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# Weekly Summary



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June 17, 1977

The WEEKLY SUMMARY, issued every Friday morning by the Current Reporting Group, reports and analyzes significant developments of the week through noon on Thursday. It frequently includes material coordinated with or prepared by the Office of Regional and Political Analysis, the Office of Economic Research, the Office of Strategic Research, the Office of Scientific Intelligence, the Office of Weapons Intelligence, and the Office of Geographic and Cartographic Research.



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*Fahmi (r) is greeted in Moscow by Gromyko*

# Middle East

## EGYPT-USSR 1-6

Little progress apparently was made toward repairing Soviet-Egyptian relations during Egyptian Foreign Minister Fahmi's visit to Moscow last week. Relations have been poor during most of the seven years Egypt's President Sadat has been in power and particularly since Sadat abrogated the Soviet-Egyptian Friendship Treaty last year.

There is no indication Fahmi succeeded in resolving the two issues most important to the Egyptians—a resumption of Soviet arms deliveries and a rescheduling of Egypt's massive debt to the USSR. The Egyptians say they were able to extract a Soviet promise to consider "concrete measures" to improve relations, but there is no evidence that the Soviets made any significant tangible commitments.

There are other signs that the talks were difficult, with the Soviets insisting that any improvement in relations is up to Cairo. Foreign Minister Gromyko was particularly rough on Fahmi at a luncheon on June 10. According to a published version of Gromyko's remarks, he pointedly noted that the "threads of trust," once broken by "thoughtless" actions, are difficult to restore.

The final communique did note some minor achievements. It indicated the Soviets and Egyptians agree that the Geneva conference on the Middle East should be reconvened "not later" than this fall. The Soviets, who have been working hard to place themselves back in the mainstream of Middle East diplomacy via the Geneva conference, doubtless can take some satisfaction in winning Egypt's public endorsement of their role. Cairo's primary interest probably was in making sure that bitterness between itself and Moscow would not impede the resumption of the Geneva peace talks.

Gromyko will visit Cairo in late August or early September for further talks aimed at improving relations, according to an announcement this week by the Egyptian government. The dates for Gromyko's visit have not yet been announced by the Soviets and may still be tentative.

## ISRAEL 9-12

Menahem Begin, leader of the right-wing Likud party, will in all likelihood be installed as Israel's new prime minister early next week. He has the votes to win a vote of confidence for a narrow coalition government that he will formally present to the 120-member Knesset—the Israeli parliament—on June 20.

The new ruling coalition will be composed of Likud, the National Religious Party, and the orthodox Aguda parties; together these groups control 62 seats. In addition, Begin can count on the support of one independent and Moshe Dayan, Begin's nominee for foreign minister, if Dayan decides not to return his Knesset seat to the Labor Party from which he has defected.

Begin's efforts to bring into his government the Democratic Movement for Change, which won 15 seats in the election last month, failed when that party's leadership group voted overwhelmingly on June 14 to break off coalition talks with Likud. Democratic Movement leader Yadin said his party had concluded that Begin was unwilling to assure it a real voice within the cabinet on Arab-Israeli and domestic reform issues.

Yadin and his colleagues emphasized in particular that Begin refused to budge from his hard-line opposition to the return of any of the occupied West bank to the Arabs in a peace settlement. Neither Begin nor Yadin excluded the possibility of resuming their coalition talks, but this appears unlikely in the near future.

Despite its narrow majority, Begin's coalition stands a good chance of holding together; it will be more close-knit and less vulnerable to internal personal and ideological conflicts than the previous Labor-led government. Likud and the National Religious Party fully agree on the need to retain permanent control of the West Bank and to reject negotiations with the Palestine Liberation Organization. The Aguda groups and the National Religious Party see eye-to-eye on the interpretation of most religious questions and seem satisfied with Begin's assurances of support on these issues. 25X1

Begin in recent days has been more restrained in discussing Arab-Israeli issues, but this appears to be mainly a tactical change of style designed to attract the Democratic Movement and ease the apprehensions of Israeli supporters in the US. Begin's more moderate tone is probably also intended to avoid antagonizing the US government before he comes to Washington for discussions with President Carter. 25X1

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# Africa

## TUNISIA-LIBYA 23-25

After several days of negotiations in Tunis, Libya and Tunisia agreed last week to seek international arbitration of their continental shelf dispute. The agreement may have defused the situation only temporarily.

A senior Tunisian Foreign Ministry official has told the US embassy that the Libyans insist the agreement must be ratified by the legislatures of both countries before the dispute is turned over to the International Court of Justice. The Libyans may use this tactic to avoid any binding arbitration.

This is the second time the two countries have agreed to take the long-standing problem to the International Court. The Libyans backed off from an arrangement last August because they were unwilling to accept Tunisia's insistence that the arbitration be binding.

The dispute flared again late last month with the appearance in the disputed waters of a privately owned US drilling ship hired by the Libyans. Tunisia initially demanded that the ship be withdrawn as a precondition to a settlement. Both governments—and the international oil companies—are confident that the shelf holds commercially exploitable oil deposits.

Tunisia has made a significant concession by allowing Libya to continue drilling in the disputed area for the time being. Libyan President Qadhafi in effect has succeeded in denying Tunisia access to offshore oil in at least part of the zone.

Qadhafi believes that Tunisia's desire to obtain access eventually will lead it to join in a "union" with Libya. By papering over the quarrel concerning the continental shelf, meanwhile, Qadhafi has protected his ability to employ Tunisian workers, a significant factor in Libyan development plans.

## ZAIRE 17-19; 21-22

Some Katangan insurgents remaining in the Shaba Region of Zaire are continuing to make harassing attacks on military and civilian targets in the area. Zairian officials fear that the Katangans are beginning a guerrilla war, but the insurgents would face severe problems in waging such a campaign.

Although the Moroccan-Zairian counteroffensive last month recaptured all the towns occupied in March and April by the Katangan exiles from Angola, Zairian authorities have reported this month that Katangans:

- Raided Mungulunga and kidnaped some 100 government railway employees.
- Blew up an army truck and ambushed a patrol just west of Mutshatsha, killing 3 soldiers and wounding 15.

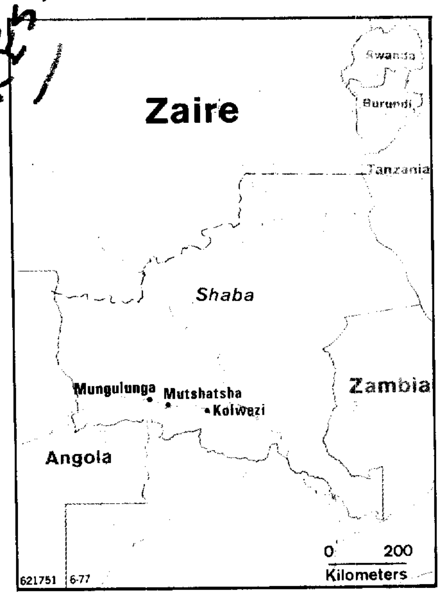

President Mobutu

Some Zairian defense officials believe such activities are the start of a guerrilla war that will soon include an attack on facilities at Kolwezi. They have increased security measures in the Kolwezi area and plan to go on full alert this weekend.

Two types of Katangans probably remain in Shaba: those still trying to make their way to sanctuary in Angola or Zambia, and those who have decided to fight on as guerrillas for as long as they can. Most of the Katangans are believed to have withdrawn from the region after Mobutu succeeded in getting Moroccan military support for his counteroffensive.

A Katangan guerrilla campaign in Shaba would be aimed at bringing down Mobutu. The Katangans would probably seek to cut the rail lines and stop the production or export of copper, Zaire's chief source of revenue; discredit the government domestically; and tie up Zairian armed forces, thus encouraging antigovernment moves elsewhere in the country.

The Katangans face a number of disadvantages. Their forces are now in disarray, with some in Angola, some possibly in Zambia, and some being hunted by Mobutu's army within Shaba. Many face food and health problems. They were demoralized by their failure to bring down the Mobutu government quickly, Mobutu's success in obtaining foreign support, and the lack of support from Angola when their offensive faltered. Angola, their exile home, now

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appears preoccupied with increased domestic problems.

The Zairian army, although lacking the drive and effectiveness of the recently departed Moroccan troops, has some 8,700 men in Shaba as well as equipment left by the Moroccans or provided by Western governments since the Katangan invasion

## USSR

45-46

### TRADE WITH THE WEST

The USSR is planning an overall cut in trade with the West this year and next because of a severe trade deficit with the US and other countries. At a recent meeting of the joint US-USSR Commercial Commission in Washington, Soviet officials said the cuts would affect both agricultural and nonagricultural products and would apply to all Western trading partners.

Last year, Moscow's hard-currency trade deficit with Western contries was $4.9 billion; trade with the US accounted for nearly half of this amount, according to Soviet statistics. Grain imports valued at an estimated $3 billion—half from the US—were a leading factor in the deficit. The grain imports were necessary because of the poor Soviet harvest in 1975.

Last year's record harvest is allowing the Soviets to reduce the cost of their grain imports this year by an estimated $2 billion. Early indications for another good harvest this year suggest that Moscow may be able to keep its grain imports at minimum levels next year as well.

These imports will largely reflect the USSR's commitment to purchase 6 million tons of grain from the US, worth roughly $700 million, each year through 1980. A Soviet grain delegation in Washington last month would say only that Moscow would meet the minimum requirement in purchasing grain from the US this year.

### NEW REPRESSION 37-40

Soviet actions against a US journalist in Moscow over the past week were apparently part of a Soviet counteroffensive on human rights issues as the East-West meeting began in Belgrade. The meeting, which began on June 15, is a preparatory session for a follow-up conference this fall on the 1975 Helsinki accords.

The temporary detention and repeated interrogation of *Los Angeles Times* newsman Robert Toth on charges of receiving state secrets from a Soviet citizen points up the Soviets' recent propaganda emphasis on the espionage potential of contacts between foreigners and Soviet citizens. On June 16, Toth was finally told that he was free to leave the USSR the next day as he had planned.

Moscow could still try to link the Toth incident to the case of jailed human rights dissident Anatoly Shcharansky, who may be charged with engaging in treasonous activities involving US diplomats and journalists. Soviet authorities presumably knew that Shcharansky had introduced Toth to the Soviet scientist who gave Toth a paper on parapsychology moments before both Toth and the scientist were apprehended. If Shcharansky is brought to trial, Toth's involvement would be useful to the Soviets in building their case against the dissident.

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The Shcharansky and Toth cases evidently are parts of the Soviet effort to keep the West from putting the USSR and its allies on the defensive at Belgrade. A further Soviet motive in moving against Toth may be to inhibit foreign journalists in the USSR from writing about human rights matters—and to discourage their Soviet contacts from talking to them.

Although the Soviet human rights movement has been demoralized and weakened in recent months by arrests, exile, harassment and emigration, members of the dissident group set up to monitor Soviet compliance with the Helsinki human rights provisions apparently continue to smuggle statements to the West. One such document, urging the West not to back down on human rights issues, appeared in an Austrian daily two days before the opening of the Belgrade meeting.

The document rejected the alternative of a propaganda confrontation. It called instead for an East-West agreement defining which restrictions on individual freedoms are permissible in order to safeguard the interests of the state. It also called for a definition of what constitutes "interference" in the internal affairs of another state, a catch-all phrase used by the Soviets to deflect Western expressions of concern about human rights in the USSR.

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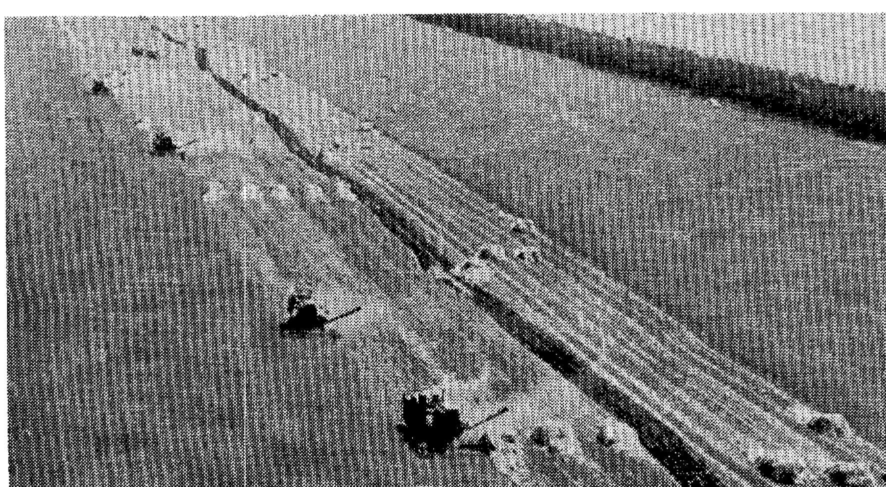

*Soviet grain being harvested; a good crop is expected in 1977*

SOVFOTO

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## STEEL PRODUCTION

Stagnation in Soviet steel production over the past year and a half and failure markedly to improve capacity and assortment have rapidly increased Soviet dependence on imports from the West.

The USSR supplanted the US as the world's largest steel producer in the early 1970s, but the annual rate of Soviet steel production has slowed considerably in recent years. Last year, it increased only 3.4 million tons, the smallest annual boost since 1957. Output in the first quarter of this year dipped below that of the same period in 1976.

The assortment and quality of Soviet finished products, particularly flat-rolled steel, are inadequate to meet domestic demand. As a result, the USSR has been a net importer of steel since 1974. The imports must be paid for in hard currency, while exports, for the most part, are sold under ruble-clearing agreements with East European countries. In 1976, payments for steel imports totaled about $2.5 billion, or about one-sixth of total hard-currency imports.

Poor quality in such items as drill and line pipe and electrical steel sheet has also been a problem. The Soviets have steadily increased investment in the industry over the past 15 years, but the amount has been inadequate for adopting modern technology, improving the quality and assortment of finished products, and upgrading Soviet iron ore.

Construction of new capacity has lagged badly. To compensate, the Soviets have delayed the retirement of old facilities; some have been refurbished, and operations intensified. Most of this potential has already been tapped, and squeezing additional output from existing plants is becoming more difficult.

These factors, together with outlays for pollution control equipment, have caused a steady rise in capital costs not matched by production increases.

Prospects are not favorable for expansion of Soviet production of those types of finished steel for which demand will remain high. Overall growth in output of finished steel is slated to slow to an average annual rate of 3.6 percent in the period 1976 to 1980. Moreover, given the poor performance in 1976 and early 1977, as well as the Soviet record of failure to carry out investment plans, the USSR will not soon be able to substitute domestic production for imports.

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President Ceausescu delivering a speech at a party conference

East Euro

## Eastern Europe

### ROMANIA 62-69

A new three-year "program on ideological cooperation" between the Romanian and Soviet communist parties is the first such agreement the Romanians have signed with any Warsaw Pact country. The document reflects a trend toward closer relations between the USSR and Romania, the most independent-minded of Moscow's Warsaw Pact allies.

The agreement capped a recent three-day visit to Bucharest by Mikhail Zimyanin, a Soviet party secretary. During his stay, Zimyanin met with Romanian President Ceausescu for talks on "diversifying" and "expanding" cooperation between the two parties. The Soviet also saw Cornel Burtica, the Romanian party's ideological watchdog, and Stefan Andrei, party secretary for foreign relations. A Romanian announcement described all these meetings in unusually warm terms.

Romania had refused to sign ideological accords with the other East European states in 1972 and 1973, when Moscow was promoting such agreements. Although no texts of Moscow's ideological agreements with the East European countries have ever been published, they presumably provide for periodic consultations and meetings between party leaders concerned with ideological matters. Ceausescu evidently had feared that such commitments would detract from Romania's nonaligned and independent image.

There is no indication that the new Romanian-Soviet arrangement commits Bucharest to "coordinate" positions on ideological issues with Moscow. The Romanians may well hope to keep the arrangement as informal as possible.

### POLAND 60-61

Prime Minister Jaroszewicz acknowledged, in a recent review of the Polish economy, that the country has made little headway so far this year in solving its pressing economic problems. The Prime Minister warned that much of the belt-tightening Poland must endure is still to come.

Jaroszewicz said the government has been unable to control excess wage increases, alleviate acute meat and consumer goods shortages, or reduce a burgeoning hard-currency trade deficit and debt. He emphasized the need for progress in slowing the rapid rise in wages. In the first four months of 1977, wages increased at a 13-percent annual rate, largely because of bonuses workers received for additional production of badly needed commodities.

The continuing rapid growth in worker income will probably have the effect of intensifying existing shortages of meat and other sought-for goods. Meat supplies are expected to fall below 1976 levels this year despite a reported halt in the decline in livestock numbers, continuing curbs on meat exports, and plans for imports.

On the sensitive issue of prices, Jaroszewicz reiterated that the growth in wages, coupled with the continued freeze on basic food prices, would force the government to raise prices on other goods. Nonalcoholic beverage prices already were increased in January. An increase in nonfood prices probably would lead to some consumer grumbling, but the reaction would almost certainly be less than that of a year ago, when a government announcement of sharp food price hikes touched off serious disturbances that forced cancellation of the increases.

Jaroszewicz described this year's foreign trade results to date as unsatisfactory. He observed that hard-currency exports were considerably below planned levels while imports continued at high levels, and warned Western countries that Poland could retaliate against their exports if Western barriers to Polish products are not lowered. 25X1

If Poland's trade picture does not begin to improve shortly, its hard-currency trade deficit could approach the 1976 record deficit of $3.3 billion. Such a development would only intensify Warsaw's difficulties in obtaining credits to finance its purchases and make debt repayments.

Jaroszewicz' remarks may foreshadow new administrative measures to deal with the country's economic problems. Discipline over industrial enterprises may be tightened to check investment growth and slow the rise in wages. The regime also may take steps to curb imports and encourage hard-currency exports through new incentives. 25X1



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## Western Hemisphere

### CHILE 79-81

Gradually recovering world copper prices and rising noncopper exports should permit Chile some relief from the harsh fiscal and monetary measures of recent years. A 24-percent increase in imports this year planned by the ruling military junta will spur a recovery in real gross domestic product and should aid in reducing Chile's triple-digit inflation.

Unlike most countries of comparable development and sophistication, Chile had to slash imports—and thus domestic income and employment—to cope with the payments problems stemming from rising oil prices and world recession. Until recently, its extremely weak international credit rating practically ruled out access to commercial funds. World criticism of the regime's human rights practices severely limited new official economic assistance and made foreign debt renegotiation difficult at best.

The Chilean people have complained little about the austerity because of the threat of government repression and, more importantly, because many citizens—if not most—still feel they are better off than under the Marxist Allende regime overthrown in 1973.

By mid-1976, the balance of payments had improved considerably because of booming copper production, moderate recovery in world copper prices, rising earnings from noncopper exports, and short-term capital inflows attracted by soaring interest rates. This year the government plans to use its improved foreign reserve position to permit an increase in imports sufficient to restore real gross domestic product to the 1974 level. It also intends to avoid debt renegotiations and to assert its independence of the US and other critics of its human rights practices by sharply reducing borrowing from governments and international agencies.

Imports are expected to rise to about $2 billion this year. Higher domestic wheat yields and low wheat import prices will permit a reduction in spending for food imports; most of the increase in imports will consist of fuel, raw materials, and goods for industry. Bringing total imports to the target level will require about $175 million more than Chile now expects to receive from trade and capital flows. Given the recent improvement in the country's credit rating, it probably can raise this additional amount from private sources.

Although the government is still pursuing a strong anti-inflation policy, it intends to ease austerity. Real wages are to be increased about 5 percent. The junta began a slight relaxation of its restrictive monetary policy in the first quarter, and last month it announced a moderate program of tax reductions, increased social spending, and wage increases for government workers.

Both the government deficit and growth in the money supply are expected to decline this year; as a result, inflation appears likely to fall to 130 percent or less, down from about 180 percent last year.

With somewhat stronger demand, real gross domestic product should grow 6.5 to 7 percent this year. Employment will rise some 4.5 percent, but the unemployment rate will decline only slightly, to 12.2 percent. 25X1

## Asia

### PAKISTAN 67-68

The latest round of negotiations between Prime Minister Bhutto and leaders of the opposition ended this week after making some progress but without reaching a definitive agreement on the resolution of Pakistan's political crisis. Despite an announcement that an accord was reached on the basic issues, at least one important matter apparently remains undecided—the establishment of guarantees that the new elections Bhutto has promised are conducted honestly.

Bhutto made several concessions during the meetings. Most important was his agreement to hold new National Assembly and provincial elections. He also agreed to release opposition leaders and thousands of their followers from jail and to end martial law, imposed in Pakistan's three largest cities in April.

The opposition dropped its demand that Bhutto resign, and he was able to avoid the formation of a coalition government in which the opposition would have considerable power. The negotiations also bought time for Bhutto. The country has been relatively quiet since the talks began in early June, and there is no sign that the opposition is planning to resume demonstrations soon.

Bhutto is under pressure from the army and the Saudis, however, and may have to make new concessions in talks that one of his closest advisers, Finance Minister Pirzada, will now hold with opposition leaders. 25X1

*Prime Minister Bhutto*

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## INDIA 65-66

Prime Minister Desai's Janata Party has won most of the 10 state assembly elections held in India from June 10 to 14. The results indicate that the Janata group, although it is a loose alliance that has been in existence less than six months, has maintained its popularity since defeating Indira Gandhi and the Congress Party in the national election three months ago.

The eight states in which the Janata Party appears to have won are all in northern India. These were the states where the party made its strongest showing in March, prompting Desai to dissolve their legislatures and call new elections.

An independent Marxist party apparently will dominate the state assembly in West Bengal, and a local party has won in Tamil Nadu, a southern state that went to the polls because an election had already been slated there. Elections were not called in India's other 12 states.

The Congress Party's poor showing in the state elections reflects the continuing stigma of former prime minister Gandhi's emergency rule. The results also mean that when a new president is elected this summer, the Desai government may be able to put its nominee in office in place of the current incumbent, a Congress Party member. State legislators cast half the votes in Indian presidential elections; members of the national parliament cast the rest. The post is essentially ceremonial, but the president does have some power to delay implementation of government policy.

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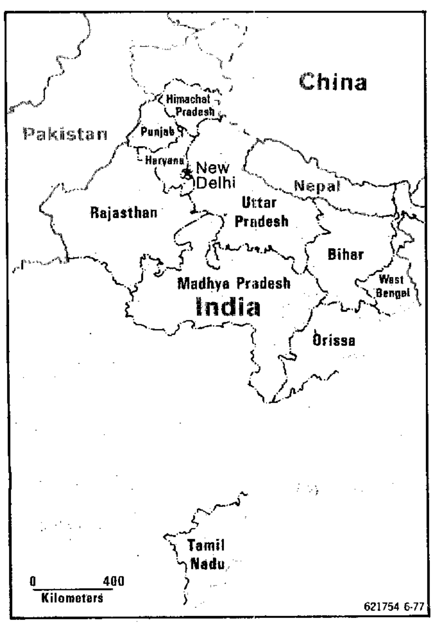
Prime Minister Morarji Desai at news conference




## China: Political Aspects of Military Modernization

72-73

A recent editorial in China's army newspaper, *Liberation Army Daily*, reaffirms party control over the military and argues that further political work in the army is required in order to accelerate military modernization.

Highlighting the editorial are two handwritten statements by party leader Hua Kuo-feng and Defense Minister Yeh Chien-ying dealing with political aspects of the modernization question. They appear to put the army on notice that the acquisition of more advanced weapons systems depends on its demonstration of proper political attitudes and performance, including strict obedience to party leadership.

In reference to defense spending, the editorial argues that "army building" must proceed "at the same time" as economic development, but avoids the difficult translation of this general directive into specific budgetary decisions.

The army is exhorted to learn from the "Hard-Boned Sixth" Company, a unit widely praised not only for its excellent combat training, loyalty, and toughness, but also for its efforts to keep its ranks politically pure. An emulation campaign, which began in low key earlier this year and seemed aimed at weeding out followers of the discredited leftists, is now being pushed more actively—implying dissatisfaction in Peking over the way some military units are carrying out their work.

The editorial clearly sets priorities for army work: "Our principle is putting revolutionization in charge of modernization." Revolutionization is defined as doing proper ideological work, obeying party instructions and, most important, "purifying" army leadership groups.

This approach seems to serve two purposes. It clearly reaffirms the principle of army subordination to party leadership, which may have come under question in the wake of the purge of the four leftists. It also provides a sound political justification for resisting the argument that military modernization should receive top priority—an argument that Peking may be forced to reject for purely economic reasons.

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*Two politically sensitive issues—wage reform and defense spending—were recently discussed but not resolved at a major economic conference in Peking.*

# China: Economic Issues Discussed

[redacted]

China's new leadership has recently concluded its first major industrial conference, the "learn from Taching" conference that went on in Peking for more than a month. Keynote speakers Hua Kuo-feng, the party chairman, and party vice chairman and defense minister Yeh Chien-ying described the "excellent situation" in the economy, and called for a new "leap forward" that would push the economy closer to the goal set by Mao Tse-tung in 1956—to overtake and surpass the US economically by the end of the century. Despite this public display of optimism, Chinese [redacted] 25X1

The Chinese media have responded with a torrent of statistics to portray an economic surge during the first quarter of 1977. In fact, however, these figures are more important for what they reveal about the sharp fall-off in production last year, when political infighting severely disrupted the economy, than they are for accomplishments in 1977. Still, it seems clear that the economic situation as a whole has greatly improved over last year. Industrial output in April reportedly was up 7.9 percent over March of this year, and 10.8 percent over April 1976.


*A broad view of the "learn from Taching" conference*

Improvements in managerial efficiency and a stricter accountability of labor for its actions have evidently contributed to the improved situation. The Chinese leaders recently issued instructions to withhold wages from workers who have been absent from their jobs without valid excuses. The same directive indicated that workers who put in extra hours would be allowed to accumulate those hours as part of their leave time. This approach appears to have helped to promote greater worker productivity. Increases in loading and unloading rail freight and shorter turnaround times have already been reported.

**Prospects for Further Growth**

In contrast to the favorable economic situation portrayed in the press, a recent series of central directives has been more critical. In these directives, Peking drew attention to numerous problems that have been noted before, such as structural imbalances in the coal and iron and steel industries, fuel shortages, and transportation difficulties. The important thing, however, is that the new leadership now appears ready to deal with these problems.

**Defense Spending**

The course and pace of Ch[redacted] 25X1 economic development over the long term [redacted] affected by the resolution of the sensitive issues of defense spending and wage reform.

At the Taching conference, Yeh Chien-ying recited a graphic Mao quote: "We have two fists and one rump. One fist is agriculture, the other defense industries. If we want the fists to pack a wallop, our rump must be firm—the rump being the basic industries." The quote underlines the overriding importance of civilian industrial development as a basis for defense modernization, and the fact that it came from the defense minister suggests the military has accepted some short-term belt tightening.

As economic recovery proceeds, however, the advocates of a more aggressive military modernization program may argue more forcefully for a greater share of the fruits of recovery. Interservice haggling over how defense modernization should proceed and resources should be allocated will, in the long run, determine the overall cost of military modernization.

**Wage Reform**

The announcement at the industrial conference by the head of the State Planning Commission that a separate conference will be held to discuss "the problems involved in employment and wage rates" underscores the complexity of wage reform and the difficulty of satisfying worker wage demands. Chinese workers have not had an across-the-board increase in industrial wages since the late 1950s, and increases in the cost of living have in many cases outpaced wage increases during the intervening years.

The leadership at first relied on bonuses of 6 to 8 percent to help supplement the low and unchanging wages of the industrial worker. Such bonuses, however, were eliminated in the later years of the Cultural Revolution; the lack of bonuses contributed to the increase in strikes, absenteeism, and other so-called acts of "sabotage" that have been occurring since that time.

Following the purge of the leading leftists last fall, the government gave strong indications to labor that wage reform will be undertaken sometime this year. In recent weeks, a bonus system tied to worker productivity was introduced on a trial basis in selected factories in Peking and Canton. Under this system, a monthly award of 20 yuan—the average monthly wage is about 60 yuan—will be made to workers fulfilling 130 percent of their quotas, and scaled-down bonuses to others who fulfill at least 120 percent of their quotas.

In addition to bonuses, the Chinese leaders apparently also are considering wage increases. Senior managers in a shoe factory in Canton informed workers that in the second half of 1977 those workers with 10 years of service will be eligible for a pay raise that will be based on their political attitude and work performance. Similarly, an official of a Shenyang factory in mid-May indicated that at the end of the year there would be selective wage increases based on worker attitude, technical level, and productivity.

Although labor in general has responded favorably to reports of pending wage raises, there is evidence that workers' expectations may exceed the willingness—and perhaps the ability—of the government to pay higher wages. Workers in a Canton factory recently complained that wage increases of only 3 to 4 yuan per month would not be enough.

The government may be temporizing, hoping to buy time to allow the economy to recover and to promote other incentive schemes, such as the emulation campaigns that have increased in the past few months. The new leadership may be reluctant to risk debate over an approach that some might construe as a retreat from socialist commitment. On the other hand, if wage increases or production bonuses are not forthcoming, planned increases in productivity and future growth prospects would be endangered. 25X1

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*Mexico's border industry program, in which factories operating under special tariff concessions assemble products largely for export to the US, is expanding again after two years in the doldrums.*

103-107

# Mexico: Border Industry Program

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The Mexican border industry program, in which US-owned firms play a major role, has begun to expand once more after languishing for two years under the weight of soaring labor costs, the US recession, and political uncertainty. A sharp drop in labor costs because of peso depreciation, increased US consumer demand, and firmer support from the new Lopez Portillo administration have boosted border industry activity. Real output and employment in these industries probably will increase between 15 and 25 percent this year.

The program consists largely of US-owned, labor-intensive manufacturing plants operating in border areas of Mexico under special US and Mexican tariff concessions. Participating factories assemble articles from US-made components. The goods produced, 70 percent of which are electric and electronic equipment and 10 percent wearing apparel, are sold mainly in the US. The program takes advantage of a part of the US Tariff Structure that limits US tariffs to the value added abroad for reimports of US goods exported for assembly or further processing.

Initiated in mid-1966 by the Mexican government, the border industry program is designed to reduce the serious unemployment problem in the area, which was aggravated by termination of the bracero (contract farm labor) program at the end of 1964. This program, which allowed Mexicans to cross the border for seasonal farm work, employed as many as 170,000 workers in the early 1960s.

Following the lead of several Southeast Asian countries, the Mexican government granted incentives to stimulate development of industries producing consumer goods for the US. Border firms were exempted from Mexican import duties on materials and equipment, and from requirements for partial Mexican input and ownership. In addition, the firms—regardless of ownership—were accorded all privileges normally granted Mexican-owned companies.

Early growth of the program was impressive, with the real value of border industry exports increasing at an average rate of more than 65 percent per year through 1974. Although factories initially were restricted to a 20-kilometer-wide zone along the US border, since late 1972 "border" firms have been allowed to locate in the interior of Mexico. Though still dominated by firms located on the border, the program is now officially termed the "in-bond" industry program.

**Depressed Activity in 1975-76**

The in-bond program was hard hit in 1975 and 1976. Real output and employment fell about 10 percent in 1975 as the US recession cut demand and sharply higher Mexican wages raised operating costs. Although the US recovery spurred output during the first half of 1976, uncertainties associated with the last months of the Echeverria administration stifled growth in the second half; for the year as a whole, real output and employment remained 5 percent below 1974 levels.

*President Lopez Portillo*

Mexican costs calculated in US dollars rose almost 50 percent faster than corresponding US labor costs between 1973 and August 1976, when the peso was devalued. As relative wage increases in Mexico accelerated, several US firms discontinued foreign in-bond operations or shifted to lower cost countries elsewhere in Latin America.

Haiti and El Salvador, which have cut labor costs relative to those of the US during the last 10 years, increased exports under the reduced duty portion of the US Tariff Structure from $33 million in 1973 to $134 million in 1976. Their in-bond exports as a percent of Mexican in-bond exports rose from 5 to 12 percent.

Ten other Central American and Caribbean countries as well as Brazil and Colombia have increased in-bond operations in recent years—although thus far on a smaller scale than Haiti and El Salvador. Since labor costs in most Southeast Asian countries have kept pace with Mexican rates, in-bond production in those countries has not expanded relative to that of Mexico.

**Outlook for 1977**

This year, sharply lower relative wages, increased US consumer demand, and greater political certainty will boost in-bond real output and employment in Mexico by about 20 percent. Exports of in-bond assembled goods are likely to reach $1.5 billion this year, and employment should reach 85,000.

The 45-percent depreciation in the peso since last fall has largely recaptured the relative advantage of low Mexican wages for the in-bond industry. Since wage demands also have been greatly restrained this year, relative Mexican labor costs are likely to be 25 percent less than in 1976.

Demand for in-bond products will jump because of expected strong growth of the US economy. Japan's recent agreement to cut television sales to the US by 40 percent starting next month will further increase demand for sets and components parts assembled in Mexico. Thirty percent of all Mexican in-bond output is directly associated with assembly of television sets and components.

In contrast to former president Echeverria, who periodically expressed serious reservations about in-bond exemptions from regulations requiring Mexican control of firms operating in the country, President Lopez Portillo firmly supports expansion of the program. With the threat of economic restrictions greatly mitigated, US manufacturers are again increasing their investments.

Value added by the in-bond industry should grow from $536 million last year to an estimated $647 million, contributing significantly to Mexican foreign exchange earnings. During the first quarter of 1977, in-bond exports were up almost 7 percent from the first quarter 1974 peak.

The increase in in-bond production will create approximately 12,000 new jobs. With an expected 800,000 new entrants to the Mexican labor force this year and combined national unemployment and underemployment approaching 50 percent, however, expansion of the in-bond program may attract more labor to the border areas than can be absorbed. Thus, while economic conditions on the border will improve for some, the expected influx of laborers to the area may increase illegal entries into the US. 25X1

*Prime Minister Vorster is responding to Western pressure for more rapid change in South Africa by indicating that no basic change in South Africa's policy of separate development for its ethnic groups is contemplated and that only minor changes will be made in discriminatory racial laws and practices.*

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# South Africa: No Sign of Give

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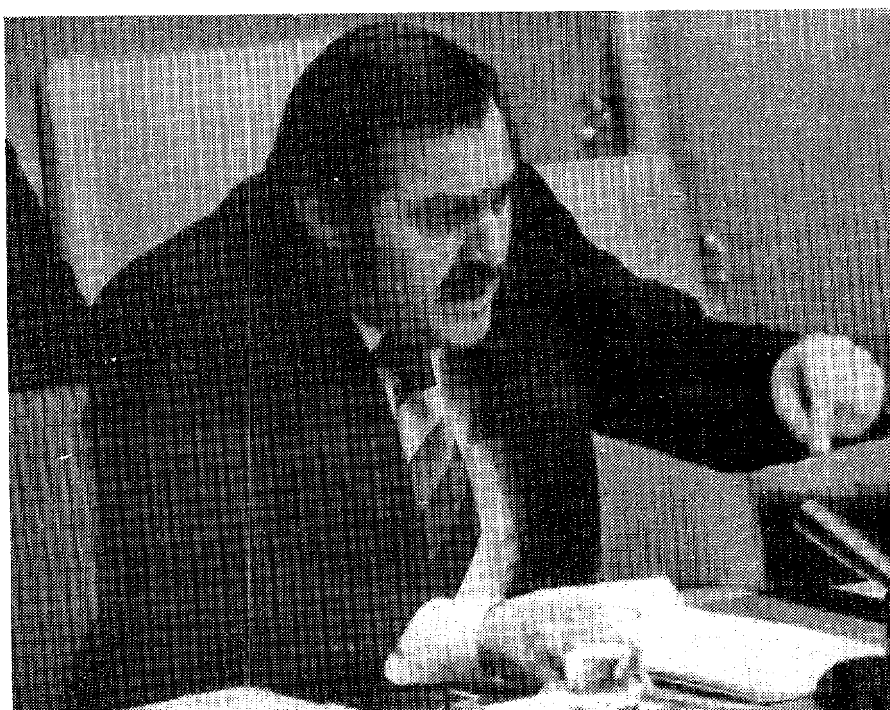
South African government officials have been talking tough in recent weeks in a determined effort to reassure their domestic white constituents that the Vorster government will protect their way of life and resist all pressure for change from both West and East as well as from the black nations to the north.

Specifically, since mid-May Prime Minister Vorster's lieutenants have:

- Reassured white South Africans that no basic change in the government is contemplated, even as plans are revealed for accelerating the pace of separate development and reducing discriminatory practices.
- Emphasized for the benefit of Western audiences the dangers of communist control of South Africa's resources and of the strategic sea lanes around the Cape of Good Hope.
- Appealed to segments of the American population to try to modify official US pressure for more rapid change in South Africa.



Foreign Minister Botha addressing the UN

Both Foreign Minister Botha and State President Diederichs are protesting that South Africa is not prepared to commit racial suicide by adopting the norms and standards of the US political system, especially the one-man, one-vote concept.

Botha, in particular, has concentrated his fire on the one-man, one-vote theme. A hard-line speech he gave on June 4 to the Cape Town press club drew strong applause from a mostly English-speaking group that represents the more liberal segments of the white population.

He played on fears of the "black peril" by pointing out that the birth rate for blacks is 3 percent a year, while their part of the gross national product only goes up 1 percent a year; he questioned whether the whites should be governed by a people who, he said, would not reach a Western standard of living for 300 years; and he threw barbs at the US. Botha concluded, "There is one thing we cannot do: we can never buy one-man, one-vote in one political entity."

Rhetoric such as this falls on receptive ears throughout white South Africa, including the so-called enlightened whites who count Botha among their number.

Top South African officials are also making much of the new Soviet threat in

Africa and are maintaining that the US has long underestimated this threat. Moscow, they say, is aiming at a world monopoly of raw materials. Botha publicly criticizes the US for not being able to stop the Soviets in Africa and claims Washington is currying favor with African radicals as a way to prevent further Soviet inroads.

Many Afrikaners sincerely believe the US needs their help in halting the USSR. A theme frequently repeated in speeches on Republic Day on May 31 was that Afrikaners are prepared to stop the Soviets themselves if necessary.

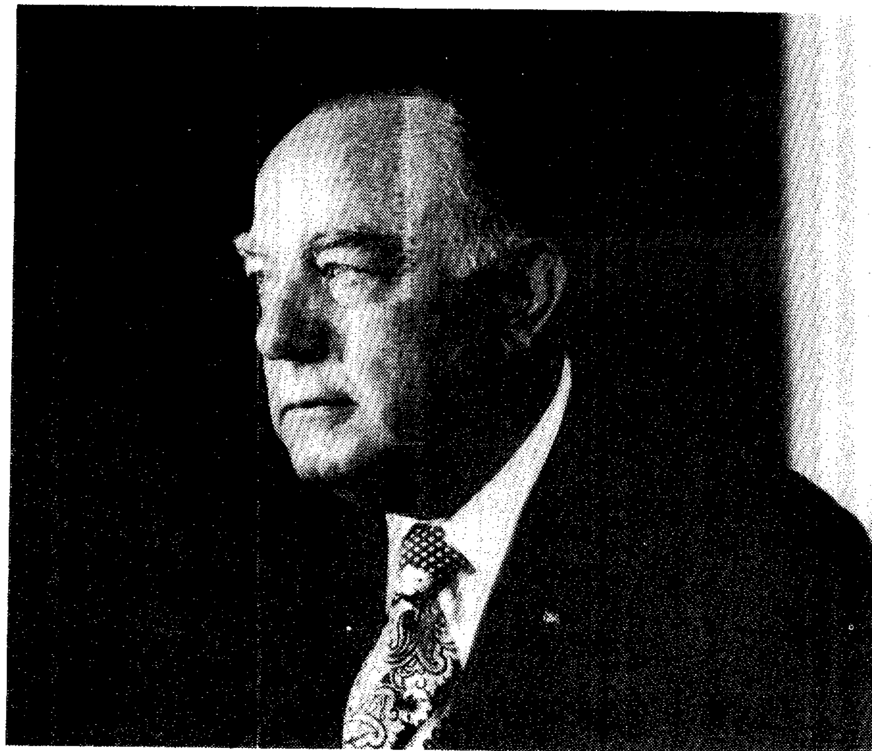
**The Limits of Flexibility**

Some officials have attempted to give the impression that the government is flexible on future political arrangements to give nonwhites a share of power, and new codewords for old concepts are being developed. One cabinet official on May 24 talked about "cultural pluralism" and "plural democracy"—apparently an extension of the concept of "separate development," which is, in turn, a codeword for apartheid.

While apartheid means racial separateness in general and was the central concept of the National Party's philosophy when it came to power in 1948, "separate development" has come to mean giving over to the blacks—70 percent of the population—some 13 percent of the land scattered in "bantustans," or tribal homelands, throughout the country. Plural democracy seems to imply that there will be some sort of confederation of whites, coloreds, and Asians.

In addition to adding new vaguely defined terms to the South African lexicon, the government has eased some of the strictures on blacks in ways that change the power equation little, but for which there has been considerable agitation. Blacks, for example, are now permitted to compete against whites in some sporting events and to own businesses in areas where they do not live.

In the face of increased international pressure, the South African leadership seems to be telling domestic audiences that it will not be stampeded into suicidal



*Prime Minister Vorster*

action. It is also saying that it is not intransigent, but is going about change in its own way and at its own pace.

At the same time, the South Africans are telling foreign audiences that recommendations from abroad are not suitable for South Africa and that the South African government is moving away from racial discrimination, which is the goal the West is pressing.

It is evident that Pretoria, in the face of new pressures, has virtually written off political emancipation for blacks outside of the homeland program. It appears also that the government does not intend to go beyond lifting some discriminatory practices against blacks who live and work in white-dominated South Africa. It is even possible that new Western pressure for more rapid accommodation with the blacks and for a settlement in Namibia will produce a siege mentality among South Africa's officials that would rule out peaceful change.

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*State President Diederichs*

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