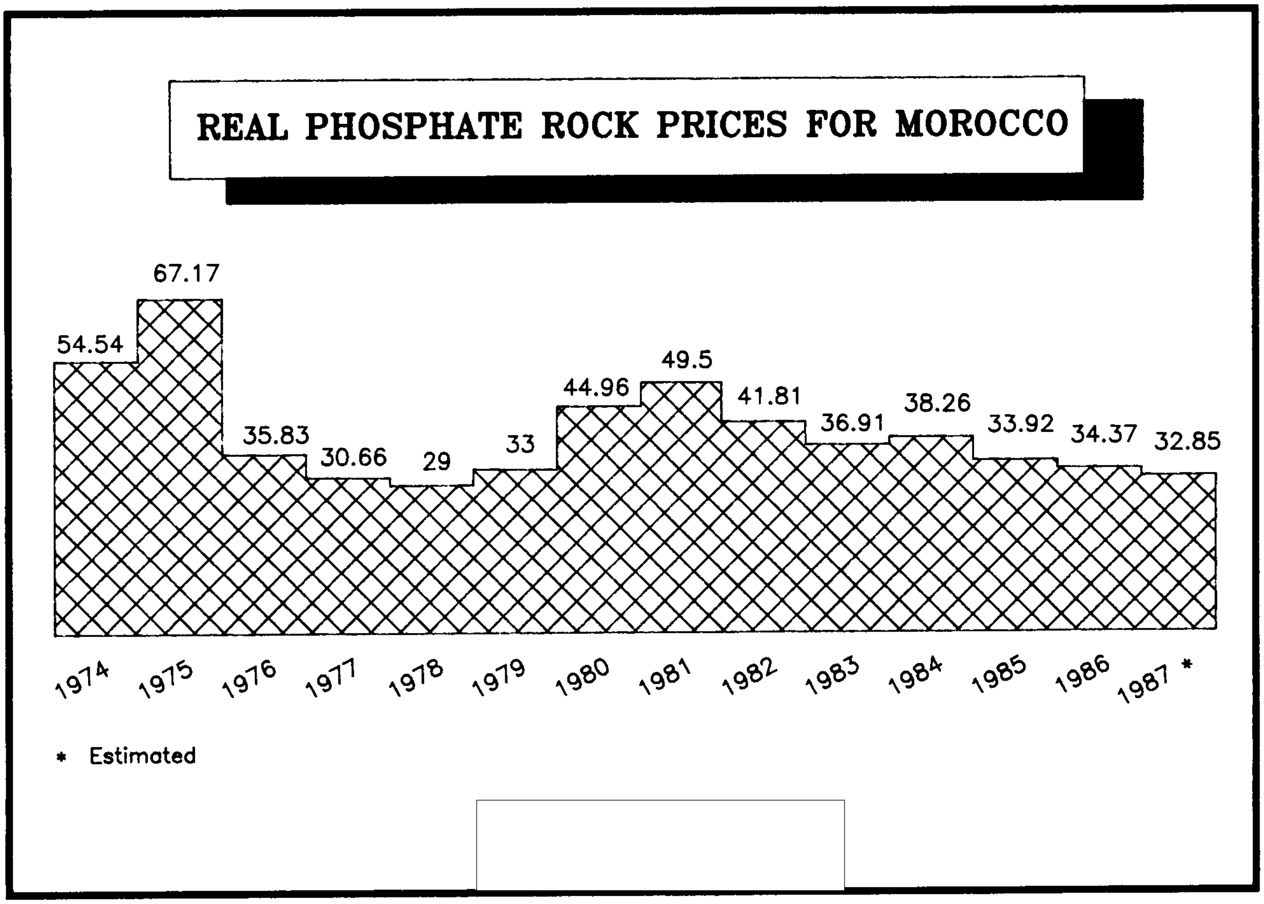
Jordan—the world's third largest exporter of phosphate rock—also is pursuing downstream activities to increase its profit margin. The state mining company acquired a debt-ridden fertilizer plant in Aqaba during 1986. Government officials, however, believe the world market will improve dramatically and have recently completed two technical feasibility studies with India and the Soviet Union for expanding phosphoric acid capacity at Aqaba. In addition, Jordan is negotiating a $31 million World Bank loan to help finance the first phase of a $71 million mining project in Shidaya, according to press reporting. Mining of up to 800,000 metric tons of phosphate per year could start by late 1988.

Israel increased downstream capabilities when it installed a second crushing station and a coal-fired purification kiln at the Nahal Zin and Oran mines in 1985 and plans to mine deposits in Bikaal to increase phosphate rock production. Furthermore, aggressive marketing strategies have enabled Israel to increase fertilizer sales to $57 million in 1985 compared with $49 million in 1984.

Seeking New Markets. Competition for phosphate sales is fierce, with second-rank exporters such as Jordan and Israel trying to enter, expand, or regain markets, largely at the expense of the leading exporters—Morocco and the United States:

- Jordan has offered generous credit terms to East European countries. It recently offered Yugoslavia six-month credit even though Yugoslavia is

[2] Upgrading raw phosphate rock into intermediate and finished products, which have a higher market value than phosphate rock. Products include phosphoric acid, monoammonium phosphate, super triple phosphate, and fertilizers.



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chronically behind on its payments. Jordan's state phosphate company also has offered Albanian officials gold jewelry, clothes, liquor, and Western consumer goods to facilitate contract negotiations, according to the US Embassy in Amman.

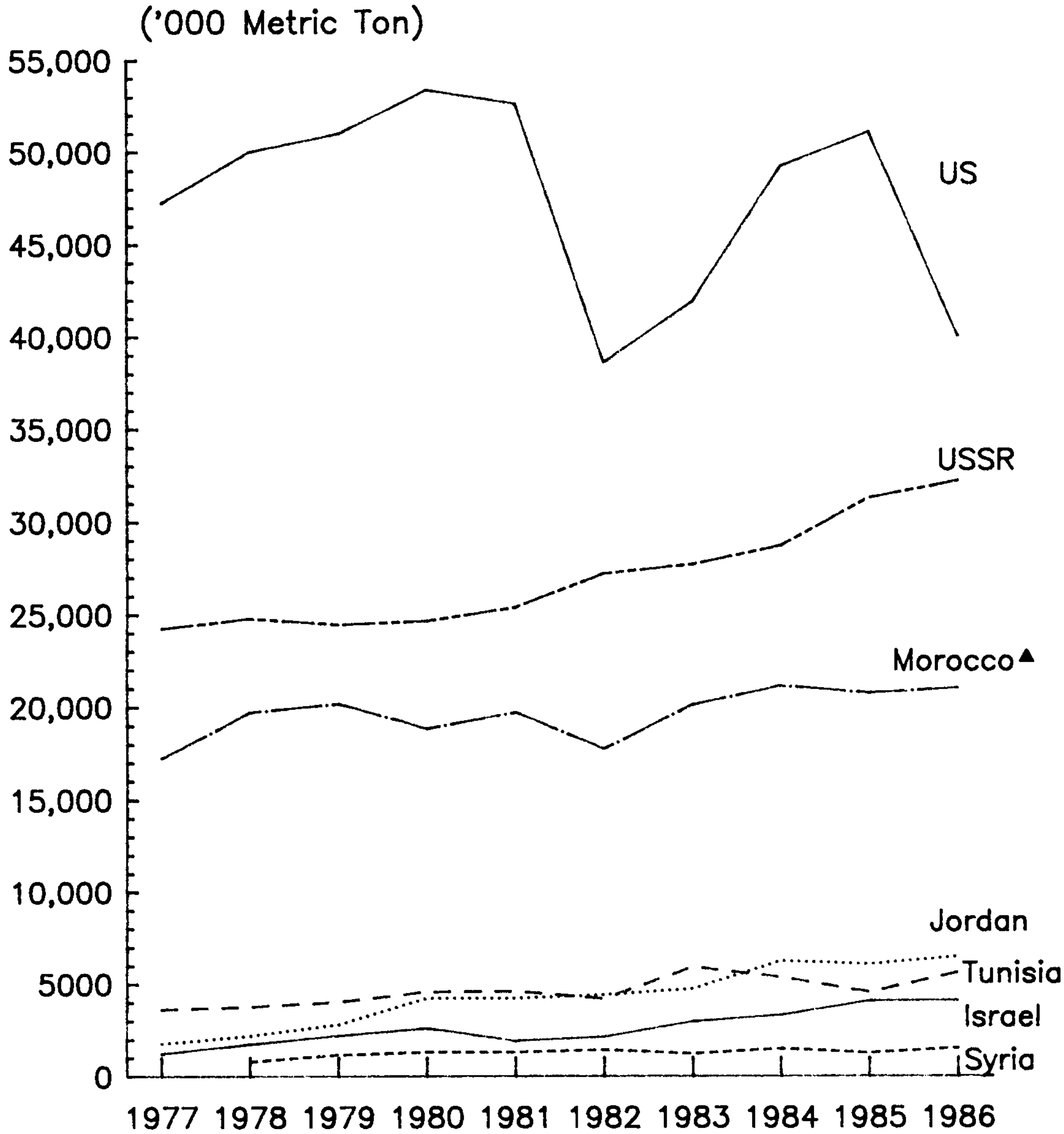
- Israel's sales of phosphate rock increased steadily over the last decade, largely as a result of breaking into markets that once were the preserve of Morocco and the United States.

Countries in the region are attempting to gain a share of the Soviet market. The Soviet Union probably will become a large importer of all kinds of phosphates during the next decade, according to phosphate market experts. The USSR is only slowly developing its large reserves of phosphate rock, and Soviet authorities predict a significant increase in demand for phosphate fertilizers:

- Morocco shipped a small quantity of phosphate rock to the Soviet Union in 1985, the first shipment of its kind. The Soviet Union is the largest purchaser of Moroccan phosphate fertilizer, according to the US Consulate in Casablanca.

- Under an agreement signed late last year, Syria's phosphate exports to the Soviet Union would reach 6 million metric tons by the year 2000, according to Syrian press. In return, the Soviet Union would give Syria equipment to boost phosphate production and assistance to improve the railroad between inland production sites and the harbor at Tartus.

PHOSPHATE ROCK PRODUCTION *



* Consists of crude ore production (includes some substances other than phosphate rock) for all countries except the US, whose production consists of "marketable production" (contaminants taken out).

Includes the disputed territory of the Western Sahara

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Phosphate Rock Sales, 1979-86 *Thousand metric tons*

	1979	1981	1983	1985	1986
Israel	NA	NA	NA	**4,029**	**3,785**
Domestic				1,717	1,298
Exports				2,312	2,487
Jordan	**2,730**	**3,520**	**4,319**	**5,451**	**6,140**
Domestic			631	841	940
Exports	2,730	3,520	3,688	4,610	5,200
Morocco [a]	**20,100**	**19,140**	**19,981**	**20,351**	**21,101**
Domestic	2,233	3,504	5,328	5,561	7,405
Exports	17,867	15,636	14,653	14,790	13,696
Syria	**1,261**	**1,070**	**1,189**	**1,164**	**1,649**
Domestic		133	178	270	347
Exports	1,261	937	1,011	894	1,302
Tunisia	**3,737**	**4,205**	**5,151**	**4,776**	**5,670**
Domestic	2,220	3,159	3,943	3,648	4,477
Exports	1,517	1,046	1,208	1,128	1,193

[a] Includes sales from Western Sahara.

Countries in the region have invested in private fertilizer companies overseas to secure export markets. For example:

- Jordan has agreed to purchase up to 10 percent of the Thai National Fertilizer Company in return for an equal percentage of the company's net profits and guaranteed phosphate sales to Thailand of as much as 750,000 tons per year for 10 years, according to the US Embassy in Amman.

- Israel has invested in phosphate conversion facilities abroad, such as the Amsterdam Fertilizers plant in Holland.

Countertrade. Some phosphate producers in the region have used counterpurchase agreements to obtain mining equipment, chemicals used in downstream phosphate activities, military hardware, consumer goods, and agricultural products. We believe many potential traders, however, are wary of countertrade deals involving phosphates because of recent failures and the risk of financial loss because of fluctuating prices for the bartered commodities. For example, a Japanese trading company arranged and financed a three-way deal in 1985 among itself, Jordan's phosphate company, and a US firm. The Japanese company has sold significant quantities of phosphates at a loss, according to the US Embassy in Amman.

Outlook

We believe that producers in the region will become more aggressive in the phosphate market. Morocco, in particular, probably will match price cuts by competitors such as Jordan and Israel. Morocco may try to negotiate countertrade agreements to increase phosphate rock exports, especially to Eastern Europe and the Soviet Union. Morocco almost certainly will remain a major competitor of the United States in the phosphate industry because of its extensive infrastructure, its marketing experience, and its substantial reserve base that is relatively easy to exploit.

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Jordan and Tunisia probably will continue using aggressive marketing strategies—including countertrade agreements—to boost phosphate rock exports. It will be difficult, however, for them to maintain sales. Stiffer competition from Morocco probably will force Jordan and Tunisia to offer more generous credit terms or even reduce the price of phosphates to maintain their market shares.

Israel and Syria almost certainly will remain the weakest in the group of major Middle Eastern and North African phosphate producers. A high proportion of their phosphate rock is low-grade and has only marginal commercial value. Some countries probably will be reluctant to purchase Israeli or Syrian phosphates as the quality of their phosphate rock continues to decline. Syria probably will rely heavily on barter deals involving phosphates despite its attempts to diversify exports, according to the US Embassy in Damascus.

We believe phosphate rock prices will continue to decline this year and that countries in the region will tire of the competition in pricing and marketing strategies. As a result, they could turn to cartel agreements to try to maintain or expand their roles in the phosphate industry. Jordan's Deputy Prime Minister Abd al-Wahhab al-Majali recently visited Tunisia and Morocco to discuss coordination of phosphate marketing by the three countries, which together supply roughly half of total world phosphate exports. Successful coordination is unlikely, however, because of mistrust between the parties, the lack of opportunities for significantly raising profits in a slack market, and the potential for price cutting. Past attempts at bilateral coordination between Tunisia and Morocco have failed. Even if countries in the Middle East and North Africa did succeed in coordinating their phosphate policies, we believe that continued slack demand for phosphates would limit their ability to significantly strengthen the world market for phosphates.

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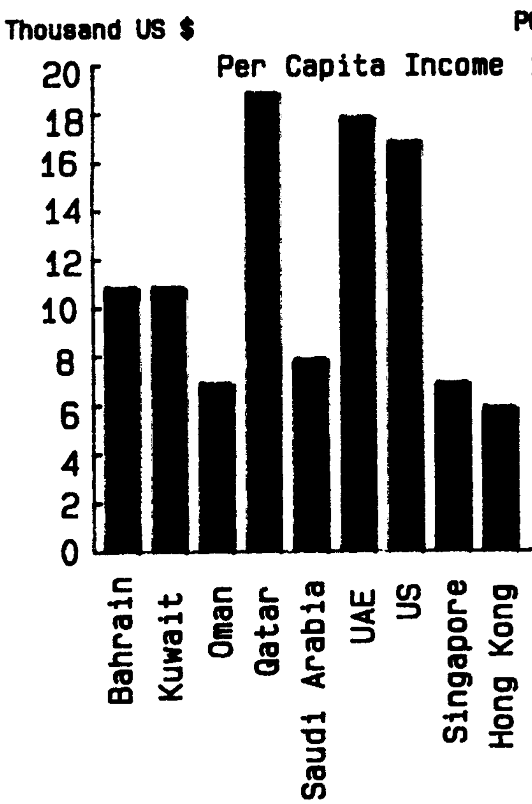
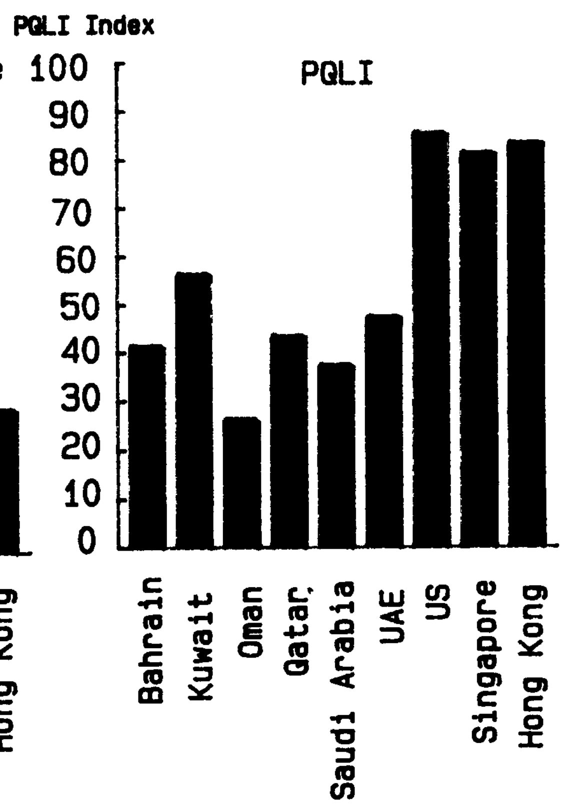
Economic Growth v. Economic Development

Per capita income is often used as an indicator of a country's welfare. Some economists criticize this measure, however, because they believe it quantifies economic growth rather than economic development. The Physical Quality of Life Index (PQLI), was designed to measure the level of economic development achieved and averages the infant mortality rate, literacy rate, and life expectancy. In general there tends to be a high correlation between the two indices. In the Gulf, however, per capita income is among the highest in the world while the PQLI is relatively low. This discrepancy highlights that the Gulf states have accumulated wealth but not yet fully utilized this wealth to make widespread improvements in public welfare.





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Persian Gulf Economies: Paradise Squandered [redacted] 25X1

During the 1970s oil boom, the Gulf states [1] set out to develop their economies on the Western model—diversified, industrialized, market economies with active private sectors. Against this standard they have failed. Although several Third World countries with fewer resources—both natural and financial—have been able to use their comparative advantage to compete successfully in the world market and catalyze economic development, the economies of the Gulf states have idled. [redacted]

Many features of the cultures and political systems of the Gulf states are incompatible with the type of economic model they seek to impose. The motivating force in Western economies is profit maximization, while the driving force in the Gulf states is maintenance of a national patronage system that distributes the available wealth. As a result, we believe that they will remain unable to build a vigorous economic base beyond oil and create the independent internal dynamic that would allow them to dictate their own prosperity or become important long-term players in the global economy. Moreover, the one-dimensional and inherently unstable nature of these economies will limit the ability of the Gulf states to enhance their value to the West. [redacted]

Obstacles to Development

During the past decade the Gulf states have used their oil wealth to build a Western-style infrastructure. They probably believed that by importing the goods and services necessary for economic growth and development they could telescope the process while controlling its pace. Instead, these efforts have produced the shell of a developed economy without the substance. They have been unable to add depth to their economies and largely continue to ignore the underlying problems that have led to their failure. [redacted]

Dependence on Vitamin W. [2] In our view, the most profound obstacle to the Westernization of the Gulf economies is the importance that is placed on maintaining a national patronage system, even at the expense of efforts to maximize national wealth. Nepotism, influence peddling, conflict of interest, and bribery—factors viewed as debilitating to free-market economies in the West—are all central and sanctioned aspects of economic life in the Gulf. Efficiency and objectivity in business and economic practices are, as a result, subordinated, particularly because a patronage system is geared to ensuring political control, not economic growth. [redacted] 25X1 25X1

Gulf businessmen often see their governments paternalistically, expecting them to develop a healthy economy and guarantee their welfare. Indeed, Gulf governments continue to serve as the engine of growth in these states and cover or assume all risks. Businessmen expect the government to bail them out of their economic troubles, and, rather than shouldering more of the burden as opportunities arise, businessmen are increasingly reluctant to take initiatives that do not have government backing. Although this responsibility allows the Gulf governments to act more independently and dictatorially than Western governments can, they also must accept the blame for economic failure, implying more catastrophic political implications than a similar failure in Western democracies. [redacted] 25X1 25X1

The Labor Pool and Work Ethic. The relatively small population of the Gulf states has hindered their economic development. Small domestic labor forces have forced them to rely on imported workers for both highly skilled jobs that Gulf workers cannot do and

[1] Saudi Arabia, Kuwait, Bahrain, Qatar, the United Arab Emirates, and Oman. [redacted] 25X1

[2] The chances of success are small for any endeavor, public or private, that does not have a healthy dose of what in the Gulf is called "Vitamin W"—for the Arabic "wasitah" meaning intermediary, link, agent, contact. [redacted] 25X1 25X1

Saudi Arabia and Kuwait:
Strategies for Exploiting Oil Wealth

Hisham Nazir, longtime Saudi Planning Minister and current Oil Minister, used to start speeches to Western audiences by saying, "We Saudis are not a wealthy people. All we have is money." With this comment he sought to capture the fragility of the Saudi economy and the danger of relying on the proceeds of a single asset, oil, as the basis of the national economy. He would explain that the Saudis had a "window of opportunity" to utilize their windfall oil revenues to diversify and create the broader economic base needed for economic security.

Successive five-year plans have reflected Nazir's thinking and have been aimed at developing, largely from scratch, agricultural and industrial sectors that would provide such stability and breadth to the economy. During the boom years the Saudis built not only the infrastructure of a modern country but two large industrial cities, automobile assembly plants, a number of basic industries factories, and self-sufficiency in wheat production.

The question remains whether there was development or just growth. Would Hisham Nazir, in an honest assessment of the past decade, conclude that Saudi Arabia successfully exploited its opportunity? In our judgment, too much artificiality remains in the nonoil sectors to conclude that they have more than a remote chance of independent viability, let alone vitality. 25X1

Kuwaitis, on the other hand, might well have said, "All we have is money, but that is all we want." Perhaps more willing to acknowledge their weaknesses, the Kuwaitis never set out during the boom years to create an artificial diversification into sectors that could not naturally evolve or survive in Kuwait. They neither built industrial cities nor tried to farm the desert. They sought instead through investment overseas to tie their fate to the performance of the strong Western economies. Despite the same obstacles to economic development as in the other Gulf states, the Kuwaitis have ridden out the recession of the 1980s with less disruption than any of the other Gulf states. 25X1

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unskilled jobs they will not do. In addition, foreigners do not contribute to domestic consumption in proportion to their numbers because many of them remit a high percentage of the earnings to their families living abroad, slowing the natural growth of domestic markets. The Gulf states hope to reduce their dependence on expatriate labor, but we do not believe that they can do so in the foreseeable future.

Within this restricted labor pool there is a weak work ethic, particularly for blue collar, industrial jobs. The US Consulate in Dhahran says of the Saudi work ethic, "The idea of working as long as it takes to complete a job before collapsing in exhausted euphoria . . . is foreign to many Saudis." As a result, no social stigma is attached to being unemployed. Indeed, unemployment is preferred to work if one can afford it, as many Gulf Arabs can. Hard times have forced many locals to accept jobs one or two notches below the optimum—to go from unemployed to idle office worker, for example. But Gulf Arabs are unlikely to accept menial jobs in sufficient numbers to staff such newly created enterprises as the industrial cities of Jubayl and Yanbu' in Saudi Arabia. 25X1

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Identity Factors

The author asked about 50 Saudis and 50 Americans to rank a set of identity factors in answer to the question, "Who am I? Am I first a Muslim? First a member of X family? First an individual? soldier? etc." The results were generally as follows:

Saudi Ranking	American Ranking
Family	Individual
Religion	Family
Ethnic Group	Profession
Individual	Nationality
Nationality	Religion
Regional Affiliation	Regional Affiliation
Profession	Ethnic Group

Noteworthy from an economic development standpoint is that "professional" and "individual" are ranked low in the Gulf, implying that there is relatively little societal value attached to individual or professional achievement.

Organizational Skills. Gulf Arabs are widely known to be intensely capitalistic, entrepreneurial, and mercantile, but the big stories are of individual, rather than corporate, success. Organizational and managerial skills are not the natural strengths of Gulf businessmen. Even now, after the phenomenal wealth of the 1970s, there are few Gulf companies of international stature, and those few that exist largely reflect the personal wealth of their owners. Only a handful of companies have successfully crossed the threshhold from small family-owned business to multimillion dollar corporation. Partly responsible are an extreme reluctance to delegate authority and an aversion to Western business practices, such as borrowing to expand. The tendencies to remain centralized, inflexible, and small work against successful privatization and industrialization on a meaningful scale.

Technology But No Science. The Gulf states will settle for nothing less than state-of-the-art technology, but they reject the science that accompanies it. This reflects their ambivalent

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The Search for Excellence, Arabian-Style

Following the Japanese example, many US firms have tried to become more competitive by analyzing the strengths, preferences, and needs of their employees and adapting these criteria to their corporate structures. Most Gulf companies have given little consideration to this approach and continue to operate as small family ventures rather than big corporations. The business community has some influence within these states, but most of this influence derives from the relationship between a ruling family member and a merchant rather than broader and less personal economic interests. Although many Gulf firms have been successful in using this sole-proprietor style of operation, they will have to adapt Arab ways to a more Western organizational structure to become more competitive in the global market—particularly in interests outside of oil. Factors to consider in designing such a business culture in the Gulf states would include:

- *Job security. Gulf Arabs may see the firm—as it does the state—paternalistically and, in return for their loyalty, will expect tenure, job security, and financial compensation.*

- *Profit sharing. Gulf Arabs have the seemingly contradictory traits of being entrepreneurial and averse to risk. Profit sharing would allow them to assume a degree of responsibility while sharing the risk.*

- *Clear chain of command. Although Gulf Arabs prefer a consultative to an authoritarian approach, they are more comfortable when the chain of command is well defined, allowing them to locate themselves within the organizational structure.*

- *Small project centers. Large, impersonal companies are foreign to Arab culture. Encouraging small project centers within larger firms would allow a company to grow without the accompanying depersonalization.*

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attitudes toward economic development. They want to be recognized as full members of the club of industrialized nations" but have grave doubts about the effects of such industrialization and development on their conservative societies. The leaders of these states almost certainly fear losing control over the pace of change that development will bring and how this will affect the stability of their regimes. Moreover, Arab academic programs foster learning by rote with no emphasis on innovation or creativity, reducing the ability of most Gulf workers to absorb the theoretical underpinnings of imported technology.

Capital Generation. The Gulf states have lent much support recently to the idea of developing their economies by building a partnership between the public and private sectors, but they have given few financial incentives to the private sector to encourage greater responsibility. Capital markets are practically nonexistent, and commercial codes are antiquated or underdeveloped, slowing the spontaneous growth of new business ventures. Monopolies, which are often given to individuals by these governments, hinder competition. These governments worry more about self-sufficiency than about efficiency and have encouraged the private sector to develop import substitution enterprises, with little success. Despite the surplus of capital in these states, the cost of entry into Gulf markets is high. Indeed, economic development literature refers to this problem as the "Kuwaiti disease"—oil dominates the market at a particular exchange rate, and at that rate other products cannot be efficiently produced. Some of the states have resorted to subsidies or tariffs to develop or protect infant industries, but these remedies have created other problems. Most Gulf citizens avoid these risks altogether and invest their capital outside the region.

Shame and Fatalism. Extensive cultural and religious factors affect economic thinking in the Gulf. Two features are particularly prominent: shame and fatalism. The Gulf emphasis on shame (how one is viewed by his peers) rather than guilt (how one views himself) permeates all of society, including business and economics. The effects of this cultural trait in the business realm are that:

- Looking successful is more important than being successful, as maintaining a facade of prosperity overrides the need for objective problem solving in hard times. In the Gulf, constructive criticism" is a contradiction in terms.

- Action to correct economic or business problems is taken late in the game, as it must counterbalance the high cost of public admission of failure. 25X1

Fatalism is an Arab quality strongly reinforced in the Gulf by Islamic dogma. The fatalist element in economic or business deliberations is the unstated premise that man is the victim, rather than controller, of events. Having a "can-do" attitude, taking the initiative, being innovative, or trying to force change are largely viewed negatively in the Gulf as tempting fate. Much of the lethargic quality of the Gulf business environment is attributable to Arab fatalism. Conversely, it can cushion the impact of failure and encourage individual speculative ventures. 25X1

Outlook and Implications for the United States

We believe that the Gulf states will be unable to develop stronger, more diversified economies and will never meet the Western standard that they have set for themselves. Although they were quick to see that their comparative advantage lay in exploiting their oil and have made considerable progress in building the framework of a modern economy, we believe they will remain bewildered about how to use the returns from oil development to jump ahead to the next stage of economic development. They are likely to refuse to acknowledge their failure and, as long as oil revenues continue, will maintain the charade of development. 25X1
Moreover, they will cite false victories—such as the Saudi achievement of self- sufficiency in wheat—as true progress.[3] 25X1

[3] Riyadh has achieved self-sufficiency in wheat production but at a high cost. Its subsidies to farmers make the effective cost of Saudi wheat as much as 10 times the world price. 25X1

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Without a recognition of their shortfalls, the economies of the Gulf states will gradually weaken because the burden of maintaining their facades of development will grow as their ability to do so shrinks. Large showpiece industrial projects such as the Mercedes assembly plant in Jiddah—which produces trucks but at a small and costly fraction of plant capacity—will serve as testaments to failed economic policies. [redacted]

Unable to create self-sustaining economies, these states will continue to be almost totally dependent on oil revenues. As such, they will continue to rely on government prodding, and progress will occur only in fits and starts. Once oil resources are depleted, these states will become largely dependent on foreign aid. For Bahrain, Oman, and several of the emirates of the UAE, this prospect is less than 20 years away. [redacted]

Economic failure and oil market vagaries will leave many of these regimes vulnerable, especially because of the close link in the Gulf between economic performance and political fortune. The recent coup attempt in Sharjah, as well as the deposition of Saudi King Sa'ud in 1963, were both the result of the perceived ineptitude of leaders in guiding their economies. The Gulf monarchies are likely to be scrutinized more closely for how equitably they fulfill the top economic priority—distributing the national wealth. [redacted] 25X1

The Gulf states will remain important to the United States because of their oil resources and geographic 25X1 position—both of which are accidents of fate. The relationship between the United States and the Gulf states will remain limited, however, and is unlikely to exceed or even match the heyday of the 1970s. These states will remain de facto protectorates of the United States or other Western powers because of their enduring fragility. US interests would have been better served, in our judgment, had the Gulf states developed stronger, more stable economies, 25X1 particularly given their Western orientation and consequent overlapping interests with the United States. [redacted] 25X1

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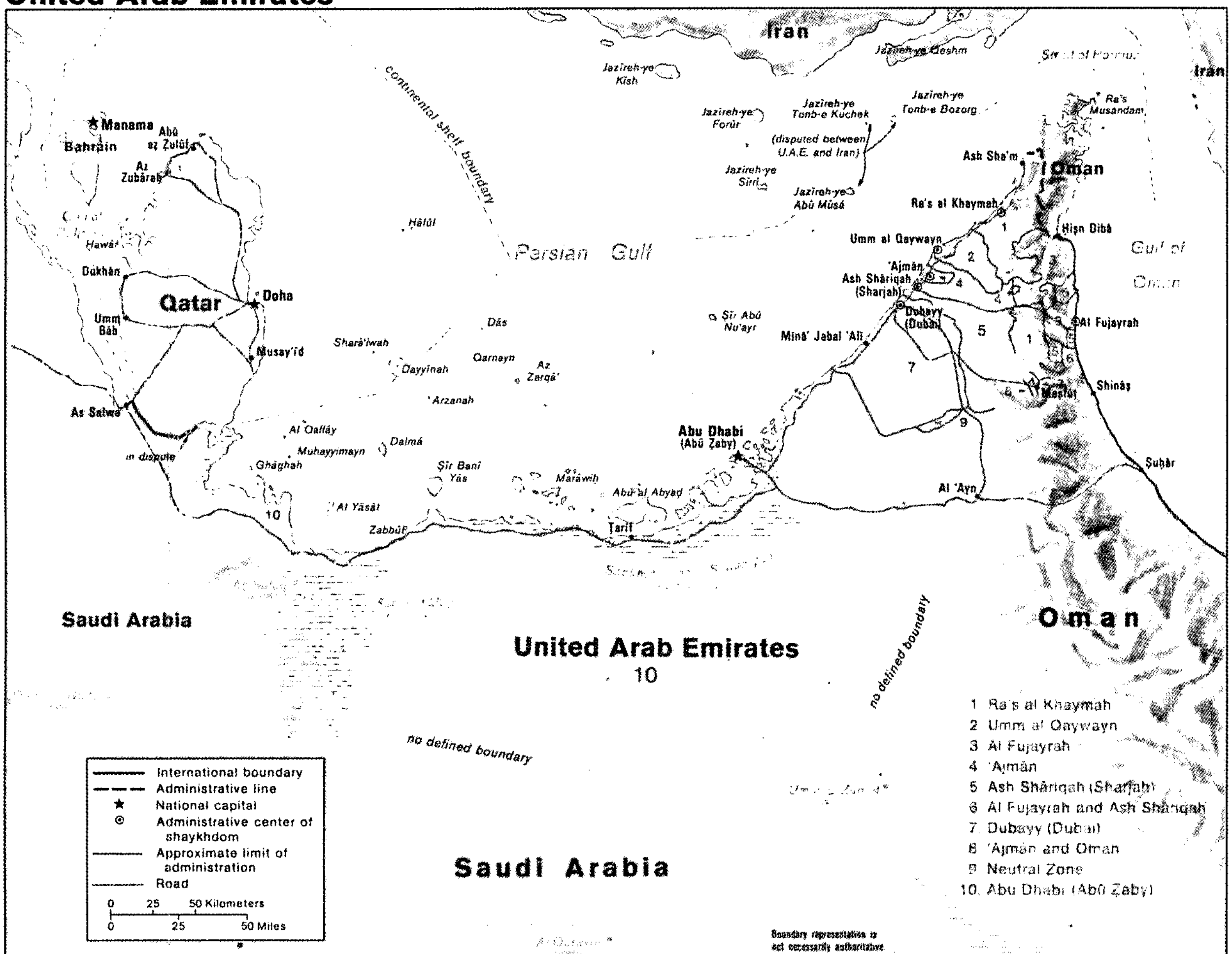
United Arab Emirates



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The UAE Armed Forces: Building Cooperation, But Still No Integration 25X1

The historically separate armed forces of the United Arab Emirates are beginning to cooperate in some areas, but the smaller emirates will continue to resist pressure from Abu Dhabi for full integration. The primary security forces of the UAE since the late 1970s have been the Abu Dhabi-led Federal Armed Forces, Dubai's Central Military Command, and several small Amiri Guard units. Recently, Abu Dhabi and Dubai have been slowly increasing military cooperation, and the smaller emirates have been showing a greater willingness to accept military assistance from Abu Dhabi.

The Seeds of Disunity

The military forces of the UAE were briefly integrated in 1976, five years after the establishment of the federation. To ease Dubai's suspicions of Abu Dhabi, Shaykh Muhammad bin Rashid, de facto ruler of Dubai, was named UAE Minister of Defense, but this office soon proved to be to a figure- head position with no real power. Abu Dhabi continued to make all important military decisions, and the Minister of Defense was not informed. In addition, the Federal Armed Forces provided only limited logistic support to the former Dubai Defense Force. Supplies ran out, reorders were delayed, and key requirements were often only half filled, according to the US Embassy.

Disillusioned with military integration, Dubai began looking for a reason to leave the Federal Armed Forces. The excuse came in 1978 when Shaykh Zayid, President of the UAE and ruler of Abu Dhabi, appointed his 24-year-old son Sultan to the newly created position of Commander in Chief. This further reduced the role of the Minister of Defense. Sultan's tour as Commander in Chief ended in 1982 when, following a personal dispute with a wealthy Dubai family, he ordered a unit from the Federal Armed Forces to march on Dubai. Although the order was overruled before Dubai was attacked, the incident further convinced Dubai's ruler of the need for an independent military.

Dubai Goes Its Own Way

Dubai's Central Military Command, named for its geographical position within the federation, is designed to balance the predominant Federal Armed Forces and guard against attempts by Abu Dhabi to use the federation's military to influence Dubai's policies. The Central Military Command has approximately 6,500 men in both ground and air units. Dubai purchases only the amount and type of equipment needed to counter the Federal Armed Forces. US Embassy sources routinely rate Dubai's military as the best, man-for-man, in the UAE 25X1 because of its training, weapons proficiency, and readiness. Like the Federal Armed Forces, Dubai's military is heavily manned with expatriates, but its staffing policies reflect greater efficiency and a unique threat perception. Unlike the Federal Armed Forces, in which some Dubai nationals serve, no Abu Dhabi citizens are allowed to serve in the Central Military Command. 25X1

Relations between Abu Dhabi and Dubai over the federation's defense policy have remained strained since integration failed in 1978. Dubai refuses to contribute to the federal defense budget, choosing instead to direct its share to the Central Military Command. Abu Dhabi and Dubai also have different threat perceptions, Abu Dhabi sees Iran as the 25X1 primary threat, while Dubai prefers to keep a wary eye on Abu Dhabi. 25X1

The stature of the Minister of Defense position, still held by Dubai despite its withdrawal from the Federal Armed Forces, continues to be a source of friction between Abu Dhabi and Dubai. As a symbol of unity, the Defense Minister is allowed to greet foreign military dignitaries on behalf of the UAE, but he does not appear to make any contribution to federation defense policy. All defense policies are formulated and implemented though a chain of command that

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Military Forces of the United Arab Emirates

Force	Headquarters Location	Manpower	Units	Major Equipment
Federal Armed Forces	Abu Dhabi	50,000	2 Infantry brigades	95 Tanks
			1 Mechanized infantry brigade	450 Armored vehicles
			1 Armored brigade	137 Artillery pieces
			1 Artillery brigade	18 Multiple rocket launchers
			1 Air defense brigade	30 Antiaircraft missile launchers
			1 Royal Guard brigade	15 Patrol boats
			2 Fighter squadrons	76 Combat aircraft
			1 Helicopter wing	64 Helicopters
				36 Combat aircraft [a]
Central Military Command	Dubai	6,500	1 Infantry regiment	36 Tanks
			1 Armored regiment	76 Armored vehicles
			1 Artillery regiment	12 Artillery pieces
			1 Engineer regiment	12 Antiaircraft missile launchers
			1 Royal Guard regiment	18 Combat aircraft
			1 Commando squadron	18 Multiple rocket launchers [a]
			1 Fighter squadron	18 Tanks [a]
Sharjah Amiri Guard	Sharjah	2,500	4 Commando companies	Helicopters [b]
				Light tanks [b]
				Mortars [b]
				Small arms [b]
Umm al Qaywayn National Guard	Umm al Qaywayn	200	1 Company	10 Armored vehicles
				12 Recoilless rifles
				4 Mortars
Fujayrah Amiri Guard	Fujayrah	150	1 Company light infantry (4 companies forming)	Small arms

[a] On Order.
[b] Possible.

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runs directly from Shaykh Zayid to his son Shaykh Khalifa, Deputy Commander in Chief, to Abu Dhabi's General Headquarters—completely circumventing the Ministry of Defense.

First Steps Toward Cooperation

Despite these frictions, the military forces of the UAE, particularly Abu Dhabi and Dubai, have recently shown signs of increased willingness to work together. Following the Iranian attack on Abu Dhabi's Abu al Bakhoosh oilfield last November, Dubai agreed to lend four RBS-70 portable surface-to-air missiles, along with trained crews, to the Federal Armed Forces. Abu Dhabi needed to borrow the weapons because it lacked suitable alternatives in its inventory. Dubai agreed to the loan despite serious misgivings over the wisdom of arming offshore oil platforms. Dubai feared that the redeployment would leave its desalination plants and onshore oil facilities largely unguarded, according to the US Embassy.

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Amiri Guard Forces: Stalwarts of Independence

In addition to the dominant military forces of Abu Dhabi and Dubai, the emirates of Sharjah, Fujayrah, and Umm al Qaywayn maintain independent forces. These forces, usually called Amiri Guards, serve under the command of the individual amirs and constitute a type of national guard that can be quickly called upon to quell domestic turmoil or border disputes. Although these forces contribute to the protection of the local ruling family, this duty rests primarily with the police or palace guard, [redacted]

Sharjah. *Sharjah's 2,500-man Amiri Guard, third largest of the UAE's military forces, was established in 1984 following border disputes with Dubai, Fujayrah, and Umm al Qaywayn.* [redacted] *the stated purpose of the unit is to provide security for Sharjah's petroleum facilities and airport, but in reality its role is mainly to balance neighboring Dubai's independent military. The structure of the Amiri Guard shows that Sharjah is designing a force for limited conventional combat rather than guarding oil installations.*

[redacted]

[redacted] 25X1

Fujayrah. *Fujayrah's fledgling Amiri Guard, formed in 1986, is a semi-autonomous unit that is still trying to establish an independent identity from Abu Dhabi. The Fujayrah Amiri Guard, however, is funded by the Federal Armed Forces, and in an emergency it will probably fall under their control. Currently manned with one company of 150 men, the Guard* 25X1 *hopes to expand to five companies of light infantry, according to the* [redacted] *To* 25X1 *man the guard, Fujayrah is conscripting local youths who have found themselves in trouble with the law. Despite these conscription practices the* [redacted] 25X1 [redacted] *says the unit appears both* 25X1 *trustworthy and motivated.* [redacted] 25X1

Umm al Qaywayn. *The emirate of Umm al Qaywayn has never integrated its National Guard into the Federal Armed Forces. The small unit of 200 men is ostensibly for royal family security, but, like the Sharjah Amiri Guard, it is outfitted for combat with* 25X1 *British Scorpion armored vehicles, recoilless rifles, and mortars.* [redacted] 25X1

The United States has helped to foster cooperation between Abu Dhabi and Dubai through work on the UAE's new air defense program. Recently, Dubai ended an old dispute by agreeing to allow an I-HAWK firing unit—part of Abu Dhabi's extensive air defense network—on its soil. Plans have also been made to include Dubai in the sophisticated command and control system that will operate the I-HAWK. [redacted]

Historically, the only training cooperation between the various military establishments of the UAE has been in a one-year UAE military academy that graduates about 500 men annually to serve in a variety of units throughout the seven emirates. During the graduation ceremony for the federal air academy this spring, however, pilots from Dubai participated in an air show with federal pilots. Dubai also sent a large delegation of senior officers to the ceremony. [redacted] 25X1

Although the northern emirates also maintain armed forces that are independent from Abu Dhabi, financial hard times are reducing their autonomy. 25X1 [redacted] 25X1 d

The decision to integrate Sharjah's Guard into the Federal Armed Forces, however, was not made until last month's attempted coup in Sharjah. During the coup, the commander of the Amiri Guard, Shaykh Abd al-Aziz, tried to seize power from his brother, the ruler of Sharjah. As a result of the attempted coup, Abu Dhabi and Dubai agreed that the Guard would be absorbed into the Federal Armed Forces as a way to limit the power of Abd al-Aziz.

Outlook

Although we believe limited military coordination will continue, Dubai's enduring suspicion of Abu Dhabi's dominance in the federation, its conservative arms procurement philosophy, and its desire to maintain its forces as a symbol of independence will prevent the complete integration of the Central Military Command and Federal Armed Forces. 25X1

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Meanwhile, Abu Dhabi will probably continue to fund some military units of the northern emirates. In return, it will insist on increasing control over the use of these forces. Although the northern emirates will attempt to preserve the autonomy of their forces, Abu Dhabi probably will use its control of the federation's purse strings to gain control of their military units.

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Pakistan: A Qualified Success in Absorbing F-16s [redacted] 25X1

Pakistan is the only country besides Israel to have flown F-16s in combat. Islamabad's F-16s have scored several combat kills, but the Pakistani Air Force has experienced its share of problems in assimilating this advanced and complex fighter aircraft. The F-16s have also proven unable to deter violations of Pakistan's airspace from Afghanistan. [redacted]

Deployment and Capabilities

Pakistan's F-16s were the key component of the $1.6 billion US military aid package approved in 1981. They have assumed almost mythic proportions among Pakistani civilians as a symbol of the country's growing technological prowess and warm relations with the United States. According to press reports, visitors to Pakistan have seen F-16s painted on numerous buses and even on schoolchildren's notebooks. [redacted]

Islamabad's 38 F-16s are deployed in two squadrons. [redacted]—closer to the areas of the Afghan border where most air violations occur. The Air Force has six two-seater training aircraft that, according to US Embassy reporting, would be available for combat in wartime. [redacted]

Pakistani F-16 pilots are good by Third World standards, but there are fewer pilots than the Air Force would like. Pilots at Sargodha are nearly as proficient as Israeli fliers, [redacted] Pakistani pilots were initially trained in the United States, but US-trained Pakistani pilots are now teaching new F-16 pilots in Pakistan. [redacted] tries to boost morale and enlarge the pool of qualified F-16 pilots by rotating F-16 pilots out of their squadrons when they accumulate 500 flying hours. Their places are filled by Mirage and F-6 pilots. The Air Force wants at least six pilots per F-16 available in case of war. [redacted] 25X1

Pakistan's F-16 technicians are relatively well trained and motivated. [redacted] they are comparable in some areas to US Air Force technicians. The Air Force assigns only those technicians with the highest aptitude test scores to work on the F-16s. Technicians were initially trained in the United States, but they—like the pilots—now train new Pakistani technicians in country. They are usually more competent than other F-16 technicians in the Third World, according to US advisers. For example, another [redacted] let radar coolant leaks—a not uncommon problem with the F-16—ruin several expensive avionic sets. The Pakistanis fixed the leaks when their F-16s encountered the same problem. [redacted] 25X1 25X1 25X1 25X1

Pakistani F-16s seem to be well maintained. The US Embassy reports that Sargodha listed 75 percent of its F-16s ready to fly as of March 1987. Usually 11 out of 12 F-16s at Kamra are operational. We believe these rates reflect the competence of Pakistani maintenance personnel, but F-16 readiness will probably decline as the airframes age. Pakistan recently arranged to build an engine servicing depot for the F100 engines in its F-16s which should help long-term reliability and save the expense involved in sending engines to the United States for overhaul. [redacted] 25X1 25X1 25X1 25X1 25X1

Problems With the F-16: The Honeymoon Is Over

Despite the proficiency of its pilots and personnel, Pakistan's Air Force is not capitalizing on the full capabilities of its F-16s. For example, Pakistani F-16s have unique and poorly performing software for their 25X1 25X1 25X1 radar warning receivers. Press reports claim that the ALR-69 sets in these F-16s were modified in the United States to operate like older ALR-46 sets. This configuration degrades the performance of the ALR-69, [redacted] As a result, Pakistani pilots fly with an inadequate knowledge of the threats they are facing. Because the system is not configured as its manufacturer intended, Pakistani Air Force's service manuals are of no use to Pakistani and US electronic warfare specialists who have tried to fix it. The problem should be solved by 1989 when a planned adjustment of the set's computer memory will standardize it with other ALR-69s. [redacted]

Pakistan has lost two of its F-16s in almost comical circumstances. Last December a Sargodha aircraft was taking off at night when it struck a wild boar on the runway. The nosewheel collapsed, the aircraft burned, but the pilot was not hurt. Another aircraft was lost to friendly fire. According to US Embassy reports, an F-16 pilot shot down his wingman while chasing Afghan aircraft along the border last April. [redacted]

Pakistan's Air Force is realizing that the F-16 is not a panacea for the nation's air defense problems. Morale among F-16 pilots has fallen somewhat as a result of the embarrassment caused by the recent accidents and frustration with restrictive rules of engagement, [redacted] The pilot who downed his wingman was reputedly one of the Air Force's best. He is now rumored to be facing a court martial, [redacted] Less competent pilots are questioning their own abilities in light of his expensive mistake. [redacted]

Morale has also declined in reaction to real and rumored deployments of modern fighters by Pakistan's neighbors. India has two squadrons of Mirage 2000s and has ordered MIG-29s, and [redacted] Pakistani pilots fear that improvements to the Mirage 2000 may make it superior to the F-16. [redacted]

Pakistan's F-16s in Combat

Pakistan has officially claimed two kills for its F-16s—an Afghan SU-22 fighter-bomber and an Afghan AN-26 military transport. A press report says Islamabad only claims kills on aircraft that crash in Pakistan. No F-16s have been lost to enemy fire. [redacted]

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[redacted] *unofficially claim at least six more kills, but these aircraft crashed in Afghanistan. Press reports maintain several more aircraft have been damaged by F-16s. On at least two occasions, Pakistani F-16s prevailed despite being outnumbered by their opponents.* [redacted]

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Although the F-16 is armed with missiles and a 20-mm cannon, all of Pakistan's kills fell to air-to-air missiles. [redacted] *but pilots prefer the former weapon. One pilot held his fire to allow another F-16 to launch a more reliable—and expensive—AIM-9L.* [redacted]

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Air Violations Increase Despite the F-16s

Islamabad's F-16s have not deterred violations of Pakistani airspace by aircraft from Afghanistan, and the increased frequency of intrusions is straining the F-16 force. Air violations more than doubled from 301 in 1985 to 757 in 1986, and air violations in the first five months of this year are 12 percent higher than the same period last year. [redacted] F-16s have even had to escort civilian flights after civilian pilots and radar operators noticed Afghan aircraft shadowing the airliners. The increased frequency of air violations has forced the Pakistani Air Force to fly its F-16s for much longer periods than officials would like. US Embassy reporting says F-16s at Sargodha are flying about 24 hours per month instead of the 16 hours the Air Force had planned. Consequently, the planes are experiencing more wear than expected. [redacted]

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The Pakistani Air Force uses its F-16s to intercept intruding aircraft, and several planes are constantly on alert. [redacted] two-plane combat air patrols fly near the Afghan border during the daylight hours. Another two F-16s are usually on the runway at Sargodha or Kamra, with pilots in the cockpits or beside their planes. These aircraft can be airborne within five minutes of a scramble order. The combat squadrons at Sargodha and Kamra rotate their patrol every two weeks, according to US Embassy reporting. [redacted]

In our judgment, the inability of the F-16s to deter air violations results from two factors. Most violations are minor, involving penetrations of less than five nautical miles and only a few minutes in duration. These violations are difficult to intercept and hence almost impossible to deter. In addition, Pakistan's cautious rules of engagement seem designed more to preserve F-16s than to allow pilots to employ tactics that would result in the downing of intruding aircraft. [redacted]

[redacted]

Outlook

Despite problems, the Pakistani Air Force is pleased with its F-16s, and Islamabad has asked the United States for nine more planes and additional AIM-9L missiles. Islamabad has not yet decided whether to modernize its Air Force with modified Chinese F-7s or the air defense variant of the F-16. [redacted] 25X1

[redacted] 25X1 25X1

[redacted] The Air Force's successful assimilation of the initial F-16s leads us to expect that it could assimilate a large infusion of the sophisticated aircraft, although there may be some strain on Pakistan's limited pool of trained pilots and technicians. [redacted] 25X1 25X1

We believe Islamabad's F-16s have improved the air defense capabilities of the Pakistani Air Force but have not given the Air Force an edge over its neighbors. Pakistan fears the numerical superiority of the Indian Air Force, and this fear will continue, in our judgment, to persuade Islamabad that it cannot afford to lose more F-16s in combat or to accidents. We believe the rules of engagement for F-16 pilots will continue to be strict, with the result that Afghan aircraft will still be able to violate Pakistani airspace with near impunity. [redacted] 25X1 25X1

[redacted] 25X1

India: Growing Trade With Western Europe [redacted] 25X1

Trade between India and Western Europe has increased dramatically over the last decade. The most significant increase has occurred in India's imports of West European goods, which have doubled since Prime Minister Gandhi entered office in December 1984, in large part the result of his economic liberalization program. This program, which reduced import restrictions and reformed the domestic tax system, is designed to modernize the industrial sector and to increase and diversify Indian exports. Indian exports to Western Europe, however, have shown little growth. Traditional products such as textiles and clothing remain the bulk of India's exports to Western Europe and have expanded only 23 percent over the decade. The recent trade expansion probably will strengthen India's productive base as planned, but the lack of growth in Indian exports is likely to complicate India's efforts to narrow its trade gap. This could prompt Gandhi to reinstitute import restrictions, which we believe would reduce the flow of West European imports more than US goods. [redacted]

Financially, gains from the decadelong growth in trade between India and Western Europe have fallen largely to the West Europeans. International financial statistics show that Indian imports from the members of the European Community have grown 250 percent since 1977, while exports have grown only 23 percent, creating an overall trade deficit of nearly $13 billion for the decade. Much of the growth in Indian imports from Western Europe has been in the capital goods sector, which includes industrial machinery. [redacted] India hopes imports of more sophisticated machinery will help to upgrade the quality of its exports and make them more competitive on the international market. [redacted]

Despite the unfavorable trade balance, [redacted] India still views the West European countries as prime trading partners. They accounted for 24 percent of its exports and 36 percent of its imports in 1986, according to press reports. In an effort to expand exports to Western Europe, New Delhi has signed several trade agreements since 1980. The most recent of these, signed in June, promotes links between small and medium-size Indian and West European manufacturers and encourages exchanges of experts and officials in high-technology fields. According to the US Embassy, India is also developing a new, simplified trade policy, scheduled to go into effect in 1988, which will be designed to encourage exports to developed economies, including Western Europe. [redacted] 25X1

According to US Embassy reporting, products designated for growth under India's export promotion program include tea, cereals, textiles, clothing, consumer durables, electronic goods, and computer software. All of these sectors face West European markets where either prices are depressed or producer competition is intense. Despite a 17 percent increase in Indian exports in FY 1986-87, the Embassy reports that the key target industries—electronics and engineering goods—showed no growth. [redacted] 25X1 25X1

Most trade between India and states belonging to the European Community takes place with West Germany, France, and Great Britain. They supplied 70 percent of India's West European imports in 1986 and received 67 percent of India's West European exports. [redacted] India sees all three nations as excellent sources of advanced technology unencumbered by the regulations and licensing restrictions that delay delivery of US technology. New Delhi therefore is turning increasingly to them for the advanced machinery necessary to meet Gandhi's economic goals. By increasing trade with the West Europeans, India also reinforces its claims of nonalignment. [redacted]

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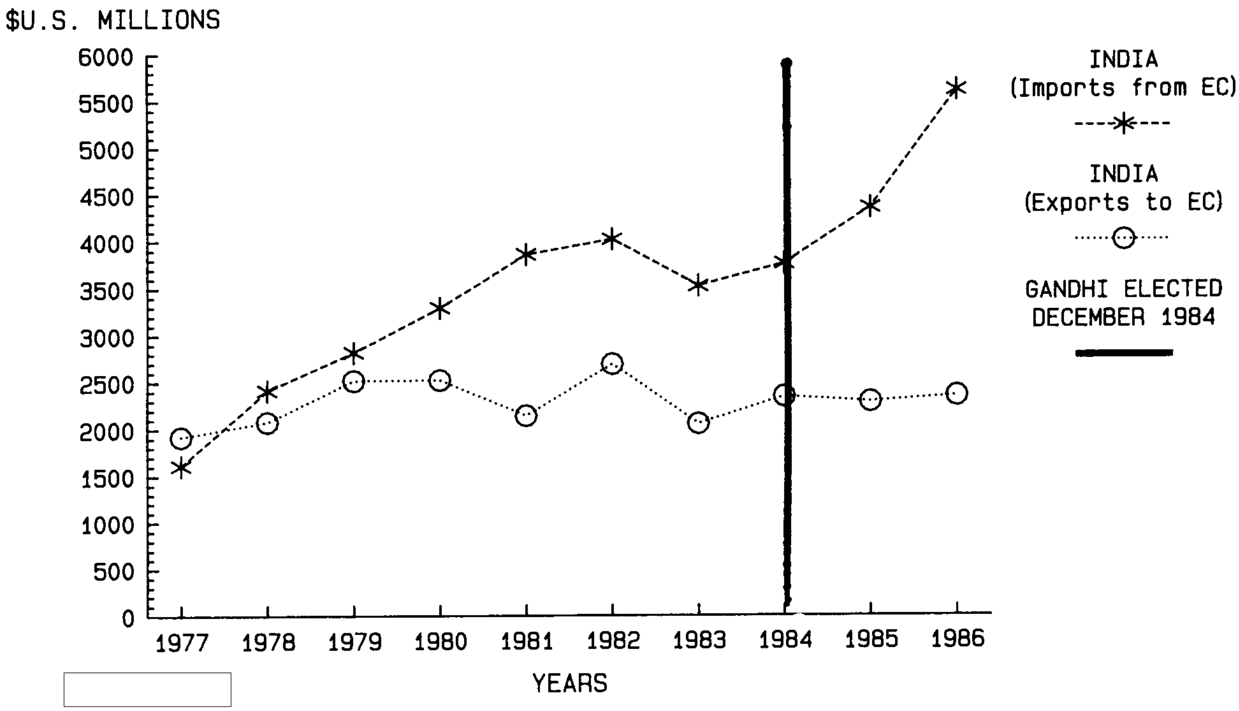
INDIAN-EC TRADE
($U.S. MILLIONS)
1977-1986



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West Germany

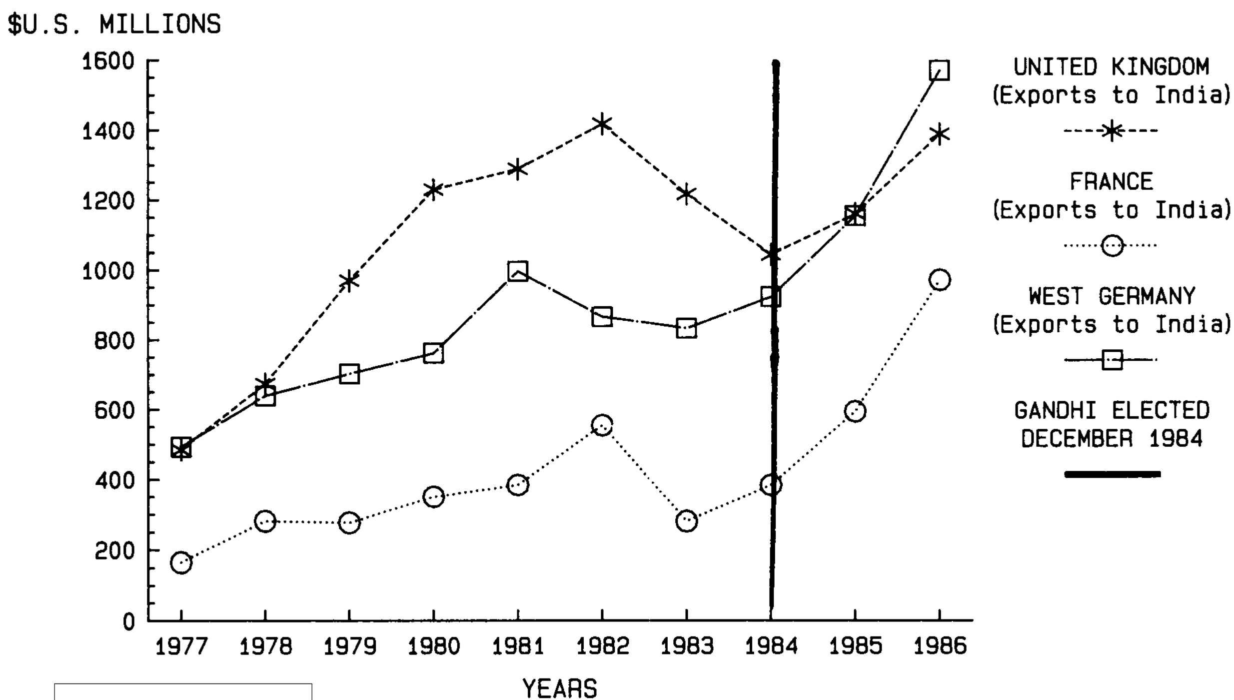
West Germany surpassed Great Britain to become India's largest European trading partner in 1986. The two countries have more than doubled the volume of bilateral trade over the last 10 years. West Germany also is the only one of India's major West European trading partners to increase its volume of Indian imports. At the same time, international financial statistics indicate that West German exports to India have more than tripled since 1977, with 60 percent of this growth occurring since Gandhi took office in 1984. Organic chemicals, machinery, and steel sheets have all been major West German exports to India since 1977, but industrial machinery and components now account for more than half of these exports.

Much of the growth in trade between India and West Germany can be attributed to significant increases in joint ventures and West German investment in the Indian economy. Bonn also has increased concessional aid. West German aid to India this year, which will be about $350 million, is at the highest level ever, according to the US Embassy in New Delhi. The aid will be used for a variety of projects, including energy, transportation, high technology, ecological, and poverty alleviation projects. The aid benefits West German business because, as the US Embassy in New Delhi notes, it is tied to purchases of West German goods. 25X1

France

France, like West Germany, has seen its trade with India expand rapidly over the last decade. Although Indian exports to France have fluctuated since 1977, Indian imports of French goods have increased almost six times, with 73 percent of that growth occurring since 1984. This growth rate is somewhat inflated by major purchases of military goods last year, including 25X1

INDIAN IMPORTS
($U.S. MILLIONS)
1977-1986



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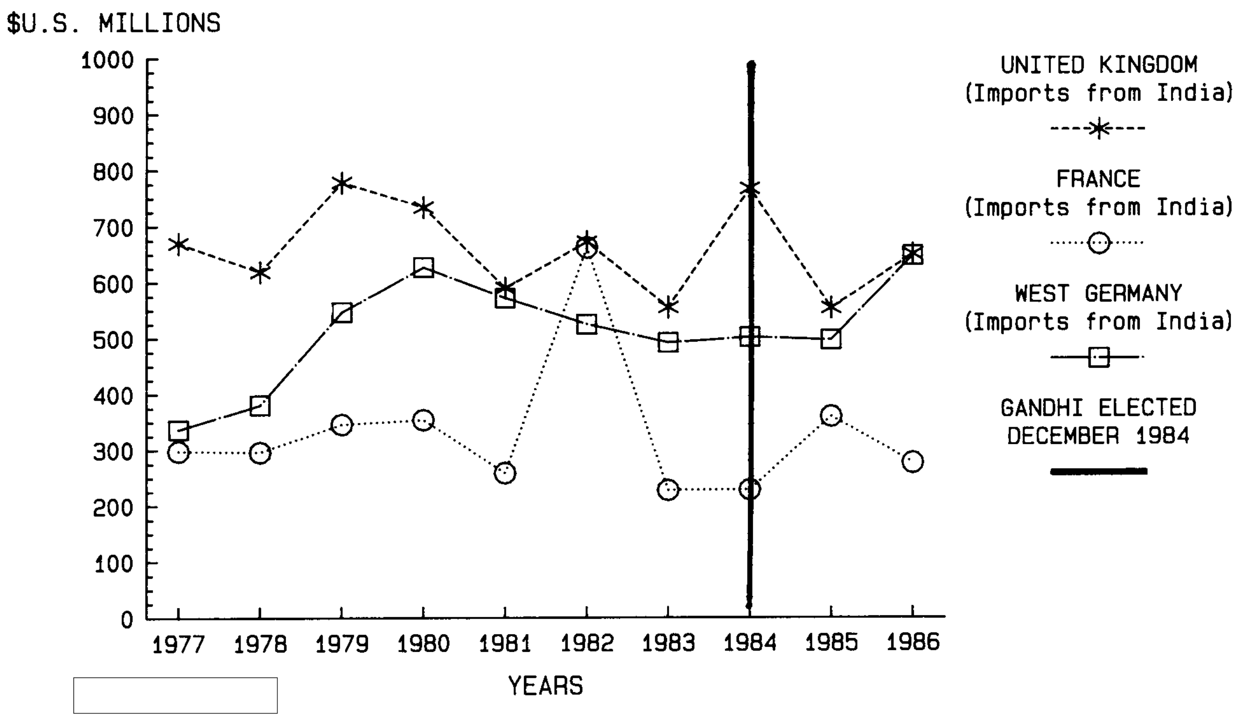
nine Mirage 2000 fighters and 21 Dauphin helicopters, according to the US Embassy. Even without these military transactions, there has been a steady upward trend in Indian imports of French civilian goods.

India is eager to expand its exports to France and eliminate some of the imbalance in bilateral trade. According to press reports, the Indians are encouraging an increase in joint ventures in an effort to repeat the success they have had with the West Germans. The two sides also continue to discuss new trade agreements, especially in military and high-technology sectors like computers and communication systems. Arrangements to help the Indian telephone industry develop the ability to manufacture sophisticated telecommunications equipment are near conclusion, according to press reports. Further, a $583 million credit package was signed between New Delhi and Paris last year to help India finance construction of a gas grid, the purchase of helicopters, and the execution of a hydrolectric project. 25X1

United Kingdom 25X1

Great Britain has traditionally been India's primary trading partner in Western Europe, but Indian trade with Britain has grown at only half the rates experienced by trade with West Germany and France over the last decade. The volume of Indian exports to Britain has actually declined since 1977. The US Consulate in Calcutta reports that Britain's loss of its dominant market position is due to a variety of factors, including less attractive financing and the inability of small British firms to compete with other Westerners who can offer higher quality technology at a cheaper price. 25X1

INDIAN EXPORTS
($U.S. MILLIONS)
1977-1986



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As with its other West European trading partners, India is trying to increase exports to Great Britain through joint ventures and investment. The United Kingdom had the third largest number of new joint venture project approvals in India in 1986, according to the US Embassy in New Delhi. Britain also was the third largest foreign investor in the Indian economy last year. Over time, this investment should help India to expand its offerings to Britain.

Outlook

Trade between India and Western Europe almost certainly will continue to expand, but the growth in Indian exports is unlikely to keep pace with the growth in Indian imports. In our opinion, continued imports of Western industrial machinery and technology are essential to long-term Indian economic growth and to an improvement in India's export performance. International competition in both traditional Indian export sectors and those targeted for expansion, however, is likely to hinder export growth for the foreseeable future. To break into these highly competitive markets, we believe that India will have to make major improvements in the quality of its goods. A significant deterioration in India's foreign payments resulting from failure to achieve this may prompt Gandhi to retreat from his efforts to renew import restrictions. This is likely to slow modernization of Indian industry and further retard the needed expansion of exports. 25X1 25X1

Implications for the United States

Growing Indian trade with Western Europe may push the United States out of a few of its traditional Indian markets such as aircraft and various types of industrial machinery. Although total Indian trade with the United States has more than doubled over the last decade, Indian imports of US goods grew at a much slower rate than those of either West Germany or France. As a result, Indian imports from West Germany exceeded imports from the United States for the first time in 1986. The United States, however, is likely to remain preeminent in nonmilitary high-technology areas such as computers, electronics, and telecommunications equipment, with the greatest potential threat to these US preserves coming from the French. 25X1

We believe New Delhi will continue to value its trade relationship with the United States, especially in light of its current foreign payments problems. The United States remains a major importer of Indian goods, importing almost four times as much in 1986 as either Britain or West Germany. This relationship is likely to help ensure continued growth in imports of US goods. 25X1

Should India be forced to retreat from its economic liberalization program due to continuing foreign payments problems, we believe the West Europeans would be more seriously affected than the United States. The West European nations have made their greatest market inroads in sectors where a domestic Indian production capability, although less technologically advanced, already exists. As a result, import restrictions—if they become necessary—are more likely to be imposed in the sectors where rapid West European growth has occurred than in the high-technology sectors where US strength and Indian need is greatest. 25X1

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