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International Economic & Energy Weekly

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1 April 1983

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International Economic & Energy Weekly

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Synopsis

Perspective—*Troubled Debtors' Adjustment Far From Over*

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There is no doubt that the rescue programs coordinated by the IMF, commercial banks, the Bank for International Settlements, and debtor and creditor governments have so far averted international financial collapse. Over the longer term, however, the only sure cure for debtors' international financial problems is a period of sustained growth among the industrial countries. While signs of a recovery are under way, any substantial impact on debtors beyond a measure of confidence building is still a couple of years away.

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Japan: Poised to Dominate the 256K RAM Market

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Japanese semiconductor manufacturers have opened a substantial lead over their US rivals in developing and bringing to market the next generation semiconductor memory device, the 256K Dynamic Random Access Memory (RAM). The Japanese position is so strong that we believe they could capture more than 70 percent of the early 256K RAM market.

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OECD: The Economic Impact of a Reduction in Oil Prices

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Using CIA's econometric model, we estimate that a fall in the price of crude oil to $25 per barrel would lead to an increase in OECD GNP growth rate of 1 percentage point in 1983 and half that in each of the next two years. It also would lead to an increase in employment of some 2.5 million people by 1985, with most jobs created in the second and third years.

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The Role of Inventories in the Oil Market

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Expectation of a decline in oil prices has been the main force triggering an inventory liquidation in the present oil market that has pressed OPEC production below 15 million b/d. If oil companies persist in the belief that OPEC will be unable to prevent a further price decline, an estimated 300-400 million barrels of inventories could be dumped on the market to add to downward price pressures.

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Hungary: Another Look at Reforms 25X1

Hungary's economic reform program has attracted more attention than any of the reform packages instituted in Eastern Europe in the postwar period. Some of Budapest's CEMA partners are watching Hungary's program closely in hopes of finding ways to solve their own economic problems. Much of the program's appeal appears to lie in it success in appeasing workers and consumers while maintaining firm party control. 25X1

Cuba: Hard Currency Constraints and Debt Problems 25X1

The Cuban economy is facing its most difficult period since Fidel Castro took power in 1959. Cuba will experience little or no growth for 1983 and will fall well short of most of its ambitious targets for 1984 and 1985. 25X1

USSR: Labor Discipline Campaign 25X1

A crackdown on workers to reduce shirking on the job has been General Secretary Andropov's major initiative thus far to increase production and rejuvenate Soviet economic performance. If greater worker effort is not rewarded by an increase in consumer goods and services, however, the discipline campaign is likely to lose momentum. 25X1

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Perspective

Troubled Debtors' Adjustment Far From Over

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There is no doubt that the rescue programs coordinated by the IMF, commercial banks, the Bank for International Settlements, and debtor and creditor governments have so far averted international financial collapse. More than 40 LDCs and East European countries have, or are negotiating, IMF standby and extended financing agreements. They include the majority of the largest LDC debtors. These programs have enabled such countries as Mexico, Brazil, and Yugoslavia to forestall default and obtain some breathing room within which to make needed economic adjustments. Moreover, programs for the major debtors have successfully tied IMF loans to commitments by banks to maintain existing short-term credit lines, reschedule maturing debt, and, most important, extend new medium-term loans.

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But the adjustment process is far from over. It has become increasingly evident that these rescue operations are only temporary solutions and are in danger of unraveling. Brazil, Chile, and Peru all have had to seek new bridging loans from Western governments this year. Since obtaining IMF agreements, Chile, Peru, and Argentina have suspended principal payments on at least some parts of their maturing debt. Mexico has fallen further behind on its private debt interest payments and has yet to reschedule long-term debt and arrears. Soft oil prices have undermined the debt servicing capability of Venezuela and Nigeria and added them to the list of countries needing expensive rescue operations. Venezuela, for example, has had to postpone principal payments on public debt falling due through mid-year.

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This month the major debtors will be evaluated on first-quarter performance under their adjustment programs. We do not believe many countries will meet their targets for the first quarter or even for the year. We base this assessment on an analysis of the restructuring programs for 14 countries that account for over 50 percent of LDC and East European debt. Export targets require volume and revenue expansion we believe to be inconsistent with the pace of economic recovery in the industrial countries, expectations for commodity prices, and trade among financially-strapped LDCs themselves. On the import side, the slight drop in value projected for 1983 may be difficult to realize because of the substantial import squeeze already under way in many countries and the need for imports as inputs for export production. On balance, the trade accounts and international reserve targets for Brazil, Mexico, Argentina, and Chile are especially vulnerable to falling short.

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We also believe the major debtors have a less than even chance of meeting performance criteria governing domestic bank credit and public sector deficits. Government leaders will be under strong political pressure to maintain economic growth, avoid offending labor groups with curbs on wage increases and public sector employment, and halt further erosion of living standards by maintaining price controls and subsidies. Protests and strikes—some violent—against austerity measures have already beset the governments of Brazil, Mexico, Chile, Peru, Bolivia, and Ecuador. We expect more in the next few months

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An important unknown is how the IMF and the commercial banks will react to the failure of major debtors to meet external and internal targets. Close to 30 percent of the combined financing needs this year of Brazil, Mexico, Argentina, and Yugoslavia, for example, is contingent on meeting these targets. If performance criteria are missed by wide margins, causing disbursement of IMF and commercial bank money to be interrupted, new large bridging loans will be needed to avoid default until new agreements on targets can be renegotiated. We believe the IMF has little choice but to give debtors wide latitude, probably settling for agreed movement toward slightly altered goals as sufficient to warrant continuation of programs.

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A second round of debt renegotiations and additional funding will likely be messy. Bankers' willingness to commit even more funds is highly uncertain:

- European bankers still consider this a largely "American" problem and probably intend to focus their international efforts on their own national export firms and on countries with whom they have traditionally close ties.

- Large US banks now are inclined to boost lending only when forced to do so by the prospect of a Fund program or rescheduling. They will likely try to limit foreign loans to public sector borrowers and forsake new credits to the private sector. Bankers tell us that many will be trying to restructure their portfolios toward trade finance and correspondent services.

- Medium-size US banks will concentrate on trade finance and overseas business of firms in their domestic marketing area. Bankers believe it will be very difficult to get this group into new loan syndications.

- The smaller regional banks that figured so prominently in loans to Mexico have nearly all refocused their lending operations on domestic customers, except when they have been forced to join restructuring programs.

- Overall, banks are coming under increasing pressure from regulatory authorities to set limits on their exposure to risky foreign borrowers.

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If additional funds are not available, troubled debtors will have little choice but to turn inward and intensify their efforts to adjust as best they can to a lack of foreign exchange. In the near term, they would probably try to maintain living standards by avoiding sharp cutbacks in public spending. Without the ability to finance imports, they would need to legislate even more austere import restrictions. Such moves would slow the recovery of the United States and other industrial nations by reducing export markets.

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Over the longer term, the only sure cure for debtors' international financial problems is a period of sustained growth among the industrial countries. While signs of a recovery are under way, any substantial impact on debtors beyond a measure of confidence building is still a couple of years away. Until then, debtors will continue to look to the industrial countries and the IMF for help from one payments crisis to the next.

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Briefs

Energy

Japanese Oil Inventories Decline

Japanese commercial oil stocks have dropped sharply from a record high of nearly 402 million barrels held last May. At the end of January private oil stocks stood at 355 million barrels or 97 days of supply—the lowest level in more than three years. While stocks probably can be reduced further, the Japanese Government requires firms to hold stocks equal to 90 days of product equivalent of consumption in the previous year. According to one major oil company, some oil firms operating in Japan have already been forced to make purchases of oil to meet the stockpiling requirements. The government-owned stockpile continues to rise and is now up to nearly 75 million barrels. 25X1

Possible Cuts in Australian Coal Prices

25X1 Japanese coal buyers are pressuring Australian firms to sell coal at least 10 to 15 percent below last year's price (denominated in US dollars) because of soft demand in the international coal market and, more recently, the 10-percent devaluation of the Australian dollar. If Australian suppliers fail to concede price cuts, Japanese firms are threatening to shift at least 30 percent of their Australian purchases to other exporters. A Japanese steel firm has already forced both US and South African suppliers to cut their prices by a comparable margin. One Australian coking coal producer has agreed to an 18-percent price cut, and we believe other suppliers will follow suit—a move that could cost Australia nearly $500 million a year in export earnings. Export prices were one of several industry problems discussed at a government-sponsored summit meeting held this week in Canberra involving coal industry executives, union representatives, and government officials. 25X1

Libya Proceeds With Offshore Oil Development

25X1 Libya will proceed with development of its first offshore oilfield despite the current world oil surplus. A construction contract was awarded last year to the Italian company Snamprogetti for a 30-well, 150,000 b/d platform to be installed in the Bouri oilfield. The field, discovered by Italy's AGIP, is about 120 kilometers northwest of Tripoli in about 150 meters of water and has proved reserves estimated at more than 650 million barrels. Initial output is planned at 75,000 b/d by 1986. Four additional platforms and a gas injection program are scheduled in later years which could raise Bouri production to over 600,000 b/d. There are a number of other oilfields of similar size in areas adjacent to Bouri, but there are no known development plans for those fields. 25X1

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Possible Financial Support for Cameroonian Kribi LNG Project

President Mitterrand plans to visit Cameroon during late May or early June and discuss possible French assistance for the Kribi liquefied natural gas project. Cameroon's President Biya had earlier held discussions with Mitterrand in mid-February about financial support for the project. The companies claim the project's prospects are poor because of the availability of alternative gas supplies for Western Europe, marginal Cameroonian gas reserves, and high construction costs. Mitterrand may provide French Government guarantees for the full $3 billion construction costs for political rather than economic reasons. If the go-ahead is given, initial output of Kribi is expected to be about 4 billion cubic meters per year by 1990, which could later be expanded if additional reserves and project financing is available.

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International Trade, Technology, and Finance

UK Firm Wins Soviet Pipeline Spare Parts Contract

The Soviets in mid-February awarded a 10-year contract to the British firm John Brown Engineering for spare parts for the turbines on the gas export pipeline, The USSR is ordering far more spare parts than it needs. Although no details on the financial arrangements have been announced, the British Government would finance the project in an effort to strengthen industry. The Soviets have to rely on Western equipment and technical expertise for the pipeline until they become self-sufficient in that technology. The announced plan to equip the 41 compressor stations along the pipeline with Soviet-built as well as Western turbines will put a strain on the USSR's current expertise and supplies of spare parts. Nonetheless, the plan will allow the Soviets to evaluate the reliability of their own equipment without risking interruption of the operation of the line.

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Declining Lebanese Imports From Israel

Lebanese imports from Israel appear to have fallen sharply in recent weeks. Press and Embassy reports indicate that purchases of Israeli goods—illegal under Lebanese law—have dropped by as much as 40 percent from last year's peak levels. The Embassy in Beirut attributes the decline to growing perceptions among local merchants that the Gemayel government, now that it controls the entire Beirut port, is better equipped to stop illegal trade. The primary reason, however, is probably recent Israeli Government decisions to withhold permits for exports that directly compete with Lebanese goods, a gesture of good will designed to convince Beirut to establish formal trade ties. The strong Israeli presence in southern Lebanon precludes Lebanese control of cross-border flows, the source of most Israeli-Lebanese trade.

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China Unlikely To Purchase US Wheat Grown in Pacific Northwest

US wheat experts have learned through scientific channels that TCK wheat smut disease exists in one and possibly two areas of China. Beijing ceased purchases in 1981 of US wheat from the Pacific northwest because of the presence of the TCK spore. Since then the northwestern states have attempted to revive sales by providing evidence to Beijing that the spore would not grow in China. We believe that CEROILFOOD, China's grain-purchasing organization, would like to reenter the market for northwest wheat because of its lower freight costs and higher quality. It purchased one shipment last summer to test for TCK spore levels. Officials in China's Bureau of Plant Protection, however, are concerned about the effect of the spore on domestic wheat crops. We believe that officials in the Bureau are, or will soon be, aware of the spore's growth in China and will continue to prohibit imports of northwest wheat.

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National Developments

Developed Countries

Portuguese Devaluation

Following the recent realignment of the European Monetary System, the Bank of Portugal devalued the escudo by 2 percent against a basket of 18 currencies. The central bank also raised the monthly depreciation rate from 0.75 percent to 1.0 percent. This will yield depreciation over 12 months of 12.7 percent, approximately equal to the difference between Portugal's rate of inflation and the average of the rates prevailing in its major trading partners. Lisbon simultaneously announced new monetary measures, including increased interest rates, which are now significantly positive in real terms for the first time in over a decade. In addition, banking authorities plan to impose external credit ceilings on a month-by-month basis in order to slow the growth of foreign debt—currently estimated at $13 billion or more than half of GDP. The new measures generally reflect IMF recommendations, although for political reasons the government kept the devaluation somewhat smaller than the IMF wanted. The new exchange rate policy will help maintain export competitiveness, while higher interest rates should promote saving and attract transfer payments.

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Less Developed Countries

El Salvador Pursues Economic Reforms

President Magana has made considerable progress in recent months in carrying out major land, banking, and commodity marketing reforms introduced in 1980, despite opposition from extreme rightists. In El Salvador's important "land-to-the-tiller" program, peasant claim filings, title awards, and compensation to former owners have accelerated since last fall. Largely as a result of recent governmental actions, more than three-fourths of peasant

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claimants evicted from properties by former owners early last year have been returned. In addition, the Constituent Assembly early last month extended for 10 additional months the period during which peasants may submit land claims so that more potential beneficiaries might be drawn into the program.

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In its reform of the banking system, the central bank in mid-March announced offerings of up to 49 percent of nationalized bank equity to private investors. Purchases will be limited to a maximum of 1 percent per owner. The government had taken over full ownership of all banking and savings and loan institutions in 1980 as the first step in eliminating the concentration of credit in the hands of a few individuals or enterprises. The Constituent Assembly has refused to endorse a campaign by major coffee growers to weaken the production, pricing, and marketing powers of the National Coffee Institute. The institute had been established three years ago as a cooperative by the government to ensure equitable returns for all producers. The government's continued progress on the three reforms represents a victory for Magana and moderate elements in the Assembly, who have had to overcome strong challenges by extreme rightist factions.

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IMF Assistance to Zimbabwe

Zimbabwe has concluded a standby agreement with the IMF for about $300 million over 18 months. Agreement was also reached on a Compensatory Financing Facility of over $56 million. The standby funds will be used largely to reduce the extensive short-term foreign debt Zimbabwe acquired during the past two years to maintain its foreign exchange reserves. The agreements follow a recent World Bank loan of $70 million for imports needed by manufacturers. Harare has told the IMF it also will continue to seek concessional balance-of-payments assistance from bilateral donors in an effort to acquire funds that could be more rapidly disbursed.

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Although agreement with the IMF was facilitated by policy reforms already implemented or announced late last year, Harare faces formidable obstacles in meeting all of the IMF conditions. Previous moves included a 20-percent devaluation, plans to cut government spending by about 10 percent, and a freeze on minimum wages until mid-1930. Harare, which has not raised minimum wages since January 1982, has now also agreed to limit future wage increases to one-half the inflation rate for the previous 12 months; prices have been rising at a 17-percent annual rate. Domestic political pressures will make it difficult to meet the IMF's requirement to remove price controls and at the same time cut food subsidies. A ceiling has been placed on domestic credit expansion, and additional short-term borrowing is prohibited. No further cuts in allocations of foreign exchange to Zimbabwe's productive private sector will be allowed, however, in the wake of cuts totaling more than 25 percent prior to the devaluation last year. The depressed economy probably will frustrate Harare's efforts to control the budget deficit, while a second year of severe drought threatens to exacerbate balance-of-payments problems by reducing agricultural exports.

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Expected Influx of Ethiopian Refugees Into Sudan

Thousands of peasants are moving toward Sudan to escape the drought in Ethiopia's Eritrea and Tigray Provinces and, by the peak of the dry season in May and June, 250,000 refugees reportedly may cross into the Kassala and Gedaref areas of Sudan. The US Embassy in Khartoum reports that the drought is as severe as that of 1973-74, which killed an estimated 200,000 people. According to the World Food Program representative in Addis Ababa, it could affect as many as 3.5 million Ethiopians. Some 600,000 Ethiopian and Ugandan refugees are now in Sudan. The food currently available in the region would accommodate only 500 refugees per week, and if many thousands of refugees arrive in May, the relief system probably will collapse. Water will remain in extremely short supply in eastern Sudan until the rains begin in late June. The resumption of the Ethiopian offensive to crush the Tigray People's Liberation Front would make the situation still worse. 25X1

Suriname Expands Ties

Army Commander Bouterse in recent weeks has pursued closer ties with Cuba, Grenada, and Libya, but because of their own financial difficulties, these countries are unlikely to provide any quick infusion of funds to offset the withdrawal of Dutch and US assistance. It is expected that the Cuban presence in Suriname might expand to some 150 people, in part to implement technical, economic, scientific, and cultural cooperation agreements that reportedly will be signed soon. Grenada recently joined Cuba and Suriname in an informal pact of mutual assistance in the event of attempts to destabilize Bouterse. In addition, Bouterse garnered unspecified Libyan support with the signing of an economic and cultural agreement in Tripoli. 25X1

Mauritian Cabinet Resignations Jeopardize IMF Negotiations

The resignation last week of Finance Minister Berenger and 11 allied cabinet members could jeopardize ongoing negotiations with the IMF and the World Bank and endanger the country's economic recovery efforts. The Mauritian Government has asked the Bank for $45 million and is to meet with the IMF soon on a standyby loan. Declining world prices for sugar—the island's primary economic activity and revenue earner—have saddled the government with chronic current account and budgetary deficits. Inflation is running at 20 to 25 percent, and urban unemployment is at record levels. 25X1

Prime Minister Jugnauth, who has actively sought aid from Libya and the USSR while downplaying the need for Western support, now reportedly wants to keep negotiations on track. His political will to enact necessary reforms, however, is open to question. 25X1 In addition, the 25X1 Socialists, on whose support Jugnauth depends, strongly oppose austerity measures. 25X1

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Possible Loosening of Controls on Pakistani Private Sector

According to US Embassy reporting, Islamabad may soon allow Pakistan's oil refineries to increase prices of petroleum products. Refinery officials claim that the present pricing arrangements are insufficient to cover cost of production, let alone provide funds for modernization or expansion of facilities. We believe that Islamabad's hesitancy to relax controls on private-sector businesses has been a major obstacle to private investment. If the Pakistani Government reaches a successful agreement with refinery authorities, this would be the first indication that Islamabad is becoming more flexible in its attitude about the role of the private sector in economic development.

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Communist

Soviet Interest in Hungarian Economic Practices

The Hungarian First Deputy Minister of Industry recently addressed a Soviet high-level course on economic management at the academy of the National Economy of the Council of Ministers. The audience included leading representatives of agriculture, food, light industry, trade, and transport. This reportedly is the first time a non-Soviet lecturer has addressed such a group. The event highlights the seriousness with which the leadership is studying the applicability of Hungarian economic practices. Previous indications have included favorable references to Hungarian and other East European economic reform measures, particularly those affecting agriculture, in the speeches of Soviet leaders and in the media. Direct exchanges in this area with the Hungarians, however, generally have been at a lower level. The fact that the speaker represented Hungary's industrial sector confirms that the Soviets are interested in a broader range of Hungarian practices than agricultural techniques alone.

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Romanian Problems in Energy Dealings With USSR

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the USSR is cool to Bucharest's request to coproduce the Soviet reactors for export and that the Romanians have big ideas but no money to back them up.

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Bucharest was withholding approval of the Soviet design because of safety flaws—the same reason the Romanians gave for abandoning the project in the early 1970s.

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the USSR is annoyed by Romania's request for increased oil deliveries at concessionary prices, especially in view of Bucharest's lack of cooperation on CEMA energy projects. Despite economic problems at home and deteriorating relations with the West, Bucharest apparently does not intend to be more accommodating to Moscow.

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Increase in Soviet Oil Deliveries to Yugoslavia

Soviet and Yugoslav negotiators meeting in Belgrade in conjunction with the recent visit of Premier Tikhonov reportedly agreed the USSR will supply 96,000 barrels of crude oil per day this year, 7 percent more than called for in the trade agreement signed in January. Moreover, a new agreement is possible later this year on the sale of an additional 20,000 barrels per day [redacted] According to the US Embassy in Belgrade, the Soviets have been seeking additional agricultural products. The increased oil deliveries reportedly also will be offset to some extent by a reduction in Soviet oil product deliveries. [redacted]

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Despite Yugoslavia's reported commitment to provide high-quality goods in exchange for the increased deliveries, the Soviets very likely view the arrangement as a concession. They had been resisting Yugoslav requests for more oil and doubtless would have preferred hard currency sales to any barter arrangement. Their agreement to it probably reflects concern that Belgrade's economic plight might result in increased Western influence or cause political instability. Even with the additional Soviet oil, Yugoslavia will have shortages of fuel. [redacted]

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OECD: The Economic Impact of a Reduction in Oil Prices [1]

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To estimate the effects of an oil price fall on the OECD, we simulated several scenarios with the CIA's econometric model [2] and tempered those results with judgments by our country economists. We estimate that a fall in the price of crude oil to $25 per barrel would lead to:

- An increase in the OECD GNP growth rate of 1 percentage point in the first year and half that in each of the next two years.
- An increase in employment of some 2.5 million people by 1985, with most jobs created in the second and third years. By 1985, unemployment rates would be below 9 percent for all the major OECD countries, except Canada and the United Kingdom.
- A fall in the average inflation rate of about 1.5 percentage points the first year, with gains dissipating rapidly thereafter.
- An initial slowdown in OECD exports that would quickly reverse as new import demand by oil importers overcomes the decline in sales to oil exporters.

With oil priced at $15 or $20 per barrel, we assume that OPEC countries reduce imports sufficiently to prevent their current account deficits from exceeding those in the $25 per barrel case. (Import cutbacks of this magnitude could well be economically and socially disruptive for many oil exporters, sparking a new sense of unity in OPEC sufficient to make markedly lower oil prices short lived.) With OPEC imports constrained, overall growth rates for the OECD with $15 or $20 oil would be only slightly higher than under the $25 per barrel scenario in the first year but substantially larger in the second and third years as the rate of domestic spending increases. The slowdown in OECD inflation in the first year would be much more pronounced in both the $20 and $15 cases.

Major foreign governments would not uniformly pass through the oil price decline to consumers. The West German government would be inclined to pass most or all the benefits along to help curb inflationary pressures and increase growth. Japan would probably allow its utilities to increase profits while selectively cutting prices to benefit energy-intensive industries. For the United Kingdom, the prospect of lost revenues would make reducing prices to the consumer an especially difficult decision, but the Thatcher government probably would do so to stimulate growth and influence public opinion for the next election. The deeper the oil price cut, the more likely are the governments of oil importers to increase energy taxes to reduce budget deficits and preserve conservation gains.

Oil at $25 Per Barrel

We estimate that if crude oil prices fall 25 percent from their 1 January 1983 level, to an average $25 a barrel for the year, and remain at that price

[1] This article summarizes a forthcoming intelligence assessment of the same title.

[2] Out analysis relies heavily on simulations using the CIA's Linked Policy Impact Model (LPIM) of the world economy. We believe that this model provides a good measure of the change in key macroeconomic variables such as real GNP and inflation. The model is also useful in highlighting differences among the OECD countries and in estimating the importance of different assumptions about policy responses. The model does not, however, contain enough detail to examine certain areas of interest such as the detailed budgetary impact of an oil-price decline, or the impact of the decline on the various sectors of each economy.

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Major Assumptions

Oil Prices
To set a baseline, we assumed that prices would remain at the 1 January 1983 level of $33.50 a barrel through 1985. In our alternative scenarios, we assumed that prices would fall to an average $25 a barrel, $20 a barrel, or $15 a barrel, and would remain at those levels through 1985. All prices are in nominal terms.

Government Policies
We assumed that governments in the baseline case would target the nominal money supply, the nominal central bank discount rate, and nominal government expenditures. We assumed that the governments would not change those targets as a result of the oil price decline. In alternative scenarios, we relaxed the assumptions for government monetary and expenditure policies. We assumed, for example, that the discount rate would fall with the inflation rate, thus reducing interest rates

Exchange Rates
In our baseline case, we assumed exchange rates would vary with the differences in inflation rates between countries. In the alternative scenarios, we assumed that exchange rates would remain the same as in the baseline case

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OPEC Imports
In the baseline case of $33.50 oil, we estimated that the OPEC current account deficit would have been $2.5 billion in 1983. In the $25 oil-price case we assumed that OPEC would reduce its imports of goods and services sufficiently to prevent its current account deficit from increasing by more than $30 billion above the baseline case. Because of OPEC's presumed inability to finance higher deficits, we assumed, in the $20 and $15 scenarios, that OPEC would cut its imports so that its current account balance would be the same as with $25 oil.

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through 1985, OECD *economic growth* would be boosted a full percentage point this year and another half percentage point in each of the next two years. The biggest stimulus to OECD growth would be the increase in real purchasing power in the oil-importing countries. A further stimulus to growth would result from the lagged effect of spending adjustments. For example, government spending plans are made in nominal terms; assuming those plans are not quickly adjusted downward, more real goods probably will be purchased with the same budgetary expenditures. Similarly, wage increases based on anticipated inflation rates will yield more spending in real terms than was expected when contracts were signed. Japan and Italy would enjoy the greatest stimulus because they are the largest energy importers relative to their GNP; even net energy exporters such as Canada and the United Kingdom would enjoy some increased growth as world trade recovers.

OECD *inflation* rates would slow by about 1.5 percentage points this year. We estimate that the rate would average about 6 percent, with the United States, West Germany, Japan, and the United Kingdom all below 5 percent. The inflation bonus would dissipate quickly, however, as the one-time price cut effect is absorbed and other growth pressures begin to mount.

Unemployment would not fall significantly in 1983 as a result of an oil price decrease. After three years, however, it would be down throughout the OECD by some 2.5 million people—slightly more than 1 percent of the labor force—from what it otherwise would have been. By 1985, unemployment rates would be below 9 percent for all the major OECD countries except Canada and the United Kingdom.

The *current account* balance of the OECD as a group would improve by some $30 billion in the first year, but the gain would fall off rapidly in 1984-85. In the first year, the saving on oil imports for the OECD would be greater than the decline in

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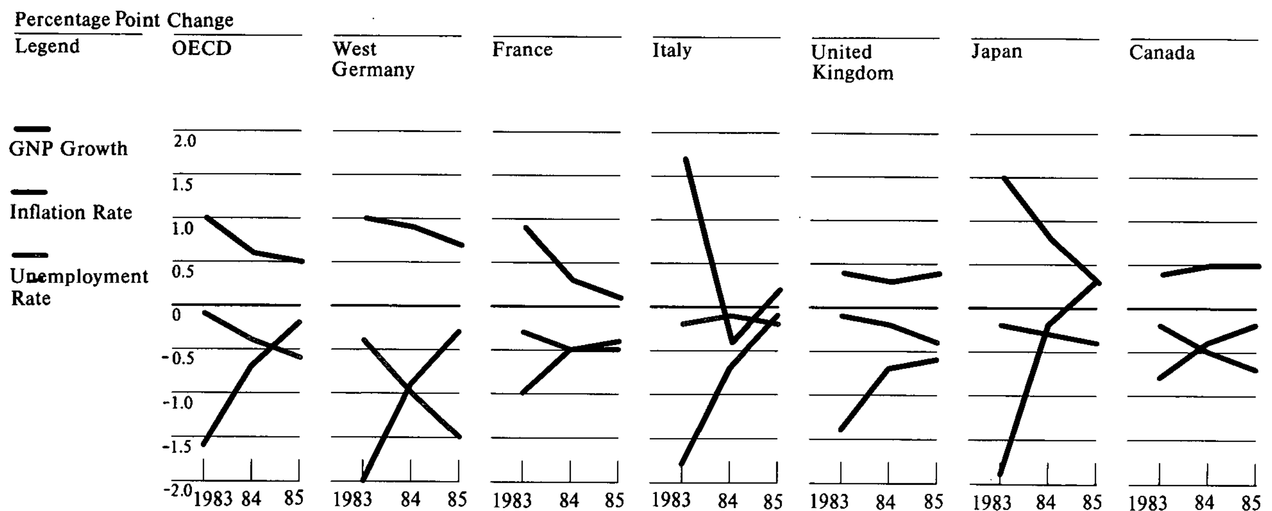
OECD Countries: Impact of Reduction in World Oil Prices to $25 per Barrel



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exports to the oil-producing countries. Moreover, greater economic growth elsewhere in the world would lead to almost a $15 billion improvement in OECD exports—offsetting about three-fourths of the loss in exports to the oil producers. By 1985 the OECD current account balance would be about the same as in the baseline case of $33.50 per barrel oil because of the continued decline in OPEC imports and the growth-induced climb in OECD import demand. Japan's surplus would increase more and remain higher through 1985 because the change in Japan's imports is a much smaller share of the increase in GNP than for other major countries. For other major OECD countries, increasing economic growth in the second and third years would lead to a runup in imports that would largely offset the trade improvement from lower oil prices. We assume that exchange rates do not shift because of changes in oil prices. If exchange rates adjust to the large increase in Japan's current account surplus relative to the other OECD countries, Japan's surplus after three years would be considerably lower and the balances of the other OECD countries would be considerably better off.

Government *budget deficits* would be smaller with an oil price decrease because faster growth would generate more revenues. Unless nominal government expenditure targets are lowered in line with the declining rates of inflation, the improvement in budget deficits would be marginal. An additional improvement in budget deficits would depend on political decisions about taxing windfall savings. Taxing savings would reduce deficits but would rob the economies of some stimulative benefits from the price cuts. Some of the negative growth effects of reducing deficits also may be countered if interest rates move downward and private investment rises.

Cheaper Oil

To test the incremental impact of further oil price drops, we ran scenarios of average oil prices at $20

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OECD: Changes Associated With a Fall in the Price of Oil to $25.00 per Barrel From $33.50

	West Germany	France	United Kingdom	Italy	Japan	Canada	Total OECD
Change in the growth rate of real GNP [a] (*percentage points*)							
1983	1.0	0.9	0.4	1.7	1.5	0.4	1.0
1984	0.9	0.3	0.3	−0.4	0.8	0.5	0.6
1985	0.7	0.1	0.4	0.2	0.3	0.5	0.5
Change in inflation rates (*percentage points*)							
1983	−2.0	−1.0	−1.4	−1.8	−1.9	−0.8	−1.6
1984	−0.9	−0.5	−0.7	−0.7	−0.2	−0.4	−0.7
1985	−0.3	−0.5	−0.6	−0.1	0.3	−0.2	−0.2
Change in unemployment rates (*percentage points*)							
1983	−0.4	−0.3	−0.1	−0.2	−0.2	−0.2	−0.1
1984	−1.0	−0.5	−0.2	−0.1	−0.3	−0.5	−0.4
1985	−1.5	−0.4	−0.4	−0.2	−0.4	−0.7	−0.6
Change in current account balances (*billion US $*)							
1983	2.1	3.6	−3.4	1.9	11.7	−0.3	29.5
1984	−0.3	1.6	−3.7	0.9	10.4	0	12.9
1985	−1.0	0.8	−3.9	−0.1	9.8	0.3	1.0

[a] The incremental changes reflected in these growth rates are from the previous year's level. The absolute benefits resulting from the oil price decline would be measured by the accumulation of the changes. For example, while Italy's GNP growth in 1984 as a result of the oil price decline in 1983 would be negative, the overall level of the Italian GNP in 1984 would still be 1.3 percent above what it would have been without the oil price reduction.

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and $15 per barrel through 1985. For those cases, however, we assumed that the financially constrained oil exporters could not increase their current account deficits further. As a result, we held the OPEC current account deficit in both cases to no more than that in the $25 oil case. This constraint would impose a reduction in OPEC imports of some $50 billion in the first year for $20 oil and $80 billion for $15 oil.

Assuming no worsening in OPEC current account balances beyond the $25 case, with oil priced at $20, OECD growth in the first year would be 1.2 percentage points higher than in the $33.50 case and a mere 0.2 percentage point higher than with $25 oil. Among the foreign countries, a few—notably West Germany and the smaller countries—would actually lose more from falling OPEC imports than they would gain from the additional stimulation from lower oil prices. The boost in trade generated by faster economic growth in the United States and other major countries would stimulate growth across the board in the second

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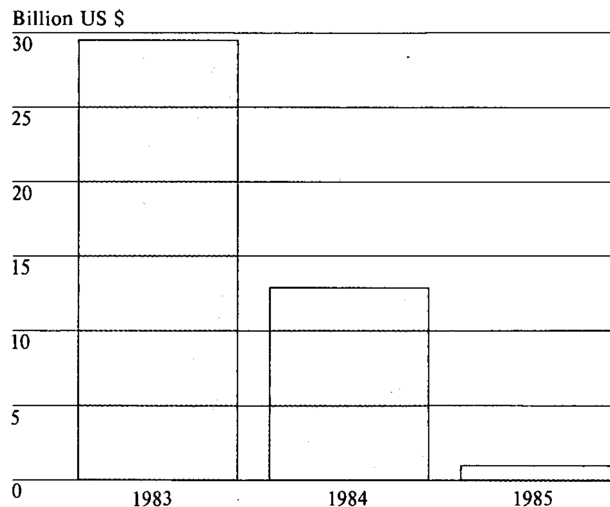
OECD Countries: Change in Current Account Balance Resulting From Reduction in Oil Price to $25 per Barrel



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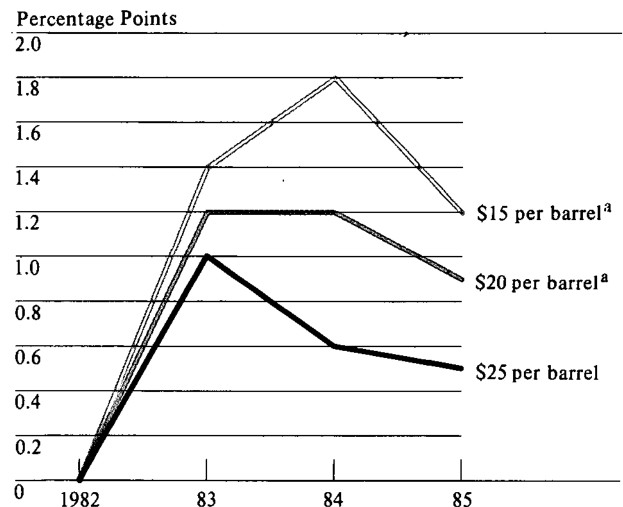
OECD Countries: Change in Growth Rate of Real GNP Under Various Oil Price Assumptions



[a] OPEC current account deficit constrained to level of the $25 oil case.

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and third years. By the third year, the level of total OECD GNP with oil at $20 would be 1 percent higher than under the $25 case and 3 percent higher than the $33.50 case.

Unemployment and inflation would come down faster. The unemployment rate would be about the same in the first year and decline in the next two years, whereas inflation would fall more in the first year than later. The overall OECD current account balance would be only slightly changed from the $25 oil case. Japan's current account surplus would improve sharply and remain high because of more exports to the United States and cheaper oil prices. For most of the other foreign OECD countries the loss of sales to OPEC would roughly offset savings on oil imports; thus there would be only a slight difference in their current accounts between the $25 and the $20 cases.

There would be a similar pattern in moving to $15 oil. Growth would be up the first year while inflation and unemployment rates would decline even more than under previous cases. Current account balances would remain little changed from the $25 case because the continued fall in OPEC imports would counter the savings on oil imports. The improvement in Japan's surplus would increase more sharply than the others; as a result, additional pressures would surely mount on the yen exchange rate.

Policy Reactions

Major foreign governments are likely to react differently to lower oil prices. If the price of oil fell

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OECD: Changes Associated With a Fall in the Price of Oil to $20.00 per Barrel From $33.50 [a]

	West Germany	France	United Kingdom	Italy	Japan	Canada	Total OECD
Change in the growth rates of real GNP [b] (*percentage points*)							
1983	0.8	1.0	0.4	2.1	1.8	0.4	1.2
1984	1.8	0.6	0.7	−0.3	1.5	0.9	1.2
1985	1.2	0.5	0.6	0.3	0.7	0.8	0.9
Change in inflation rates (*percentage points*)							
1983	−3.2	−1.7	−2.2	−3.0	−2.9	−1.3	−2.6
1984	−1.5	−1.0	−1.0	−1.0	−0.5	−0.7	−1.1
1985	−0.5	−1.4	−1.0	−0.2	0.4	−0.4	−0.3
Change in unemployment rates (*percentage points*)							
1983	−0.3	−0.3	−0.1	−0.2	−0.2	−0.2	−0.1
1984	−1.2	−0.5	−0.3	−0.1	−0.5	−0.6	−0.5
1985	−2.2	−0.7	−0.6	−0.2	−0.7	−1.2	−1.0
Change in current account balances (*billion US $*)							
1983	0.9	4.5	−6.8	2.3	16.2	−1.0	31.3
1984	−1.1	2.3	−6.5	1.2	15.7	−0.2	13.3
1985	−2.1	0.7	−6.6	−0.2	15.3	0.5	−3.3

[a] These estimates assume that OPEC would reduce its imports sufficiently to ensure that its current account deficit would be no larger than in the $25 scenario.

[b] The incremental changes reflected in these growth rates are from the previous year's level. The absolute benefits resulting from the oil price decline would be measured by the accumulation of the changes.

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to $25, we believe the major OECD countries would respond in the following manner.

- The *West German* Government would not impose tax increases if oil prices were to stabilize. West Germany, in its longest economic slump since World War II and with record unemployment, would not want to limit potential improvement in employment or inflation. Bonn also would not want to disadvantage its industry vis-a-vis its OECD competitors. The government worries that a fall in oil prices would jeopardize domestic energy conservation, but we believe Bonn would not counteract lower prices until they reached $20.

- The *French* Government probably would not fully pass through an oil-price decline. The tough economic austerity program announced last week included an energy tax, which will offset the recent price cut. Although the government has not released full details of the program, press reports indicate that Paris will increase the tax on gasoline to keep pump prices at their current levels and may tax other refined products. In addition, the tax will protect the French oil conservation program and ease the trade deficit by curbing consumer spending on imports. The

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OECD: Changes Associated With a Fall in the Price of Oil to $15.00 per Barrel From $33.50 [a]

	West Germany	France	United Kingdom	Italy	Japan	Canada	Total OECD
Change in growth rates of real GNP [b] (*percentage points*)							
1983	0.6	1.2	0.4	2.6	2.1	0.6	1.4
1984	2.6	0.8	1.0	−0.3	2.2	1.6	1.8
1985	1.9	0.7	0.8	0.5	1.1	1.2	1.2
Change in inflation rates (*percentage points*)							
1983	−4.4	−2.2	−3.0	−4.2	−3.9	−1.9	−3.8
1984	−2.0	−1.3	−1.3	−1.2	−0.6	−1.0	−1.5
1985	−0.6	−1.4	−1.2	0	0.6	−0.5	−0.2
Change in unemployment rates (*percentage points*)							
1983	−0.2	−0.3	−0.1	−0.2	−0.3	−0.2	−0.2
1984	−1.4	−0.6	−0.4	−0.2	−0.6	−0.8	−0.6
1985	−2.8	−0.9	−0.7	−0.2	−0.9	−1.7	−1.4
Change in current account balances (*billion US $*)							
1983	−0.4	5.4	−10.1	2.7	20.8	−1.6	33.4
1984	−2.2	2.9	−9.1	1.4	20.5	−0.3	12.2
1985	−2.7	1.4	−8.4	−0.3	20.5	0.8	−3.9

[a] These estimates assume that OPEC would reduce its imports sufficiently to ensure that its current account deficit would be no larger than in the $25 scenario.

[b] The incremental changes reflected in these growth rates are from the previous year's level. The absolute benefits resulting from the oil price decline would be measured by the accumulation of the changes.

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extent to which Paris would pass through additional oil price declines would depend on its success in curbing the budget deficit and inflation by other means.

- The *British* Government would probably pass on most of the savings to consumers. The government has already reduced taxes on oil companies and would probably further reduce them to prevent a collapse of offshore exploration and development that would result in future supply constraints. As a result, budgetary pressures would probably grow, in which case the government could be forced to relax monetary policies to help finance a larger-than-expected deficit.

- The *Italian* Government probably would not fully pass through a cut in energy prices to domestic customers. The extent to which Rome would allow the passthrough would be hotly debated within the governing coalition. Christian Democratic Treasury Minister Goria probably would press to keep oil product prices high through energy taxes and to apply the receipts to the burgeoning deficit. The Socialists, on the other hand, would probably press for passing some part of the price break to the consumers.

- The *Japanese* Government and energy industry would not permit a complete passthrough of a fall

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in oil prices. Japanese oil refiners and retailers, who have incurred heavy losses in recent years, would take advantage of falling oil prices to improve their own rather than their customers' financial position. At the same time, the Ministry of International Trade and Industry would probably push for selective price cuts in electricity to benefit only ailing energy-intensive industries and would instruct the electric utilities to earmark part of their windfall profits for investment in nuclear facilities.

- The *Canadian* Government probably would allow domestic oil prices to remain steady as world oil prices fell. Prime Minister Trudeau, thus, would forgo his 1980 election promise to keep domestic oil prices well below world levels. A 25-percent drop in the world price would require a cut in the domestic price from the current $24.10 to about $18.75, costing the Canadian federal government $8 billion in lost energy tax revenues over the next three years. Ottawa can ill afford more than the $25 billion deficit already forecast for 1983/84 on the basis of current oil prices.

Governments in all the major oil-importing countries probably would prevent domestic oil prices from falling much below the $20 level. Most would tax gains to curb deficits and to prevent a reversal in energy conservation. The oil exporters would have different problems. The Canadians probably would reduce domestic prices as they fell below $25 per barrel in order to keep them at or below world levels. If so, other taxes—most likely on industry—would have to be increased to offset lost revenues. In the United Kingdom a drop in oil prices to $20 per barrel would threaten the profitability of North Sea production in existing wells and would end exploration and development activity.

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The Role of Inventories in the Oil Market

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Expectation of a decline in oil prices has been the main force triggering a sizable inventory liquidation in the present oil market that has pressed OPEC production below 15 million b/d. If oil companies persist in the belief that OPEC will be unable to prevent a further price decline, an estimated 300-400 million barrels of inventories could be dumped on the market to add to downward price pressures. At some point, however, inventory depletion will be halted either because stocks will be approaching minimum levels or companies perceive that the price decline is over. This will cause a sharp reversal in oil demand and, combined with some effort to rebuild inventories for the seasonal rise in consumption, could raise demand for OPEC oil to about 20 million b/d.

Anatomy of Inventories

Oil consumers hold stocks for two primary reasons: (1) to meet operating requirements including the need to balance seasonal fluctuations in consumption, and (2) for speculative purposes such as insuring against unexpected delivery shortfalls or surges in demand.

Inventories are categorized as primary stocks held by major companies and refiners and secondary and tertiary stocks held by wholesalers, distributors, and end users. Government-owned stocks are also included in primary stocks although they are outside the normal commercial channels. nearly 70 percent of primary stocks represent minimum operating stocks needed to ensure smooth functioning of the distribution system. An additional 5 to 10 percent of primary stocks are compulsory stocks held by companies at the direction of foreign governments. Minimum operating stocks, government-owned stocks, and compulsory stocks combined represent about 85 to 90 percent of total primary stocks and would normally not be available for commercial use

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Present Stock Situation

We estimate primary stocks totaled about 4.9 billion barrels as of 1 January 1983 including 600 million barrels at sea, 500 million barrels of government-owned strategic stocks, and 400-500 million barrels of compulsory stocks. Nearly 250 million barrels of primary stocks represented seasonal demand for inventories to meet high winter consumption requirements. Based on these estimates and minimum operating requirements, an additional 300 to 400 million barrels could be considered available for drawdown, allowing companies to defer crude liftings in anticipation of a price reduction.

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Reliable estimates of secondary and tertiary stocks are not available. Based on one industry estimate, storage capacity for these stocks is about 3-4 billion barrels. Assuming a 50-percent capacity utilization rate, secondary and tertiary stocks probably total 1.5-2 billion barrels.

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Market Impact

Declining oil consumption, high interest rates, and surplus productive capacity combined to provide incentives for oil companies to reduce inventory levels last year. Companies managed to trim stocks at the rate of 1 million b/d during 1982, but because estimated levels of consumption exceeded

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Estimated Free World Oil Stocks, January 1983 *Billion barrels*

Land	4.3
Afloat	0.6
Total primary	4.9
Minimum operating	3.4
Government-owned	0.5
Compulsory	0.4 to 0.5
Seasonal	0.2
Available for liquidation	0.3 to 0.4
Secondary/tertiary stocks	1.5 to 2.0

actual consumption in the fourth quarter, companies wound up with stocks in excess of their needs. As a result, there is still a substantial leeway to reduce inventories.

An anticipated decline in oil prices has intensified pressures to unload stocks in recent weeks. Companies are now attempting to reduce stocks at a rapid rate to avoid the large accounting losses that would occur with a price drop. Moreover, continued declines in oil use are reducing the level of stock requirements and adding to surplus productive capacity in the system. Based on recent estimates of production and consumption, we believe that companies are now depleting primary inventories at the rate of about 4 million b/d compared with a normal seasonal rate of about 3 million b/d. Given this rate, companies could still sustain a net drawdown rate of 3 million b/d during the second quarter, implying that demand for OPEC crude oil would remain at about 16-17 million b/d. We believe there is also ample incentive for secondary and tertiary stockholders to reduce inventories although individually they do not have as much flexibility as primary stockholders. Beyond midyear, however, we believe all inventory holders will have to begin rebuilding stocks for the winter.

Future Variables

The exact level of usable stocks held by companies is less a function of their intentions than it is a result of miscalculations in balancing supply and demand. Beyond minimum operating levels, compulsory stocks, and government-owned stocks, inventory levels are a residual that cannot easily be fine tuned to match a companies' financial objectives. Factors influencing future stock decisions include:

- Expectations about future supply availability, particularly stability in certain key oil-producing nations.
- Estimates of future consumption levels including the strength of economic recovery.
- The level of interest rates.
- Expectations about future price movements.

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Oil Inventories in Major Producing Countries

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From a market standpoint, the implications of the producer-held stocks are small. Venezuela gains an advantage because of its ability to draw upon stocks to keep exports substantially higher than its OPEC-mandated production ceiling would otherwise allow, but none of the other producers enjoys this position. In practicality, inventories in producing countries are no more important to the market than surplus capacity in producing oilfields except that stocks provide some measure of flexibility in raising exports for a short period of time.

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OPEC nations and Mexico have a combined crude oil storage capacity of some 300 million barrels. Most of this capacity is located in tank farms feeding tanker loading facilities or export pipelines, primarily to accommodate fluctuations in export operations. In general, stocks are maintained at about half of capacity to provide maximum flexibility. Iran and Iraq have been keeping lower inventories because of reduced production and export levels and the threat of war damage. In anticipation

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Oil Inventories of Major Producing Countries *Million barrels*

	Crude Oil Storage Capacity [a]	Current Estimate of Crude Inventories
Total	**297.4**	**167.9**
Mexico	27.0 [b]	20.0 [b]
OPEC	270.4	147.9
Venezuela	45.0	35.0 [c]
Saudi Arabia	57.0	24.0
Nigeria	23.9	18.0
Libya	24.4	15.0
Iran	24.5 [d]	9.0
Iraq	18.8 [e]	8.5
UAE	16.8	8.5
Algeria	16.0	8.0
Ecuador	4.9 [f]	5.5 [f]
Indonesia	13.0 [g]	5.5
Kuwait	10.4	4.4
Neutral Zone	10.1	4.0
Qatar	5.6	2.5
Gabon	NA	NA

[a] In most cases storage capacity represents capacity of the export system and does not include stocks held within the domestic distribution network.
[b] Includes about 9 million barrels in floating storage.
[c] Excludes approximately 43 million barrels of refined products in storage as of mid-March.
[d] Excludes damaged tanks at Khark Island.
[e] Includes 7 million barrels storage at Ceyhan, Turkey, the export terminal for the Iraq-Turkey crude oil pipeline; excludes 9 million barrels of prewar capacity at the Persian Gulf outlet at Al-Fao.
[f] Includes 1 million barrels in floating storage.
[g] Estimated.

of production restrictions imposed by the OPEC agreement, Venezuela has been accumulating stocks of crude and products, possibly to avoid a cut in exports. Storage capacity in Nigeria and Mexico is reported nearly full because of recent reduced sales. In the aggregate, we believe that crude inventories in OPEC and Mexico approximate 167 million barrels—equivalent to about two weeks of exports at February's level. Because some inventories are working stocks and others are used for domestic purposes, however, not all of this oil is available for export. (S NF NC)

Saudi Arabia's crude oil inventories are near normal levels—just under half of total capacity of about 55-60 million barrels. Based on total capacity, we believe the three Saudi export terminals have about 20 million barrels in storage.

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Venezuela has an estimated 35 million barrels of crude oil and 43 million barrels of refined products distributed among 21 export terminals. With its new production ceiling of 1.675 million b/d, Caracas is left with an implied export level of 1.3 million b/d after accounting for domestic consumption. This is 300,000 b/d under its goal for 1983. The shortfall could be made up, however, through a combination of natural gas liquids (NGL) sales and stock drawdowns. Exports of 60,000 b/d of NGL and 240,000 b/d from inventories would allow Venezuela to meet its export target and still leave over 8 million barrels in storage at yearend. This allows Caracas the option of meeting the letter of the new OPEC agreement, while putting it in a position to "dump" 200,000 to 300,000 b/d of additional oil on the market to raise revenues.

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More than 80 percent of **Iran's** crude oil storage is at Khark Island, which despite war-inflicted damage to several tanks still has over 20 million barrels of storage capacity. Stocks are being maintained at about 30 to 40 percent of capacity. Crude is also stored at Lavan Island at the southern end of the Persian Gulf. Iran has recovered its large product storage areas near Abadan, but their proximity to Iraq and continued inactivity at the refinery makes it doubtful they are being used. **Iraq** has several large storage areas in the northern part of the country, as well as use of a 7-million-barrel tank farm at Ceyhan, Turkey—its sole export outlet.

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Iraq's estimated capacity of nearly 19 million barrels excludes its largest, war-damaged storage facility at Al-Fao on the Persian Gulf.

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Nigeria's crude oil storage capacity is nearly 25 million barrels, stored principally at the port city of Bonny and inland at the Forcados terminal. The bulk of current production of about 900,000 b/d is reportedly being stored as buyers await a response by North Sea producers to the recent OPEC price cut.

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Mexico normally builds its crude stocks during the winter because seasonal storms disrupt tanker loading operations in the Bay of Campeche. Pemex—the state oil company—rents additional storage in Curacao and charters tankers to build inventories for export later in the year. This winter, buyer resistance to prices was primarily responsible for depressed sales, reportedly forcing Mexico to fill its available storage facilities near capacity. According to a source reporting to the US Embassy, as of mid-March Pemex-rented storage facilities in Curacao—amounting to 5.5 million barrels—are full, as are onshore facilities providing another 12.5 million barrels in capacity. Pemex has also chartered about six tankers providing storage capacity of about 9 million barrels.

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Hungary: Another Look at Reforms

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Hungary's economic reform, the New Economic Mechanism (NEM), has attracted more attention than any of the reform packages instituted in Eastern Europe in the postwar period. Some of Budapest's CEMA partners are watching the NEM closely in hopes of finding ways to solve their own economic problems. Much of the NEM's appeal appears to be its success in appeasing workers and consumers and in easing central planning rigidities while maintaining firm party control and at least the outward semblance of the Soviet-style economic model.

The New Economic Mechanism

By the mid-1960s, all the East European regimes were trying to cope with growing economic problems resulting from central planning: physical output targets with little attention to quality, central allocation of inputs, and centrally administered prices that did not reflect real costs and relative scarcities. Diminishing availability of new human and natural resources precluded relying on extensive economic growth to solve these problems. Hungary, as a small, resource-poor, and heavily trade-dependent country, felt particularly hurt by the autarkic features of central planning and, consequently, felt a strong need to rationalize its ties to world markets.

Budapest's response was the NEM, a reform package implemented in 1968 that went far beyond anything previously attempted in the Warsaw Pact. The NEM's key feature was its decentralization of decisionmaking, with enterprise managers and farmers gaining freer rein over important output and investment decisions. Enterprises were expected to aim for maximum profits and to be guided in this effort largely by mechanisms such as exchange rates, prices, interest rates, and taxes rather than by detailed plan directives. Planning and allocation of inputs were replaced, except for a few key commodities, by a relatively free trade system among enterprises. Wholesale and retail prices were drastically overhauled—and some freed—in order to bring them more in line with prices on the world market. Moreover, a system of foreign trade multipliers—one for trade with Communist countries and another for trade with the West—was created to bridge the gap between domestic and foreign trade prices.

In making these changes, the Hungarians had no intention of developing a market economy. Rather, they wanted to inject some market forces into a controlled, planned system. The state retained sufficient power to adjust overall output in the direction of national priorities established by the plan. The government also maintained its monopoly over foreign trade and kept extensive controls—far beyond those of a market economy—over investment, credit, wages, and distribution of profits. In effect, detailed planning was relaxed, but detailed economic regulation was not.

The government also wanted to prevent severe external shocks that might cause unemployment, rapid inflation, or unmanageable trade deficits, particularly in the transition to the reformed system. Consequently, the Hungarians installed an additional layer of controls—subsidies, price controls, and administrative guidance—to provide more insulation for the economy. The government recognized that these controls would block or obscure the effects of market forces but hoped the controls could be reduced sharply or eliminated within a few years.

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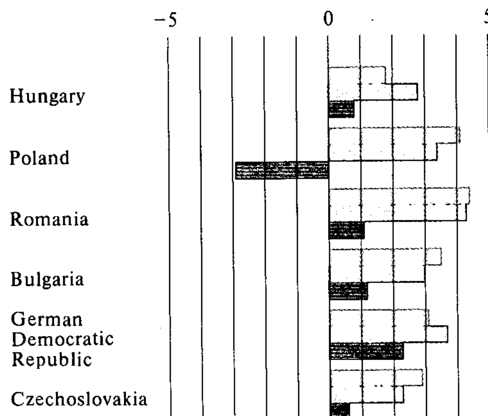
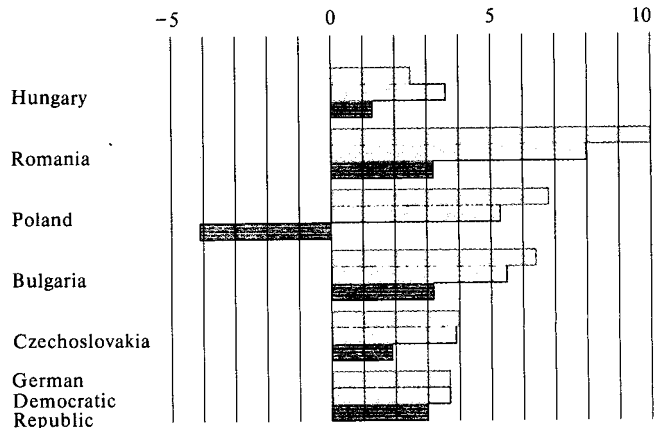
Eastern Europe: Growth of GNP Per Capita and Industrial Production

Average Annual Rates of Growth





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Reform Experience

These hopes have not been realized. In fact, the regime began a period of retreat from the reform in 1971, when soaring imports to support overinvestment by enterprises led to balance-of-payments difficulties. Additional problems arose a few years later due to growing social strains over widening wage differentials. The NEM then suffered the double blow in the mid-1970s of escalating energy and raw material prices and the world recession. Budapest responded to these problems by increasing subsidies to consumers and unprofitable firms, tightening price controls, and hiking wages across the board. The government also assumed tighter control over investment. While providing short-term remedies, these subsidies shielded enterprises and consumers from pressures to adjust to real costs and scarcities. Along with a progrowth strategy by the regime, the subsidies contributed to serious external payments problems in 1975-78 by encouraging imports and discouraging exports.

In the late 1970s, the government shifted its chief goal from economic growth to external equilibrium. Budapest cut investment, slowed improvements in living standards, and pushed exports. The government also revived the reform program by unifying the exchange rate, devaluing the forint, and liberalizing regulations for small private firms, craftsmen, and cooperative farmers. Cautious steps have been taken to reduce the size and powers of branch ministries, pare some subsidies, and ease some price restrictions.

Early successes in improving Hungary's financial position faltered in 1981/82 due to recession and high interest rates in the West and to the cutback in bank lending to Eastern Europe. The need to reduce the current account deficit to regain the confidence of Western creditors has led to a debate over the pace of reform. Some Hungarian officials

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Hungary: Hard Currency Trade Balance With Socialist and Non-Socialist Countries *Million US $*

	1979	1980	1981	1982 [a]
Total	**−167**	**279**	**443**	**750**
Trade with non-Socialist countries	−474	−291	−265	0
Trade with Socialist countries	307	570	708	750

[a] Estimated.

argue that reform momentum should be subordinated to finding solutions to more pressing external financing requirements. Others contend that rapid reform is necessary to help overcome economic problems, many of which they trace to the lack of followthrough on the reform's original program.

The NEM and Economic Performance

The NEM clearly sets the Hungarian economic system apart from the other CEMA countries, but there is little evidence that the reforms have improved economic performance substantially. The Hungarians themselves are relatively pleased with the NEM, claiming that overall economic growth and improvements in living standards have been greater after the reform than in the early 1960s. This, however, is true throughout Eastern Europe, where economic growth picked up from the late 1960s through the mid-1970s. Indeed, economic growth in Hungary has been outpaced by growth in most of Eastern Europe since the introduction of the NEM. After the revival of the reform in 1978, the growth of GNP per capita and industrial production in Hungary—although not the first priority of the reform in recent years—has exceeded only that of Poland and Czechoslovakia.

The reform also has failed to boost Hungarian export competitiveness in Western markets and thus shield Hungary from the external financing problems that have afflicted much of Eastern Europe. By the middle of last year, Hungary was dangerously close to insolvency. Budapest has been able to improve its hard currency trade balance in recent years largely by increasing its hard currency trade surplus with socialist countries—mainly the USSR—rather than by large export increases to the West. Moreover, Hungary achieved a balance in trade with the West in 1982 only by cutting imports sharply.

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Agricultural Success Story

Although the reform has fallen short in some areas, there are sectors of the economy that are prospering. Hungarian agriculture is the showcase of Eastern Europe. Grain yields have doubled since the imposition of the NEM and are the highest in Eastern Europe. Similarly, per capita meat production has either kept pace with or exceeded that of the rest of the countries in the region and currently equals that of East Germany. Agricultural exports also are strong: one-third of output is sold abroad, and agricultural exports account for one-fourth of total exports. Hungary is the only major net exporter of grain in Eastern Europe and is the region's largest net exporter of meat.

The improvements in agriculture are, in part, attributable to the NEM. The reforms ended the practice of compulsory deliveries at set prices to predetermined distribution centers, a system common in Eastern Europe. Greater managerial freedom in investment, planting, and harvesting decisions, wide-ranging rights for cooperative farms to set up agriculture-related businesses, and increased support for private plots all have improved efficiency. Small-scale industries and cooperative farms have greater flexibility to make production choices, leading to a marked improvement in ancillary services and equipment for small farms. This has helped improve productivity and living standards and thus has kept many able-bodied workers on the farm.

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**Eastern Europe:
Agricultural Growth Trends**

	Annual Averages	Hungary	Bulgaria	Czecho-slovakia	GDR	Poland	Romania
Grain production *(tons per hectare)*	1960-67	2.2	2.5	2.3	2.7	1.8	1.7
	1968-77	3.4	3.0	3.3	3.4	2.4	3.1
	1978-80	4.4	3.6	3.8	3.8	2.4	3.1
Net imports of grain *(thousand tons)*	1960-67	−417	4	1,805	1,647	2,603	−1,193
	1968-77	−640	−73	1,412	2,718	3,747	−336
	1978-80	−734	432	1,297	3,084	7,402	723
Meat production *(kg per capita)*	1960-67	47	35	43	44	43	NA
	1968-77	82	54	65	69	63	NA
	1978-80	93	70	74	94	85	NA
Meat consumption *(kg per capita)*	1960-67	43	32 [a]	47	51 [a]	38	NA
	1968-77	59	48	63	68	59	NA
	1978-80	72	62	76	83	80	NA
Net imports of meat *(thousand tons)*	1961-67	−36.0 [a]	−18.5	75.9	96.2	−164.6	NA
	1968-77	−135.7	−48.4	49.2	−17.0	−137.3	NA
	1978-80	−230.1	−73.3	6.8	−189.7	−152.9	NA

[a] Figures may be slightly understated due to lack of poultry data for 1961-63.

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Not all of agriculture's success is due to the NEM, however. Hungary has unusually fertile land and a long and proud agricultural tradition that predates the reforms. In addition, agriculture was not affected significantly by the forced collectivization of the 1950s nor has the regime neglected the sector to the extent evident in much of Eastern Europe. Finally, much of the productivity gains have resulted from significant boosts in use of fertilizers, pesticides, herbicides, and tractors—all steps that could have been taken without the reforms.

Consumer Welfare

The Hungarian economy's greatest success has perhaps been its ability to improve the lot of consumers and to keep discontent at a relatively low level. The growth in the consumption of food and consumer durables has been good, often keeping pace with Czechoslovakia and East Germany—the region's two most prosperous countries. Beyond the statistics, Budapest has a lifestyle not far removed from almost any West European city. Long lines for food are absent. Not only are domestic foodstuffs readily available but so, too, are imports of fruits and coffee. Department stores carry a variety of Western goods—including designer jeans, Japanese cameras and stereos, and Parisian fashions—that can be purchased in forints, not dollars.

The NEM deserves some credit for the improvement, in large part because it has allowed the country's underground economy to thrive. One important feature of the NEM is its legalization or official toleration of many activities—such as moonlighting—that are performed on the sly in most centrally planned economies. Budapest has recognized that the underground economy is instrumental in easing consumer demands and channeling excess entrepreneurial energy to productive

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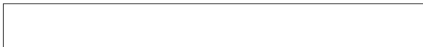
Eastern Europe: Stocks of Consumer Durables [a]

Units per thousand persons

		Hungary	Bulgaria	Czechoslovakia	GDR	Poland	Romania
Refrigerators	1965	25	14	91	94	16	54
	1980	296	233	305	423	269	156
Washing machines	1965	114	63	200	101	72	46
	1980	300	217	411	328	253	102
Television sets	1965	82	22	167	189	52	82
	1980	258	231	372	408	269	210
Radios	1965	245	166	333	337	253 [b]	179
	1980	243 [c]	267	604	383	65	251
Passenger cars	1965	10	5	30	30	15 [b]	6
	1980	85 [c]	88	139	148	64	29

[a] Source: CEMA yearbooks and Romanian plan reports.
[b] Base year is 1970.
[c] 1979.



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uses. For example, the small farmer accounts for roughly one third of agricultural output and, according to one official estimate, moonlighters may be responsible for nearly 40 percent of residential construction. The regime estimates that 75 percent of all households are involved in the underground economy and that it accounts for approximately one-sixth of total consumption.

At the same time, the leadership's emphasis on consumer welfare—irrespective of the NEM—is responsible for much of the improvement in consumer supplies. The regime's decision to import large quantities of consumer goods—their share of total imports in Hungary is the highest in Eastern Europe—has been an option open to all the East European regimes. Moreover, the rather low level of consumer discontent in Hungary is as much the result of the relatively liberal political climate instituted by party Secretary Janos Kadar as the high living standard. The hallmarks of Kadarism—open discussion of policy issues and options, leveling with the population on such decisions as price increases, and the philosophy of "who is not against us is with us"—have all earned the regime some trust from the people and convinced many that they have a real stake in the system. Recent decisions reluctantly taken by the regime to cut living standards in order to improve financial prospects probably have eroded but not yet seriously threatened this social compact between the population and the leadership.

Lessons for CEMA

A key question is whether the Hungarian system can serve as a model for centrally planned economies. The USSR and other East European countries appear to be studying the economic mechanisms of the NEM carefully, with an eye to possibly transferring them to their own economies. They are less likely, however, to consider adopting the political liberalism that makes the Hungarian system work.

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The Hungarians themselves say that the NEM was designed for the particular strengths and weaknesses of the Hungarian economy and other economies might well need different solutions. Moreover, the Hungarians introduced the NEM only after elevating competent economists and bankers to key policy positions. The NEM also was instituted at a time when a prosperous world economy and little domestic debt provided a cushion for correcting mistakes. Centrally planned economies now face serious debt problems and a world in recession. Finally, the Hungarians have a small economy where branch ministers know every plant manager and are able to supplement NEM principles with informal pressures and arm twisting. Large economies such as the USSR or even Poland are less able to use these informal methods.

Nevertheless, the USSR and East European countries could well benefit from adopting some of the principles of the NEM. Decentralization of decisionmaking to the producing unit could ease the rigidities of detailed planning and allow more adjustment to local conditions. Agriculture, in particular, could gain from greater authority and control at the farm level and from wider latitude in permitting farms to set up new agriculture-related operations. Price reforms could bring prices closer to real costs and scarcities and retail markets closer to equilibrium. And consumers and workers alike could benefit from legalization of underground economic activities and more favorable treatment of small private businesses.

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Cuba: Hard Currency Constraints and Debt Problems

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The Cuban economy is facing its most difficult period since Fidel Castro took power in 1959. A steep decline in sugar prices since late 1980, followed by the withdrawal of over $550 million in international credit lines as banker nervousness grew, presented the Castro regime with a hard currency crisis by mid-1982. Even after sharp import cuts, the Castro government in August 1982 requested a rescheduling of the $1.3 billion in medium- and long-term debt falling due through 1985. Accordingly, Havana signed an agreement with its creditors last month.

Still, Havana faces serious hard currency constraints for the foreseeable future. World market prospects for sugar are bleak, earnings from Cuba's other sources of foreign exchange are unlikely to make up shortfalls, and lender apprehension probably will continue. Furthermore, we believe that Cuba will not be able to rely on the USSR to provide it with enough foreign exchange to resolve its difficulties. Thus, we project that Cuba will almost certainly look to secure additional net credit from Western sources in 1984 and, perhaps, in 1985. In our view, these constraints will prevent Havana from meeting the balance-of-payment targets that were established in the recent rescheduling agreement and will make negotiations for any rescheduling more difficult in the future. In these circumstances, Cuba will experience little or no growth for 1983 and will fall well short of most of its ambitious targets for 1984 and 1985.

The Beginnings of Stress

The Cuban economy began to worsen in late 1980 with plummetting world sugar prices—the source of more than half of Havana's hard currency export earnings—and a sharp rise in debt service requirements. Increased hard currency sugar purchases by COMECON countries and earnings from Havana's other major sources of foreign exchange—nickel, seafood, tobacco, tourism, and construction services—did not fill the gap. By 1982 the debt service ratio had reached 50 percent.

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As the situation worsened, Havana undertook a variety of measures to deal with its hard currency bind that proved insufficient and costly. Import cuts slashed economic growth from 12 percent in 1981 to 2.5 percent in 1982. Moreover, the actions failed to impress Western financial institutions. New loans were denied, and short-term credits were withdrawn as international bankers became more wary.

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In late August 1982 Havana formally requested a rescheduling of part of its debt. These negotiations were completed last month. As a result, 95 percent of Cuba's medium- and long-term principal due from September 1982 to December 1983 was rescheduled for eight years, including a three-year grace period. The creditors established the following convertible currency performance targets for the end of 1983 in place of a traditional IMF-stabilization program:

- Minimum trade surplus of $410 million.
- Current account surplus of $6 million.
- Short-term debt minimum of $1.1 billion and maximum of $1.2 billion.
- Maximum total debt of $3.4 billion.
- A minimum of $180 million and maximum of $360 million in the foreign exchange reserves.
- Real growth rate of economy of 2.0 to 2.5 percent.

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To assure compliance with these targets, a task force composed of five of the largest creditors was

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Cuba: Hard Currency Current Account Balance [a]

Million US $

	1978	1979	1980	1981	1982	1983	1984	1985
Current account balance	**−586.5**	**−101.7**	**−194.4**	**150.8**	**201.9**	**−299.7**	**−272.9**	**21.3**
Merchandise trade balance	−88.4	135.9	384.3	455.1	632.8	105.1	139.2	382.7
Exports	882.8	1,020.9	1,809.8	1,719.5	1,513.1	1,155.6	1,297.0	1,550.3
Imports	971.2	885.0	1,425.5	1,264.4	880.3	1,050.5	1,157.8	1,167.6
Service account balance	−498.1	−237.6	−578.7	−304.3	−430.9	−404.8	−412.1	−361.4
Service earnings	223.0	404.1	340.2	440.1	318.4	286.0	318.0	375.6
Service expenditures	721.1	641.7	918.9	744.4	749.3	690.8	730.1	737.0
Interest	190.4	243.0	371.4	432.4	413.9	406.3	417.4	433.8

[a] Data for 1978-81 is from Cuban sources. Merchandise export earnings for 1982-85 are CIA estimates and differ from Cuban projections. All other forecasts (imports, service earnings and expenditures) are Cuban projections, which we believe are reasonable.

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established to monitor Cuba's performance. The group mandated a monitoring system consisting of quarterly economic reports to be released by Havana and a semiannual review by the creditors. Provision for rescheduling principal due in 1984 was linked to Cuba's compliance with the targets.

Trade Adjustments

Cuban projections envisage a gradual buildup in hard currency imports, but even in 1985 the projected level would still be nearly 15 percent below the 1981 level in real terms. Havana has stated it will import only essential items, but our study of Cuba's hard currency imports reveals that few nonessential goods are imported from the West. Machinery and transport equipment, basic manufactured goods, and food make up the bulk of these imports.

We forecast that Havana's current account balance will be deeply in the red in 1983 and 1984. Exports should increase somewhat because of renewed policy emphasis but material shortages arising from import cutbacks will limit their growth. Cuba depends on these imports for high-quality capital and intermediate goods unavailable within the Soviet Bloc, including items that affect production of export goods such as herbicides, pesticides, spare parts, and whole plants. The transport sector is particularly vulnerable, and its growing inefficiency would quickly hurt all other sectors.

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Economic Stagnation

Cuba's 1981-85 Five-Year Plan envisioned average annual real growth—as measured by GSP—of 5 percent.[2] Major increases in production were predicted throughout the economy, particularly in electric power generation, steel output, and housing construction.

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[2] The Cuban measure of economic output—gross social product (GSP)—counts the value of goods and services at all stages of production, a procedure that results in significant double counting. At any point in time, it is difficult to specify how growth projections based on this system would translate to equivalent Western measures.

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Cuba: Creditor Exposure

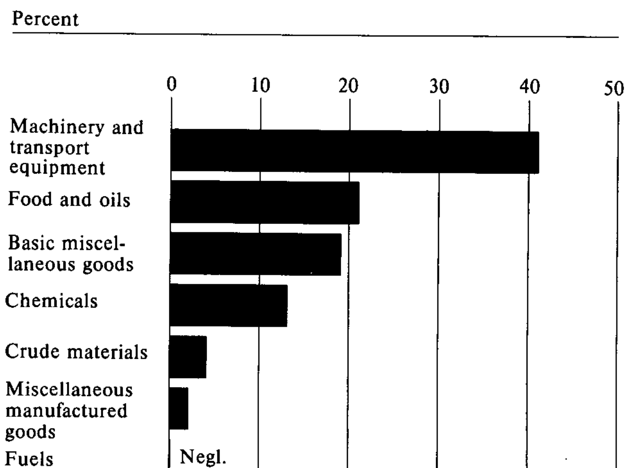
Cuba places its total hard currency debt at about $3.2 billion. Over half of the debt ($1.7 billion) is held by private institutions, primarily as short-term deposits ($1.1 billion) and medium- and long-term bilateral and consortium loans ($532 million). The remainder is held by official creditors, mainly as export credits ($1.2 billion) and intergovernmental loans ($240 million). The countries with the largest exposure are:

Million US$

Spain	*406*	*Switzerland*	*131*
France	*392*	*Argentina*	*206*
Japan	*376*	*Canada*	*109*
United Kingdom	*234*		

Nearly 60 percent of the total debt was originally scheduled to be repaid by the end of 1983.

Cuba: Composition of Hard Currency Imports, 1981



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Havana has little hope of achieving these targets. Sagging construction activities will thwart Cuban efforts to build new sugar mills, hotels, electric power plants, and similar projects. In addition, capital equipment will not be replaced or repaired, and increasing numbers of factories—particularly in the nonexport sectors—will be forced to close or reduce operations. Cuba envisions an economic growth rate of 2.5 percent for this year. We, however, foresee little or no economic growth for 1983 partly because of crop losses resulting from recent severe weather.

The outlook for growth in 1984 and 1985 is only slightly brighter. Even then, growth is unlikely to recover to the goal of 5 percent annually. Although we believe the production of exports will increase steadily in these years, Havana will be constrained by poor market prospects for its traditional key foreign exchange earners. Moreover, activity in nonexport sectors is likely to remain stagnant as resources are diverted to foreign exchange producers. We judge that the already spartan standard of living in Cuba will be reduced further during 1983-85 as a result of the hard currency shortage and slowed economic growth.

Financing Options

Despite the recent rescheduling, Cuba will need significant new financing in 1983 and 1984 to import even the reduced amounts it has forecast. It will be restrained from doing so, however, by the $3.4 billion limit on total debt—only $200 million above current indebtedness—set in the rescheduling agreement. Cuba cannot afford to cut further into its reserves, which probably are less than the $180 million minimum—equivalent to nine weeks' import cover at 1982 levels—established in the rescheduling agreement.

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Financing problems for 1983 will be particularly acute because $235 million in short-term deposits falls due this year. Cuba is seeking to roll over these deposits, but is meeting some opposition. In recent months it has unilaterally assumed that its credits have been extended and has placed new orders, according to a Western embassy in Havana. We believe Havana may need to ask bankers to

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Cuba:
Hard Currency Foreign Debt and Projected Maturity

Million US $

	Total	Sep-Dec 1982	1983	1984	1985
Total debt balance owed [a]	**3,219.6**	**1,033.2**	**790.9**	**438.1**	**338.6**
Bilateral public debt	1,478.8	118.2	341.6	294.6	220.8
Intergovernmental loans	239.3	0	35.3	35.3	35.4
Development aid credits	34.9	0.2	0.7	1.0	1.4
Export credits guaranteed by the state	1,204.8	118.0	305.6	258.3	184.0
Multilateral public debt	21.0	0	2.8	2.3	3.7
Suppliers (credit)	33.1	3.5	10.2	10.8	7.0
Financial institutions	1,686.0	911.2	436.2	130.3	107.0
Bank loans and deposits	1,619.6	894.5	392.4	124.4	107.0
Medium-term bilateral and consortium loans	531.6	41.8	157.1	124.4	107.0
Short-term deposits	1,088.0	852.7	235.3	0	0
Current import credits	66.4	16.7	43.8	5.9	0
Other credits	0.7	0.5	0.1	0.1	0.1

[a] Includes short-term obligations as of 31 August 1982; assumes a constant dollar/peso exchange rate at the 1982 level of $1.2/1.

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stretch out repayments of short-term debt if it is unsuccessful in rolling them over. (S NF)

Cuba already has publicly indicated that it will request a rescheduling of principal falling due in 1984. Based on our current account projections, such action will be necessary. Because Havana is unlikely to meet the balance-of-payments and growth targets set in the rescheduling agreement, it will probably find negotiations more difficult next year.

Havana cannot count on the USSR to provide the necessary foreign exchange to alleviate its problems. Cuba has indicated that it plans to integrate its trade further into the Soviet Bloc economic system in order to decrease its dependence on hard currency imports. Havana's ability to accomplish this is hampered by the immediate need to earn convertible foreign exchange to service its debt and to purchase imports unavailable from the USSR or its allies. Moreover, even if the strategy of further integration takes hold, subsidies from Moscow for Cuban sugar exports and oil imports are unlikely to rise significantly above the $3.8 billion in 1982.[3]

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Cuba is constrained in diverting its soft-currency trade into hard-currency markets because its quota for sugar exports to the West is established by the International Sugar Agreement. In addition, multilateral agreements with the USSR and its allies specify that the major portion of future output of new nickel and citrus plants be exported to the East.

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[3] Subsidy levels swing with the world market prices of sugar and oil. Accordingly, the oil price decline will reduce the nominal value of the oil subsidy for this year.

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Implications for the United States

In the domestic arena, Havana's primary preoccupation will be how to motivate the work force while imposing tighter austerity. In our view, worker apathy and absenteeism will grow, productivity and product quality probably will decline, and black-market activities will expand. It is unlikely, however, that the social ferment of 1979-80 will reappear in the near future. The Mariel exodus purged the island of those who were the most dissatisfied, and the Castro regime is unlikely to repeat its mistake of allowing thousands of Cuban exiles to return for visits.

Over the longer run, however, Cuba's dim economic prospects will cause increasing domestic stress as large numbers of entrants join the labor force. During the next seven to 10 years, record numbers of young people will seek jobs and housing. Because the cumulative effect of these population trends will develop gradually, Havana will be more likely to use the emigration option toward the end of the decade than in the short term. However, if Castro perceives that US actions are causing popular discontent, he might well unleash another Mariel-style exodus in retaliation.

The growing labor surplus will also provide a powerful motive for the expansion of Cuba's overseas military and civilian forces. The economic costs of Cuba's overseas activities probably are not large enough to offset the benefits. Some of the larger civilian assistance projects—such as the construction teams in the oil-producing Arab nations—actually return a profit. Perhaps most important, the Cuban "internationalists" are central to Castro's drive for foreign influence.

Finally, we believe Cuba's hard currency shortages will push the island toward even greater dependence on the USSR. As Havana's dependence on Moscow grows, Castro will have little room for maneuverability should the USSR call upon Havana to support Soviet interests in the Third World.

Cuba's inability to get its economic house in order could lead to a Soviet move to demand greater control over economic activities on the island. This risk would rise sharply if Havana shows signs of being unable to begin repayments of its over $7 billion soft currency economic debt to the USSR, scheduled to begin in 1986

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USSR: Labor Discipline Campaign

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A crackdown on workers to reduce shirking on the job is General Secretary Andropov's major initiative thus far to increase production and rejuvenate Soviet economic performance. The campaign to improve labor discipline aims at punishing workers or depriving them of rewards because of absenteeism, tardiness, excessive job turnover, and alcoholism. The campaign was initially well received by the public and appears to be boosting production. If greater effort is not rewarded by an increase in consumer goods and services, however, the discipline campaign is likely to lose momentum.

Origin of the Campaign

Andropov's strategy to get laggards back on the job began with the use of administrative measures to enforce discipline: "Although everything cannot be reduced to discipline," he said, "it is with discipline that we must begin, comrades." The regime hopes for a gain in production large enough to provide incentives for boosting productivity. At the same time, Andropov is promoting two additional measures designed to elicit better job performance: (1) linking wages and bonuses more directly to production results and (2) granting more managerial responsibility at the primary production level.

The keynote of the current campaign was Andropov's 22 November plenum speech noting that poor performance should have "an immediate and unavoidable effect on the earnings, official status, and moral prestige of shoddy, inactive, and irresponsible workers." Since mid-December, when a Politburo meeting focused on letters from workers complaining about the lack of labor discipline, the campaign has picked up steam. At a 24 December meeting, representatives of Moscow enterprises called for a reduction in absenteeism and turnover and demanded increased firings for those who do not comply. That meeting has been followed by a daily barrage of articles, exhortations, and exposes in the central and regional press reinforcing these themes. Soviet frustration over the effect of drunkenness on work time was stressed in a December 1982 *Pravda* article; it stated that as a result of excessive drinking by workers "machines stand idle and building sites come to life on Tuesday instead of Monday, becoming deserted again by Friday."

While malingering workers are the prime targets for punishment, laggards in management—including party, trade union, and enterprise authorities—are under pressure to shape up as well. For example, in late December, *Pravda* published an open letter from dissatisfied workers in a heavy construction enterprise complaining about nondelivery of supplies.

The police reportedly have raided stores, restaurants, theaters, and public transportation to check documents. These tactics appear to have been successful. Queues at shops are said to be shorter, and the US Embassy Moscow reports having heard of numerous cases of workers who were dismissed for being absent without leave.

Popular Reaction

Many Soviets have expressed satisfaction with the discipline campaign as something that is long overdue and will get the economy moving again. Because the Soviet system can implement coercion more quickly and easily than it can change entrenched bureaucratic procedures, however, the campaign runs the risk of being carried too far too fast. Indeed, in a manner typical of Soviet-style campaigns, the police have been heavyhanded and indiscriminate in cracking down on absenteeism. A

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continuation of this tactic could foster an atmosphere of resentment and fear throughout the work force. Because of widespread use of shift work in industrial centers, many workers are on the streets during normal working hours. Such workers reportedly are becoming annoyed and frustrated by delays involved in waiting for document checks.

Perhaps recognizing that too much zeal in carrying out the discipline program could further alienate the work force, the Politburo, at a meeting in mid-January, evidently examined other measures to keep workers on the job. The Council of Ministers issued a resolution providing flexible work hours for the services sector and expanding consumer services such as shoe repairs, laundries, and retail food outlets at factories. This would reduce the pressures on workers to leave work for long stretches during the day to attend to personal business. The deadline set for implementation of this decree is 1 April 1983. The US Embassy Moscow reports that a number of stores are already adopting evening hours in response to the resolution.

The campaign seems to be boosting efficiency and production. East European diplomats have reported, for example, that the tempo of work in the Soviet institutions with which they do business has picked up markedly. Moreover, some of the 5-percent increase in industrial production in January, as compared with January 1982, may have been the result of better work habits. January 1982, however, was a particularly poor month for Soviet industry, and we have no way of determining how much of the rebound was due to tighter discipline and how much to a rebound from an unusually poor production month.

The best the Soviets can probably hope for from the present campaign is a gain in production per worker corresponding to an increase in the hours actually worked. The payoff ends when downtime is reduced to the level dictated by machine breakdowns, interruptions in material supplies, and the like. This benefit could be offset by growing resentment if greater worker effort is not rewarded by an increase in the supply of consumer goods and services.

The discipline campaign will face tough sledding. Until priorities change, there is little hope for large increases in the supply of consumer goods and services. Public tolerance of a tough discipline drive is likely to be transitory. Moreover, in the current tight labor market, management will be reluctant to crack down on workers, who can easily quit and get jobs elsewhere. In addition, it has been standard managerial practice to hoard labor "reserves" to meet erratic work schedules or provide temporary help for the harvest from the pool of nonfarm-workers. Finally, firing workers goes against the grain of Soviet society, which believes a worker has the right to a job.

The aim of reducing excessive job turnover will have a particularly heavy impact on young workers and could be counterproductive. Workers under 30 are responsible for about 60 to 65 percent of all turnover, and 75 percent of those leaving their jobs have worked less than three years.

Soviets Recognize Limits

Several recent articles have suggested that improvements in economic management rather than harsh measures to change poor attitudes and habits among workers hold the key to higher productivity. V. Kostakov, a sector head at Gosplan's Institute for Economic Research, recently wrote in *Literaturnaya gazeta* that "it is necessary to infuse the struggle for strengthening discipline with the understanding that we should have in mind the whole productive chain. This matter should not be reduced only to a struggle with idlers." Andropov himself stressed the long-term nature of the task and collective responsibility in carrying it out. He may have been signaling the police to back off somewhat by emphasizing the risks in getting bogged down in "trivialities like coming a few minutes late for work or taking too many breaks."

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