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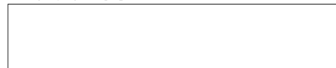

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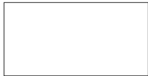

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International Economic & Energy Weekly

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Synopsis

Perspective—*Williamsburg Summit*

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Prospects for the ninth economic summit have changed considerably in recent weeks. Foreign participants see greater opportunities to turn attention to US economic policies. Also, many see improved opportunities to raise North-South issues.

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Western Europe: Caught in a Fiscal Squeeze

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West European governments face the dilemma of big budget deficits and slow growth. At the same time, reducing budget deficits implies additional economic, political, and social strains on top of those generated by three years of stagnant economic activity.

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OECD: Slow Recovery in 1983

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The OECD economies appear to be pulling out of the recession, but not uniformly or rapidly. If, as we expect, the recovery continues to develop throughout 1983, the stage should be set for more rapid growth in 1984.

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Japan: No Resurgence in Growth This Year

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Domestic policy choices, a poor investment climate, and voluntary restraints on exports will prevent Japan's economy from staging a strong recovery this year. Nonetheless, we do expect a significant increase in the current account surplus.

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Western Europe: Implications of Energy Import Dependence

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Our analysis of recent industry forecasts indicates that Western Europe will continue to rely on imports for 40 to 50 percent of total energy supplies through the end of the century. As a result, Western Europe will remain extremely vulnerable to energy supply disruptions, especially if the energy market begins to tighten in the early 1990s as most of these forecasts project.

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20 May 1983

Perspective

Williamsburg Summit

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Prospects for the ninth economic summit, at Williamsburg on 28-30 May, have changed considerably in recent weeks. The East-West controversy appears to have been put on the back burner as studies in IEA, COCOM, OECD, and NATO have generally proceeded without major conflicts. Foreign participants, however, in addition to feeling relief, may now see greater opportunities to turn attention to the US budget deficit, high interest rates, and reluctance to intervene actively on foreign exchange markets. Also, many participants see improved opportunities to raise North-South issues.

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Most other participants believe the United States is placing too much reliance on industrial country recovery to solve the world's problems, including those of the less developed:

- The French argue that debt-burdened countries will not be able to repay unless they have immediate large-scale financial help and much greater access to developed-country markets.

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- Italian Foreign Minister Colombo is urging that Italy make an initiative similar to Spadolini's "world campaign against hunger" proposed last year.

On trade in general, most other participants, led by the French, fear that lifting protectionist barriers among industrial countries may not be the major spur to growth Washington claims. Indeed, some argue that, with unemployment expected to remain high, the nascent economic recovery may actually encourage protectionist pressure as import demand picks up.

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As usual, the leaders will be bringing to Williamsburg a wide range of interests:

- West German Chancellor Helmut Kohl is attending his first summit. Relieved by US assurances that East-West trade issues will not be pushed aggressively and hoping for a harmonious summit, Kohl is unlikely to spring any surprises.

- French President Francois Mitterrand, at his third summit, is arriving in the wake of troublesome demonstrations against his policies at home and several weeks of intense press play on both sides of the Atlantic on the deterioration in Franco-American relations. The French have long found it convenient to blame US economic policy for a large share of their own ills, and their rhetoric has increased as the dollar's strength threatens their hopes for reducing their trade deficit this year.

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- British Prime Minister Margaret Thatcher will be making a whistlestop in Williamsburg, her fifth summit, and will then rush back to campaign for the 9 June national elections. Thatcher is looking for an optimistic summit statement on economic recovery to augment growing signs of recovery at home.

- Italian caretaker Prime Minister Amintore Fanfani is attending his first summit. His government fell last month, and national legislative elections are to be held less than a month after his return to Rome.

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- Japanese Prime Minister Yasuhiro Nakasone, also attending his first summit, has been in some political hot water at home ever since he took over, largely because of his independent views and his perceived tendency to be too pro-United States.

- Canadian Prime Minister Pierre Trudeau is now the senior summiteer (his seventh) following the exit of Chancellor Schmidt. Domestic dissatisfaction with Trudeau's government is the highest it has ever been; Trudeau appears somewhat tired both of governing and of summits.

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Factors encouraging summit harmony include pressure to maintain Western unity. Mitterrand, for example, a general hardliner on *noneconomic* East-West relations, wants to avoid any display of serious Western disunity during the "year of the missiles." Another strong argument for harmony is to provide the proper psychological climate for economic recovery.

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There are, of course, several factors—not all of them substantive—that may push the summit toward disharmony:

- Thousands of journalists will be on hand, and their primary focus will be finding—and perhaps encouraging—controversy.
- Past summits have sometimes run into difficulties when delegates have attempted to "make points" or claim victories, aided by the press's tendency—not always discouraged by official delegations—to name summit winners and losers.

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The major question mark—not for the first time—is the position of the French. President Mitterrand's 9 May speech to OECD ministers called for a new Bretton Woods–type conference to revamp the international monetary system, took relatively mild and indirect swipes at US economic policies, and called for a better deal for LDCs. The speech also contained hints that French participation in future economic summits could depend on how his positions fared at Williamsburg.

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The French may simply be blowing presummit smoke, in an attempt to divert attention from their domestic problems. Mitterrand would perhaps be satisfied if the Williamsburg participants could agree to study the idea of an international monetary conference, for example, following up on the intervention study issued last month. He, however, is looking for some way out of his

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international payments problems and is somewhat bitter that his ideas have received so little support from other summit participants. How this works out at Williamsburg will depend on the real extent of his frustration with US policy, his judgment of the need for Western unity, how seriously he takes his own initiative (which, indeed, is largely a dusted-off version of Giscard "initiatives" promised but only half delivered over several years), and, of course, on the US rhetorical and substantive response.

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Williamsburg Summit Positions

	United States	West Germany	France	United Kingdom	Italy	Japan	Canada
Debt and Finance	Wants increased IMF resources and temporary "bridge loans"; solutions to LDC problems, however, lie in (1) private bank lending to countries adopting sound adjustment policies, (2) Western economic recovery, and (3) maintaining open markets for LDC products.	Will resist unproven new solutions to LDC debt problems; long-term rescheduling with LDCs should proceed on case-by-case basis. Will encourage export earnings stabilization fund for LDCs.	Wants more resources for IMF and IBRD and closer cooperation between them. Special effort required for neediest LDCs, especially Africa. Supports action to stabilize raw materials prices. Will argue that stronger aid programs, featuring multiyear commitments, are not only moral imperative but support Western economic recovery.	Recognizes need for action to correct LDC debt problems; should support US proposals. Sees reducing US deficit as a means of spurring Third World growth. Will support increased market access for LDC products.	Wants assurance of minimum net credit flows, especially through multilateral agencies (IDA, IMF), and including the possibility of subsidized interest rates on new loans. Supports bridging loans and wants greater attention to balance of payments and external debt problems of LDCs. Endorses commodity revenue stabilization programs to alleviate debt problems.	MITI studying possible changes in international financial institutions. Government insists official aid must accompany increased trade if LDC debt problems are to be solved, but aides doubt Nakasone will push idea of $500 billion Global Investment Fund.	Will seek $82 billion in funds—$20 billion from private bank loans and the rest from the IMF—to prevent LDC bankruptcies. Opposes major overhaul of international financial system. May again criticize US for not contributing its fair share toward international development.
Growth/ Inflation	Advocates noninflationary growth—low inflation, low interest rates, and low budget deficits; one country alone cannot serve as "locomotive." Wants follow up multilateral surveillance as agreed at Versailles, aimed at greater exchange rate stability and periodic evaluations of each country's economic policies.	Primary focus should be clarification of overall growth strategy; but will resist detailed plans to adjust country policies and opposes US multilateral surveillance suggestions. US budget deficit needs immediate reduction. Strongly opposes French ideas on intervention and a new Bretton Woods.	Acknowledges need to fight inflation but fears recovery will sputter out in absence of coordinated Western strategy to promote growth. Advocates carefully prepared, IMF-sponsored conference to revamp international monetary system. Wants coordinated intervention along lines of Versailles-mandated report. Sees current strong dollar as hurting efforts to reduce balance-of-payments deficit.	Believes primary Summit objective is agreement on cooperative economic policies. Will not welcome suggestions that British pursue more reflationary posture to quicken recovery. Will express concern about US budget deficit and interest rates. Favors IMF reform but opposes French calls for new Bretton Woods to revamp exchange rate system.	Supports multilateral surveillance system as agreed at Versailles; wants more expansionary policies in countries such as US where inflation has moderated. Will support push for greater exchange market intervention to smooth erratic short-run currency fluctuations. Sees need for increased technological cooperation.	Believes path to noninflationary growth will be main Summit topic. Fearful of pressure on Japan to reflate. May try to rally support for coordinated exchange rate intervention. Tokyo supports US proposal for multilateral surveillance system, but Ministry of Finance favors limiting to G-5.	Believes primary objective should be ensuring strong and lasting global recovery through the coordination of economic policies. Will caution that needs of LDCs must be kept in mind. Is likely to criticize US for high real interest rates.
Trade	Proposes unified stand against protectionism; more interchange between trade and finance policymakers; and more frequent meetings of trade officials, including GATT ministerials, looking toward eventual trade negotiations with LDCs.	Wants general commitment from Seven to lower trade barriers. US-EC dispute will have to be addressed. Will resist detailed discussion of North-South issues.	Agrees in general on dangers of protectionism. Will emphasize need for LDC access to markets but sees protectionism affecting LDC earnings much less than slow growth, insufficient aid, low commodity prices, and rise in interest rates. May argue need for rules of conduct on industrial policy and strategies.	Will support stand against protectionism; will urge liberalization of trade in services and reductions in barriers to British goods but refuses to reduce subsidies to British industry. Willing to discuss North-South trade but wants reciprocity. Concerned about growing differences on farm subsidies between EC and US.	Opposes protectionism generally but may endorse import measures in exceptional circumstances. Supports US objectives in North-South round of trade negotiations. Wants more interchange between trade and finance officials at all levels and more frequent GATT ministerials and meetings of summit country trade ministers.	Generally supports call for 1985 GATT ministerial. Foreign Ministry opposes establishment of Summit country ministerial group to discuss trade issues on regular basis.	Has stated that free trade is the keystone of economic recovery and will call for the removal of temporary protectionist measures installed during the period of recession. However, will continue to pursue own nationalistic economic policies.
East-West	Desires agreement that trade with East not like trade among Western partners; wants discussion on security implications of East-West economic relations; seeks statement welcoming work already accomplished on the series of East-West studies in OECD, IEA, COCOM, and NATO, and urging further efforts.	Supports East-West trade. Considers US plans for expanding COCOM list too far-reaching; will agree to include only direct military items. If compromise unavoidable, is more likely to accept US views on COCOM than on East-West trade.	Strongly supports East-West trade in industrial goods. Favors tough measures to prevent illegal Soviet acquisition of military technology but will insist on reserving final decisions for national level. Also defines military technology more narrowly than United States.	Regards extraterritoriality as key problem between the US and Britain. Sees Soviet trade as necessary to survival of some British firms and to improve trade balance. Hopes for conciliatory US stance but is open to tightening COCOM controls on high technology items. Will urge completion of East-West trade studies.	Generally sees East-West trade as beneficial to both sides. Believes high technology trade should be subject to tighter controls and Soviets denied subsidized interest rates; favors coordinated system of trade guidelines that serves common security interests while preserving trade levels.	Foreign Ministry contends US attaching excessive importance to East-West economic relations. Tokyo likely to adopt low profile during East-West discussions to avoid siding with Washington or EC.	Wishes to keep East-West issues quiet. Does not believe that economic pressure on the Soviet Union is effective but does support restrictions on exports of sensitive technology. May push for greater US-USSR dialogue. Is pleased with progress of East-West trade studies.

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Briefs

Energy

Possible Iranian Oil Price Discounts

Press reports that Tehran has granted Japanese oil customers discounts ranging from $0.20 to $2.00 per barrel on contract renewals remain unconfirmed. Before March, Tehran had sold about 250,000 b/d of crude to Japan. Remaining contracts for about 90,000 b/d expire by July.

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With Iranian production in April at 2.1 million b/d, Tehran may feel it needs to make some concession to customers in order to reach its 2.4-million-b/d OPEC quota. With spot prices close to its official price of $28, however, the discount is unlikely to be more than $0.50 per barrel. Moreover, Tehran is unlikely to grant large discounts in light of its recent agreement with Tokyo to pay Japanese construction firms about $500 million to complete the remaining construction of the $3.5 billion Bandar Khomeini petrochemical plant. Japanese oil buyers nevertheless will continue to press for discounts. Other OPEC members probably would not object to a small discount as long as Iranian production does not exceed its ceiling.

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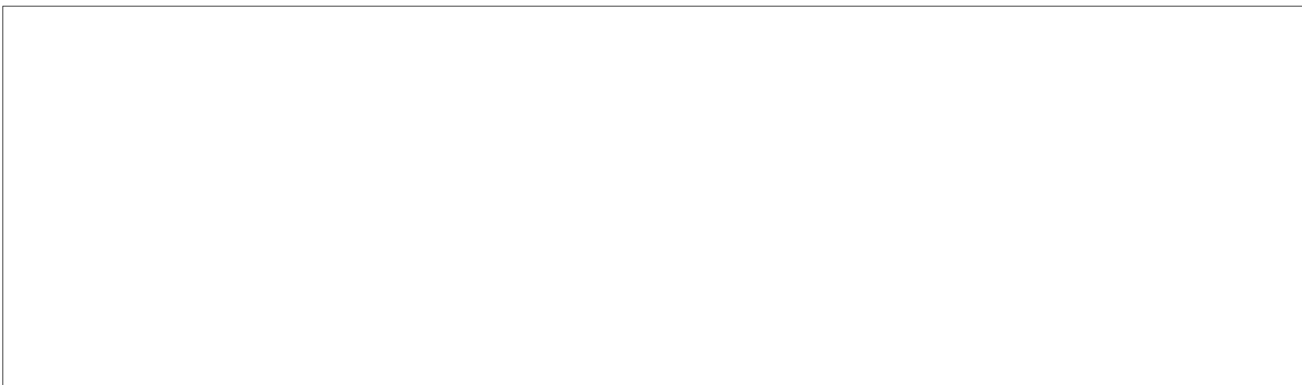

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New Iraqi Refinery

Baghdad completed a 200,000-b/d refinery expansion project last month at Baiji in northern Iraq. The expansion could enable Baghdad to raise crude production and exports because the added capacity reduces the need to ship crude outside the country for processing and reimport. War damage to the Basrah refinery had forced Baghdad to use about 100,000 b/d of the Turkish pipeline's 700,000-b/d capacity for processing deals and apparently spurred Baghdad to accelerate construction of the Japanese-built Baiji refinery, orginally planned to be finished at yearend 1983.

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Even with new sales, however, limits on the capacity of the Turkish export line will keep Iraqi production at least 200,000 b/d below its output quota of 1.2 million b/d under the March OPEC accord.

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Chinese Offshore Oil Contracts

The most promising areas for oil exploration in the South China Sea remain to be leased as US companies continue to have difficulty coming to terms with Beijing. A consortium led by British Petroleum was awarded four blocks in the South China Sea last week, after competitive bidding. Chinese officials have told the US Embassy, however, that three major US firms are out of the running because their bids are not competitive.

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The British Petroleum contract comes after years of negotiations between Western firms and China and is the first time China has opened its most promising offshore oil basin to Western exploration. The main issue has been the portion of oil that the companies may retain as their share. British Petroleum probably settled on between 5 and 10 percent.

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International Trade, Technology, and Finance

EC Approves Loan to France

EC finance ministers on Monday approved a $3.7 billion loan to help France finance its large balance-of-payments deficit. No conditions are attached to the loan, and France probably will have five to seven years to repay the loan. The EC ministers apparently are satisfied that the Mitterrand government's austerity program announced last March is sufficient proof of Paris's determination to turn the economy around. This is the first loan to be made under the

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EC's so-called oil facility after it was revamped in 1981 to provide up to a total of $5.5 billion to EC members suffering from severe payments difficulties. Unlike other EC funds available to member countries—which are project specific, approved by the Commission, and administered through the European Investment Bank—oil facility loans require the unanimous approval of the 10 members. The Mitterrand government, therefore, probably will portray the loan as proof of international acceptance and support for its austerity program. The Community bailout probably will make it more difficult for Mitterrand to pursue economic policies independent of France's EC partners, although he may continue to promote his ideas for a new Bretton Woods system at the Williamsburg summit later this month. 25X1

IMF Loan for Panama

An agreement with the IMF for an 18-month $165 million standby loan, reached in principle last week and scheduled for signing in early June, should substantially help Panama meet its foreign financing needs. In return for the funds, the Panamanian Government—which has one of the highest foreign debt–GDP ratios in the world—will be obliged to restrict its public-sector deficit to $270 million and sharply limit its further recourse to foreign borrowing. 25X1

Panama has estimated that it will need $120 million in foreign bank loans this year to meet debt amortization payments and, together with IMF drawings and a World Bank loan, to cover its public-sector deficit. Panama's large international banking community this year so far has been unwilling to extend sizable amounts of new loans to the government because:

- Panama's economic stagnation, coupled with its extremely large debt, has made further loans increasingly risky.
- The financial crises in Mexico, Brazil, and elsewhere have soured international banks on lending to the entire Latin American region.
- International bankers worry that, with an election campaign approaching, the government will become unwilling to undertake needed economic adjustment measures.

Now that the IMF has endorsed Panama's economic program, however, foreign bankers are expected to be more receptive to Panama's request for $120 million 25X1 Without these new bank loans, Panama will probably be forced to reschedule its existing foreign debt. 25X1

Algeria Returns to Euromarket

The Algerian Exterior Bank agreed last month to guarantee a $500 million loan for the Algerian state energy company, SONATRACH, ending Algeria's four-year absence from the Eurocurrency market. The loan will provide financing to complete SONATRACH's $1 billion liquid petroleum gas plant at Arzew—the first phase is scheduled to be finished in 1984. The loan has received a very favorable response from international banks and is expected to be signed in early June. The credit will carry an eight-year maturity and be priced at 0.5 percentage point above LIBOR for the first two years and 0.625 thereafter. These terms reflect Algeria's cautious financial management in recent years, including limits on capital intensive projects. 25X1

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Sudan Wavering on Economic Reform Program

Sudanese President Nimeiri informed the US Ambassador last week that he was determined to build a new international airport in Khartoum despite his country's other economic needs. Sudan's willingness to abandon the airport project was an important condition in the IMF-inspired economic reform package that Khartoum accepted last year. Nimeiri justified his decision by claiming that a $100 million grant from the United Arab Emirates is earmarked for the airport. Nonetheless, construction of the facility will alarm the country's Western donors and creditors who believe Sudan must use its scarce investment funds for improving infrastructure and rehabilitating existing agricultural projects. The airport almost certainly will become an issue between Khartoum and the IMF, which was due to being its midterm review of Sudan's economic performance this week.

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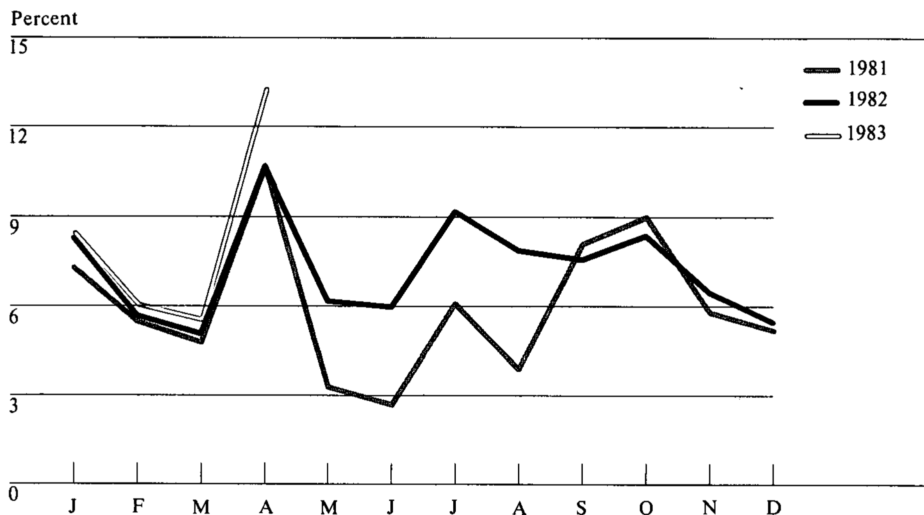
National Developments

Developed Countries

Increasing Pressure on Israeli Finance Minister

Finance Minister Aridor is coming under increasing pressure to alter his economic policies. The most recent in a spate of bad economic news was the announcement on Sunday that prices rose a record 13.3 percent in April; inflation since last year is running at an annual rate of 161 percent. In

Israel: Monthly Consumer Price Increases



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addition, export receipts during the first four months of the year were 9.4 percent below the same period in 1982, and the trade deficit increased by $275 million. Recent polls indicate that a majority of Israelis believe the country's economy has worsened in the last year and that Aridor's popularity is at a record low. While grumbling about the economy is nothing new, we believe preliminary indications that unemployment is rising are probably heightening public concern. 25X1

The April price rise provides the Histadrut, the large labor organization, with ammunition in its call for higher wages. The Manufacturers' Association will point to the export decline to push for an increase in the pace of the shekel depreciation in order to increase the competitiveness of Israeli exports. Both moves, however, would only exacerbate inflationary pressures. The US Embassy reports that the Finance Ministry cited the April increase in support of its efforts to hold down government spending and fight what it views are excessive wage demands; we believe this was a warning to doctors, who have been on strike for three months demanding wage increases in excess of the 22 percent awarded in the public-sector wage agreement signed late last year. Several opposition leaders called for Aridor to resign, according to press reports, and one cabinet member said Aridor would have to change his policies. 25X1

The opposition Labor Party has submitted a no-confidence motion on the government's handling of the economy that will be voted on next week. Two polls show Labor's popularity rising, with one of them suggesting that Labor would defeat Begin's Likud bloc in an election. Despite unhappiness over the economy, however, we believe the Begin government is not in any immediate danger. Polls continue to indicate that the big losers in an early election would be the minor parties on which Begin depends for his majority, and they appear unwilling to break with the government. Begin's personal popularity, moreover, remains much higher than that of any Labor leader. If current economic trends continue, however, as seems likely, the Begin government will find it increasingly difficult to turn back similar challenges. 25X1

Less Developed Countries

Mexican Economy Still Plummeting

Industrial production plunged at an annual rate of 12 percent in the first quarter of this year, according to data released by the Mexican treasury. The decline was most pronounced in investment goods, consumer durables, beverages, and metals. 25X1 the pharmaceutical and automotive industries are currently operating at about 50 percent capacity, while as many as 25 percent of their workers have been laid off. Continuing shortages of imported raw materials, intermediate goods, and spare parts and price controls have eliminated profits for many firms and have led to a stoppage or pronounced slowdown in production. 25X1

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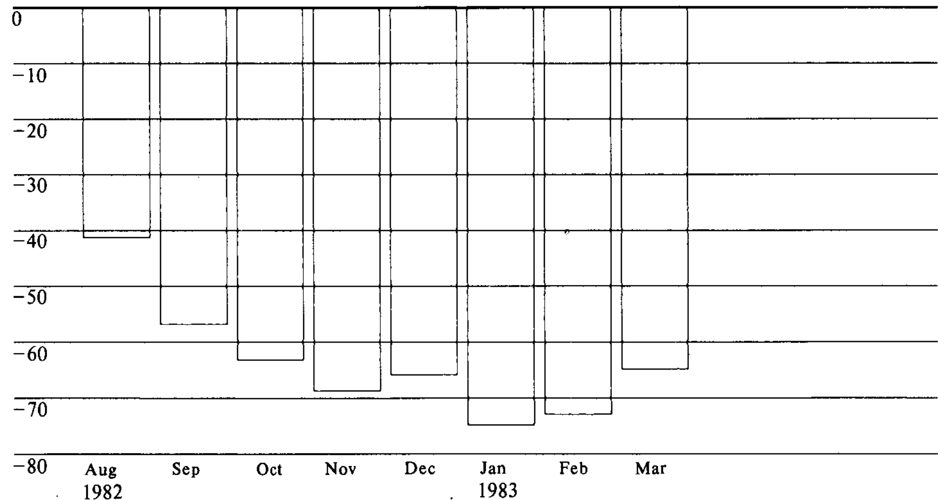
Mexico: Import Plunge



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Normal foreign trade lines have been disrupted since the debt moratorium was announced last August. New official trade data indicate Mexican imports in February and March remained 70 percent below the import level during the same period a year earlier. As local supplies dwindle, the national consumer price index in the first four months of this year rose at an annualized rate of 120 percent.

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Mexico Announces New Export Development Plan

Mexico City last week announced the first stage of a new export development plan aimed at quadrupling nonoil exports by 1988. According to Embassy reporting, the plan will reduce redtape and provide short-term financial support for export-related activities. Export permits will no longer be required on 94 percent of exports, and most export tariffs are being reduced or eliminated. Moreover, most export regulations and incentive programs will now be administered by the expanded Foreign Trade Institute rather than the five or more agencies with which exporters previously had to contend.

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Financial efforts to assist firms in developing exports include a 400 billion peso ($2.7 billion) credit program that will be administered by Bancomex, the government foreign trade bank. A credit program now being negotiated with the World Bank will provide funds to exporters at preferred rates through several existing government trust funds, and government export guarantees

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will be raised from 109 million pesos ($2.0 million) in 1982 to 12.5 billion pesos ($84 million) this year. The full export development plan will be released later this month as part of President de la Madrid's National Development Plan. [ ] 25X1

Although we believe such a program will help exporters, its effectiveness in the short run will be hampered by the scarcity of foreign exchange and the expected slow recovery in industrial country imports. Indeed, according to a Mexican treasury report, merchandise exports fell by 14 percent in the first quarter. The new export financing schemes may, however, complicate US-Mexican trade treaty negotiations that are scheduled to resume this year. Even though [ ] the government will try to fine tune its programs to avoid conflicts with US policy on export subsidies, in the past public financial supports have caused the United States to impose countervailing duties. [ ] 25X1 25X1

Mexican Strike Threats

The government probably will try to avert possible strikes by granting workers a larger wage increase than currently promised. Labor leader Velazquez is threatening strikes against some 11,000 companies, including the government oil monopoly, to persuade the government to allow a more favorable wage settlement. One opposition party is calling for a general strike, but Velazquez stresses that his demands are nonpolitical. [ ] 25X1

President de la Madrid recognizes that organized labor's loyalty is important to continued political stability, and he is likely to agree to a small concession on wages. The Minimum Wage Commission probably will add about 5 percentage points to the promised 12.5-percent hike and could make it effective several weeks sooner than its scheduled start in July. Although labor leaders understand the necessity for maintaining austerity, they are likely to continue to urge the government and business to accept still higher minimum wages to deflect complaints from the rank and file that their interests are being ignored. [ ] 25X1

Possible Brazilian Debt Moratorium

Brazil may suspend servicing its foreign debt in the next month or so. [ ] 25X1

Discussions that began on Monday with the IMF may bring the issue to a head. The US Embassy reports that Brasilia has been unable to comply with the IMF's targets and is seeking a waiver. If a waiver cannot be negotiated promptly, Brasilia will have little hope of restoring short-term credits or

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raising new money. Although a debt moratorium might help halt the loss of deposits from Brazilian banks, West European, Japanese, and small US banks probably would demand even tougher austerity measures by Brasilia in return for new money. Moreover, suspensions of payments would become increasingly attractive to other debtors in Latin America. 25X1

Colombian Payments Problems Worsen

Colombia faces a record $2 billion current account deficit this year and may not be able to avoid a debt financing crisis despite corrective measures already in effect. To improve the trade accounts, the Betancur administration recently hiked tariffs, accelerated the depreciation of the peso, and increased export subsidies. Bogota also has cut in half the annual foreign travel allowance and declared illegal private transfers to bank accounts abroad to halt capital flight. Although import growth may be checked, export earnings will improve only modestly in the face of declines in coffee, sugar, banana, and cotton sales. Moreover, forecasted declines in interest earnings, tourism receipts, and remittances from Colombians living abroad, as well as a 10-percent increase in interest payments will double Colombia's services deficit to $1.3 billion this year. 25X1

Bankers probably will be unwilling to substantially finance Colombia's 1983 payments deficit. Bogota already has encountered difficulties in raising an $80 million balance-of-payments loan because creditors were reluctant to increase their exposure in the face of unattractive lending terms. Banco Commerical Antioqueno—a Colombian commercial bank—had to underwrite $12 million to complete the syndication. To finance the payments deficit, however, Bogota will have to pay more for credit later in the year. If Colombia is unable to attract new international lending, it could soon encounter debt servicing problems. Reserves have fallen nearly $750 million during the first quarter of 1983, exceeding the loss for 1982 as a whole. If this rate of depletion continues, Colombia's $3 billion cushion of liquid reserves will be cut in half by midyear. 25X1

Natural Disasters Hurt Peru's Recovery Efforts

A series of natural disasters is adding to Lima's financial problems. Flooding in the north and drought in the south have caused nearly $190 million in food crop and livestock losses, according to Peru's National Planning Institute. Resulting food shortages will boost prices and require increased imports that will erode a planned $300 million trade surplus. Finance Minister Rodriguez Pastor set the cost of recovery, including rehabilitation of roads, housing, and agricultural infrastructure, at $500 million. Peru plans to seek an additional $200 million in new foreign loans to help fund reconstruction. Lima is already struggling to line up bank support for a $770 million medium-term loan, however, and we expect commercial banks will be reluctant to offer more money. 25X1

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Moroccan Labor Strife Increases

A railway strike, which began on 3 May, could pose serious problems for the economy, particularly if it is allowed to interrupt the transport of phosphates, Morocco's primary export. The already weak economy and the country's severe foreign financial crunch limit Rabat's ability to meet worker demands for higher pay and benefits. There have already been several incidents of sabotage and fighting between union members and military personnel attempting to maintain services. The strike, organized by the centrist Moroccan Worker's Union, is the largest labor dispute since the Casablanca riots in June 1981.

25X1

Communist

China To Invest in Foreign Raw Materials

Beijing has decided to invest part of its record foreign-exchange surplus in major overseas projects to acquire scarce raw materials. Earlier this year, the State Council authorized the China International Trust and Investment Corporation (CITIC) to develop several model projects, some of which had been under negotiation since 1980. A paper pulp mill in Canada is currently the front-running project, but Beijing has been examining similar investment opportunities in the United States, Australia, New Zealand, Brazil, and Chile. The Chinese require that such ventures be profitable and allow China access to both products and technology.

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Natural Disasters Hit Central China

The Chinese press reports that recent storms in Hunan Province have killed 339 people, injured at least 6,000, and destroyed 500,000 hectares of crops. An unusual pattern of cool, wet weather and hailstorms over the past month has destroyed crops on nearly 10 percent of the province's sown area, and crops have been affected over a much wider area. Hunan is one of China's major crop-growing regions and produces roughly 14 percent of the nation's rice crop. If the weather clears in the next few days, peasants still may be able to plant some of the early rice crop.

25X1

China Seeking New Markets for Textiles

China faces increasingly restrictive markets for textiles and apparel, which accounted for 25 percent of China's export earnings last year. Canada already has requested a downward revision of quotas on Chinese-origin textiles, and the European Community is now pressing for a new agreement that will protect its textile firms. Sino-US talks on textile quotas will probably resume next month. Beijing, meanwhile, already is looking for new markets and has arranged for additional sales to Eastern Europe and the Soviet Union. These markets, however, are unlikely to absorb the volume of goods China hoped to sell in North America and Western Europe and will not generate hard currency earnings.

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Western Europe: Caught in a Fiscal Squeeze

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West European governments face the dilemma of big budget deficits and slow growth. They are constrained from employing fiscal stimulus because they fear that existing deficits—now totaling $150 billion, 5 percent of West European GDP—are putting upward pressure on interest rates and retarding economic growth. At the same time, reducing budget deficits implies additional economic,

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Western Europe: Government-Sector Spending as a Share of GDP [a]

Percent

	1960	1970	1973	1974	1975	1979	1980	1981	1982
Western Europe	30.3	36.4	38.4	40.5	43.9	45.3	46.8	48.6	50.0
Big Four	32.5	37.8	39.6	41.9	45.4	45.5	46.5	48.5	49.8
West Germany	32.0	37.6	40.5	43.4	47.1	47.6	48.1	49.0	49.5
France	34.6	38.9	38.5	39.7	43.5	45.5	46.4	48.9	52.2
United Kingdom	32.6	39.3	41.1	45.2	46.9	42.0	44.0	45.1	44.2
Italy	30.1	34.2	37.8	37.9	43.2	45.6	46.4	51.1	53.6
Small Fifteen	25.4	33.6	36.1	37.5	40.7	44.7	47.3	49.0	50.4
Austria	32.1	39.2	41.3	41.9	46.1	48.8	48.5	49.7	53.2
Belgium	30.3	36.5	39.1	39.4	44.5	49.5	51.7	56.6	57.5
Denmark	24.8	40.2	40.2	44.3	47.5	51.4	55.3	56.3	57.5
Finland	26.7	31.3	31.9	32.9	37.1	38.5	38.2	39.0	40.8
Greece	23.8	29.1	28.9	31.7	32.5	35.2	35.8	39.8	42.2
Iceland	28.2	29.6	35.5	36.6	38.7	NA	NA	NA	NA
Ireland	28.0	39.6	38.9	43.1	47.2	49.0	53.1	55.8	56.6
Luxembourg	30.5	33.1	35.7	35.3	47.9	51.8	55.1	57.6	57.9
Netherlands	33.7	45.5	48.7	50.8	55.9	59.5	62.5	64.0	64.8
Norway	29.9	41.0	44.6	44.6	46.6	51.4	49.4	49.0	48.2
Portugal	17.0	21.6	21.3	24.6	30.2	30.4	33.6	36.5	39.2
Spain	13.7	22.2	23.0	23.1	24.7	30.5	32.4	34.5	35.8
Sweden	31.1	43.7	44.9	48.1	49.0	65.1	65.7	66.7	68.9
Switzerland	17.2	21.3	24.2	25.5	28.7	30.2	29.7	28.4	30.4
Turkey	NA	21.9	NA	NA	NA	23.4	NA	NA	NA

[a] Includes central and local governments and autonomous social security agencies and excludes government-owned enterprises.

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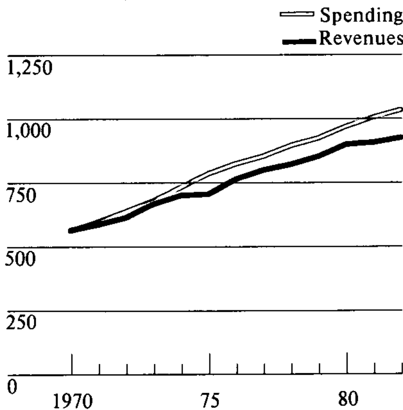
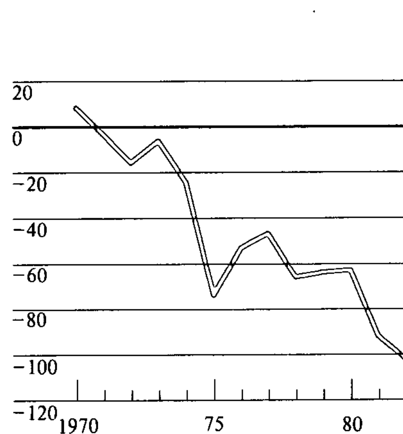
Western Europe: Domestic Economic Indicators

Note change in scale

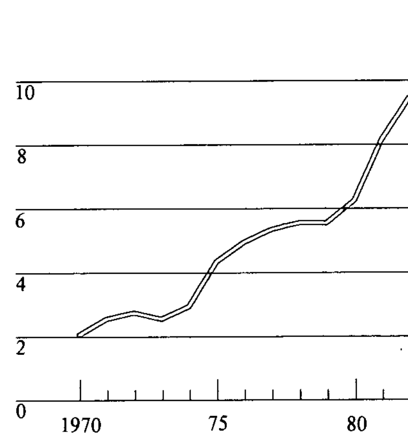
Government Sector Spending and Revenues
Billion 1975 $



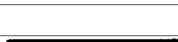
Government Sector Budget Balances
Billion 1975 $



Unemployment Rate[a]
Percent



[a] European Community only.



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political, and social strains on top of those generated by three years of stagnant economic activity.

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Most West European efforts to reduce deficits will be blocked by rising unemployment and high debt service costs. The economic upturn expected this year probably will only retard the rise in jobless rates, already in double digits in most West European countries. The falloff in interest rates that began in 1982 should ease part of the debt servicing burden, but financing the additional debt from last year's deficits should offset the savings from lower rates in several countries.

The Magnitude and Causes of the Deficits

To a large extent, Western Europe's fiscal difficulties stem from the depressive effects of the OPEC oil price rises over the last decade. During that period, Western Europe's commitment to maintaining social programs kept total spending rising more rapidly than GDP. From 1973 to 1981, government spending as a share of GDP increased by 10 percentage points, rising to nearly 50 percent. About one-half of the increase in the EC went to higher outlays for social benefits, one-fourth for government salaries, and one-fifth for interest on public debt.

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Government revenues grew at a slower pace. By 1981, total revenues of the West European governments amounted to about 44 percent of their combined GDP, up 6 points from the 1973 level. For most countries, the tax bracket creep that accompanies inflation provided the largest share of additional revenues. In a few countries like West Germany, the United Kingdom, and Sweden, some tax rates were increased, particularly for value-added taxes (VAT).

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Unemployment Costs

The single largest factor contributing to the burgeoning deficits in Western Europe has been mounting unemployment. Unemployment has an even greater impact on West European budgets than on US budgets because West European benefits generally replace a greater share of the unemployed workers' previous income for a longer period. In West Germany, benefits replace 68 percent of income for the first two years of unemployment and 50 percent thereafter; in Belgium, the Netherlands, and Denmark, unemployment compensation and related welfare payments can provide up to 90 percent of previous income with no time limit. According to estimates by the Netherlands Central Bank, some jobless Dutch workers have more after-tax income than they earned while working. In the United States, unemployment compensation averages 25 percent of previous income for less than a year.

By using a combination of national government data on the costs of unemployment benefits and OECD estimates of the revenue losses caused by a 1-percentage-point change in unemployment rates, we estimate that the average government sector deficit of the Big Four [2] would disappear if roughly one-half of the unemployed found private-sector jobs. Most of the budgetary improvement would result from the additional taxes that the newly employed would pay. General government budgets would be balanced for West Germany if the unemployment rate fell 7 percentage points to 3 percent, for France if the rate dropped 3 points to 6 percent, and for the United Kingdom if the rate slipped only 2.5 points to 10.5 percent. Italy's government sector deficit, on the other hand, would fall by only about one-third if all the unemployed found jobs.

[2] The Big Four economies are West Germany, France, the United Kingdom, and Italy; together they account for two-thirds of Western Europe's GDP.

Debt Service Costs

Interest payments on public debt also have accounted for a large share of government deficits. The runup in interest rates, particularly during 1979-81, boosted the costs for new or rolled-over government borrowing as well as for loans based on floating rates. The Italian, Belgian, and Irish budgets were the most severely affected because of the size of their deficits and their relatively poor credit ratings. As each country's ability to borrow deteriorated, the governments turned more to short-term maturities for financing. As a result, interest costs for the three countries rose faster with each increase in interest rates than for other West European governments who still held long-term loans at lower rates. By 1981, Italian, Belgian, and Irish interest payments on government debt had reached 7.5 percent, 7.9 percent, and 8.4 percent of GDP, respectively.

Although the falloff in interest rates that began in 1982 should ease part of the burden, the additional debt from last year's deficits will offset the gain from lower rates in these countries. The strong US dollar also is hurting countries like Belgium, Denmark, and Ireland that rely heavily on foreign debt—usually dollar-denominated—to finance budget deficits.

Efforts To Reduce Deficits

West European governments are making a greater effort than in previous years to put a brake on spending while raising taxes modestly. Paris wants to limit central government borrowing this year to 3 percent of GDP—the same as last year. London plans to hold the public-sector borrowing requirement [3] to 2.75 percent of GDP in fiscal year

[3] Includes the deficits of the central government, local governments, and social security programs as well as borrowing by government-owned enterprises and quasi-governmental organizations.

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Western Europe: General Government Budget Balances as a Share of GDP [a]

Percent

	1960	1970	1973	1974	1975	1979	1980	1981	1982	1983 [b]
Western Europe	0.9	0.4	−0.6	−1.6	−4.2	−3.2	−3.1	−4.5	−5.0	−5.1
Big Four	0.9	0.1	−1.5	−2.5	− 5.6	−3.4	−3.1	−4.3	−4.6	−4.5
West Germany	3.1	0.3	1.2	−1.4	− 5.8	−2.9	−3.5	−4.0	−3.9	−3.6
France	0.9	0.9	0.9	0.6	− 2.2	−0.6	0.6	−1.5	−3.0	−3.1
United Kingdom	−1.0	2.6	−3.5	−3.8	− 4.9	−3.1	−3.2	−2.4	−2.0	−2.0
Italy	−0.9	−5.0	−8.5	−8.1	−11.7	−9.4	−8.4	−11.9	−12.0	−12.3
Small Fifteen	0.8	1.1	1.7	0.7	−0.6	−2.6	−3.1	−5.1	−6.0	−6.2
Austria	−0.4	1.0	1.3	1.3	−2.5	−2.5	−2.0	−1.8	−2.2	−2.4
Belgium	−2.9	−1.1	−2.7	−1.8	−4.1	−6.9	−9.3	−13.4	−12.8	−12.1
Denmark	3.1	2.1	5.9	4.5	−1.7	−1.6	−3.2	−7.1	−9.5	−9.6
Finland	3.9	4.4	5.8	4.7	2.7	0.5	0.8	1.3	−0.4	−0.8
Greece	−3.7	−2.3	−3.5	−4.7	−5.1	−4.6	0.4	−10.1	−9.2	−8.6
Iceland	8.2	2.2	0.9	−2.4	−3.1	−2.2	−1.4	0.1	0.2	0.2
Ireland	−1.3	−4.0	−4.1	−7.5	−11.6	−12.8	−15.4	−15.4	−14.7	−14.4
Luxembourg	3.0	2.9	3.5	5.1	1.2	0.1	−1.8	−0.8	−0.9	−1.0
Netherlands	0.8	−0.8	1.1	−0.1	−2.7	−3.7	−4.1	−7.4	−8.4	−8.2
Norway	3.8	3.2	5.7	4.7	3.8	1.8	5.7	5.1	5.2	3.9
Portugal	0.6	2.7	1.4	−1.6	−5.5	−8.1	−8.8	−10.2	−10.3	−10.2
Spain	NA	0.7	1.1	0.2	NEGL	−1.8	−3.3	−4.0	−6.0	−6.3
Sweden	2.0	4.4	4.1	2.0	5.1	−3.0	−3.8	−5.3	−6.6	−8.0
Switzerland	NA	NA	NA	NA	NA	−0.5	NEGL	−0.2	−0.5	−0.8
Turkey	NA	2.1	NA	NA	NA	NA	NA	NA	NA	NA

[a] Includes central and local governments and autonomous social security agencies and excludes government-owned enterprises.
[b] Estimated.

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1983/84, down from the 3.25-percent target in fiscal year 1982/83. Brussels hopes to trim central government borrowing from 1982's 12.8 percent of GDP to about 12.0 percent this year.

Public-sector salaries, which average more than 25 percent of government spending, are a prime target of budget cutters. Several governments are trying to keep the nominal increase in total public-sector pay at or below the expected inflation rate in 1983. The new Dutch Government is freezing pay, increases are being limited to 3.5 percent in the United Kingdom, 4 percent in Denmark, and 6 percent in Belgium. Both France and Italy plan to hold government raises to projected increases in consumer prices. In general, real spending on public salaries is to be perhaps $3 billion less than if salaries had risen as rapidly as inflation.

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A number of West European governments also are beginning to tackle what they believe is the more fundamental—and certainly more politically sensitive—problem of social welfare spending, which

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Selected West European Countries: General Government Debt as a Share of GDP [a]

Percent

	Total	Domestic	Foreign	Short Term	Long Term
1973					
Big Four					
West Germany	17.8	17.4	0.4	1.9	15.9
France [b]	16.9	16.2	0.7	13.0	3.9
United Kingdom [c]	71.9	60.9	10.9	26.1	30.7
Italy [d]	46.1	NA	NA	25.3	20.8
Other					
Belgium	64.2	63.6	0.6	6.9	57.3
Denmark [e f]	−13.6	−17.9	4.3	0	7.4
Greece [b]	19.5	14.4	5.1	8.0	11.5
Ireland [b f]	53.0	48.3	4.7	NA	NA
Luxembourg [b]	21.5	17.9	3.6	1.4	20.1
Netherlands	41.4	NA	NA	3.5	37.9
1981					
Big Four					
West Germany	35.1	30.8	4.3	4.2	30.9
France [b]	17.3	16.8	0.5	12.2	5.1
United Kingdom [c]	58.8	51.8	7.0	18.6	30.9
Italy [d]	64.9	NA	NA	44.8	20.1
Other					
Belgium	88.6	77.7	10.9	24.9	63.7
Denmark	16.3	2.5	13.8	7.2	36.1
Greece [b]	40.4	32.6	7.8	14.1	26.3
Ireland [b]	98.4	62.7	35.7	NA	NA
Luxembourg [b]	22.1	20.1	2.0	0.8	21.3
Netherlands	47.2	NA	NA	5.8	41.4

[a] Data may understate total government debt in cases where government-owned banks borrow in their own names for the state.
[b] Central government.
[c] Public sector. Data on maturities do not add to the total shown because some British public debt has no maturity date.
[d] Excludes central government debt owed by autonomous central government bodies,the postal savings system, and local governments.
[e] Minus sign represents net creditor position; maturity data show gross borrowing.
[f] Data are for 1974.

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accounts for almost one-half of government spending in the European Community. West Germany and France are delaying cost-of-living increases on social security benefits; the Netherlands and Belgium are placing a cap on social security adjustments; and Denmark is freezing benefits. Paris not only is looking for ways to cut spending on old-age benefits, but also wants to reduce unemployment compensation. For its part, the government of West German Chancellor Helmut Kohl has changed the formula for calculating unemployment benefits to make the allowances less costly to the government.

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Governments are looking for fixes on the revenue side as well. Increases in the VAT and other indirect taxes such as those on gasoline, tobacco, and liquor are slated to go into effect this year in West Germany, France, the United Kingdom, Italy, Sweden, Belgium, Norway, Finland, Greece, Portugal, and Ireland. Oslo and London, however, are offsetting some of the indirect tax increases by trimming income tax rates. Several countries are also raising social security taxes.

Results of the Budget-Cutting Exercise

We believe that the changes in spending and tax policies approved this year are generally too small to overcome the impact of mounting unemployment benefits and related revenue losses, and increasing debt servicing costs. Sweeping budget cuts have been ruled out because strong public support for existing social programs has encouraged politicians to defend current spending policies. The changes, however, should keep government deficits from expanding significantly in 1983 and lay the groundwork for substantial improvement next year, when the economic recovery is expected to pick up steam.

Paris probably will keep the central government deficit from rising, but the deficits of local governments and the social security and unemployment funds are likely to grow. After running a smaller deficit than planned in 1982, the British government sector deficit will increase somewhat this year as tax cuts take effect. Nonetheless, the United Kingdom will still have proportionally the smallest government sector deficit of the Big Four. The Italian government sector budget is likely to slip further into deficit because of relatively slow GDP growth and Rome's inability to control spending. The spending cuts and tax changes put in place by the Kohl government should lower the West German deficit this year, and similar measures should bring down deficits in Belgium, the Netherlands, and Ireland, as well.

Prospects for Future Budget Balancing

We believe that most West European governments will put more emphasis on reducing budget deficits over the next few years than using government spending as an economic booster. Only the United Kingdom, where the deficit has already been trimmed significantly, and perhaps the Scandinavian countries are likely to provide more fiscal stimulus. Leaders in countries running large budget deficits appear convinced that the negative impact of high interest rates aggravated by the deficits more than offsets the gains from fiscal stimulus. West German Economics Minister Lambsdorff's unhappiness with the budget deficit contributed to his Free Democrats' defection from Helmut Schmidt's coalition.

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Moreover, we believe that a groundswell of public support for major spending programs is unlikely to develop soon. The surprising public quiescence results from a number of factors:

- Generous government benefits have reduced much of the economic deprivation caused by unemployment.
- The steady rise in joblessness over the last 10 years may have made the public less sensitive to this problem.
- Earlier unsuccessful efforts by the Mitterrand government to stimulate the French economy may have convinced many West Europeans of the futility of unilateral action.

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Nonetheless, public concern over the economy remains high, even where other political issues have been in the forefront. According to West German Finance Minister Gerhard Stoltenberg and other observers, West German voters—as well as other West Europeans—want stable, noninflationary economic growth, and they increasingly doubt the ability of higher government spending to provide it. Since the recession began in 1979, West Europeans have turned more often to political parties that promised restraint in government spending than to those offering new government programs.

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Implications for the United States

Efforts to reduce budget deficits significantly through politically acceptable domestic measures will prove unsuccessful this year and will lead the West Europeans to rely increasingly on the US economy to pull the region out of its economic malaise. In effect, West Europeans expect the United States to become the "locomotive" for industrial country growth.

With additional fiscal stimulus ruled out in most West European countries, we believe that governments will try to ease their own monetary policies in an effort to prompt economic growth. These efforts will lead to further West European demands for lower US interest rates. Several West European central bankers, such as Bundesbank President Karl Otto Poehl and Swiss National Bank President Fritz Leutwiler, have publicly blamed the mix of tight US monetary policies and growing budget deficits for the continuation of high real interest rates in Western Europe.

The West Europeans also argue that, without a comparable reduction in US rates, West European currencies would weaken against the US dollar and lead to increased inflation from rising import prices. More expensive imports would lead to a drop in total West European purchasing power at a time of slow economic growth. Although a strong dollar would increase West European exports and reduce the competitiveness of US products, West European leaders appear convinced that a further strengthening of the dollar is not in their countries' best interests.

Even if West European governments reduce their deficits and US interest rates come down, pressure will continue to build on West European governments to protect jobs through trade restrictions. We believe that West European economies are unlikely to improve enough over the next year or two to reduce unemployment substantially. Political pressure to erect trade barriers probably will mount even faster once the West European economic recovery is clearly under way and unemployment remains high.

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OECD: Slow Recovery in 1983

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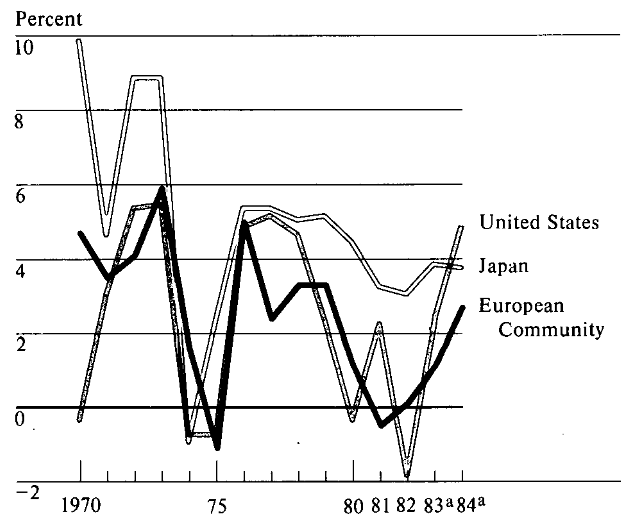
The OECD economies appear to be pulling out of the recession, but not uniformly or rapidly. Growth in the United States and Japan, for example, is expected to outpace growth in most of Western Europe. While most OECD governments are attempting to relax their monetary policies, most also are trying to cut budget deficits. Consumer spending will be held back by the depressed labor market, and investment for machinery and equipment will be slack because unused capacity and real interest rates are high. Although increased trade among OECD countries will help recovery, exports to non-OECD countries probably will slip in real terms. With overall OECD economic growth likely to advance only 2.0 percent this year, unemployment will continue rising, particularly in Western Europe. Inflation, on the other hand, should slow, perhaps to only 5 to 6 percent—the smallest price rise since 1972. If, as we expect, the recovery continues to develop throughout 1983, the stage should be set for more rapid growth in 1984.

OECD: GNP, for Selected Countries



a Projected.

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The Upturn

We expect economic growth in the OECD to gather speed through the year, but in most countries growth will be comparatively weaker than in previous recoveries. For the non-US OECD countries, we expect real economic growth to average 1.7 percent, with the Big Six expanding 1.9 percent and the smaller countries growing at 1.0 percent. The recession appears to have bottomed out in most major countries by the end of 1982 or the first quarter of 1983. Leading indicators have been rising in most countries for the past six months, and industrial production recently has begun to improve.

The recent fall in interest rates, the decline in oil prices, the end of inventory destocking, and lower inflationary expectations are all factors which should help promote the economic recovery. Indeed, economic sentiment, as measured by surveys of industrialists and by stock exchange prices, has been improving since the beginning of the year.

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Unlike previous rebounds, however, no individual country or economic sector will be sufficiently dynamic to lead the OECD economies out of recession.

In most of the Big Six countries, consumer spending will remain weak this year. Although recent surveys in the European Community indicate that consumers have adopted a less pessimistic view of the economic and financial situation, the surveys also show that consumers remain unwilling to purchase big ticket items. We believe continued high unemployment rates and expected low wage gains will inhibit a pickup in spending by the Europeans. Consumers are expected to reduce real spending in France as higher taxes and utility rates cut into other consumption. Consumer spending in the United Kingdom and Japan will be relatively buoyant; London reduced personal income taxes this year, and Japanese consumers are trimming savings to maintain spending.

The outlook for private investment in the OECD is also mixed. Japan, West Germany, and the United Kingdom will likely show 2- to 3-percent real growth in investment, while Canada, France, and Italy will show a decline of 2 to 4 percent. Lower nominal interest rates probably will lead to increased housing starts in most countries. Between January 1982 and March 1983, interest rates in West Germany and the United Kingdom dropped 4 and 3 percentage points to 6 and 11 percent, respectively, while interest rates in Japan have remained a low 7 percent. Continuing high real interest rates, however, will likely impede business investment in most countries. Long-term interest rates are running about 4 percentage points higher than inflation in each of the Big Six countries. In addition, the high level of excess industrial capacity, about 24 percent in the European Community, will impede new investment.

Unlike the situation following the 1974/75 recession, exports will not be a major driving force in the recovery. While export growth in some OECD countries may exceed real GNP growth, most of the advance will come from increased sales to other developed countries. Of the Big Six, only Japanese export growth is likely to grow by a considerable amount—exports of goods and services should advance by more than 5 percent. Export growth in the other five countries should range from about 1.5 percent in Canada to 2.7 percent in West Germany. Relatively high US growth along with continued

OECD: GNP Growth Rates *Percent*

	1982	1983 [a]	1984 [a]
OECD	**−0.2**	**2.0**	**3.7**
United States [b]	−1.8	2.5	4.9
Non-US OECD	**0.7**	**1.7**	**2.9**
Big Six	0.8	1.9	3.1
Japan	3.0	3.8	3.7
West Germany	−1.1	1.0	2.9
France	1.6	0.2	2.7
United Kingdom	1.4	2.3	3.0
Italy	−0.3	0.4	2.9
Canada	−4.8	1.4	3.1
Smaller countries	0.6	1.0	2.2
Australia	1.1	−1.0	3.0
Austria	1.0	0.8	2.3
Belgium	−1.0	1.1	1.8
Denmark	2.5	1.4	2.2
Finland	1.1	2.9	2.4
Greece	0.5	1.4	2.6
Iceland	−3.9	−2.3	3.6
Ireland	1.9	1.3	3.1
Luxembourg	−0.5	1.4	2.1
Netherlands	−0.1	−0.6	1.9
New Zealand	0.1	0.6	2.4
Norway	−0.1	1.1	2.1
Portugal	1.0	1.2	2.3
Spain	1.2	0.8	2.2
Sweden	−0.7	1.8	2.1
Switzerland	−1.3	0.6	−0.4
Turkey	4.0	4.5	4.2

[a] CIA forecast.
[b] Data Resources, Inc. forecast.

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strength in the dollar will help exports in the other OECD countries.

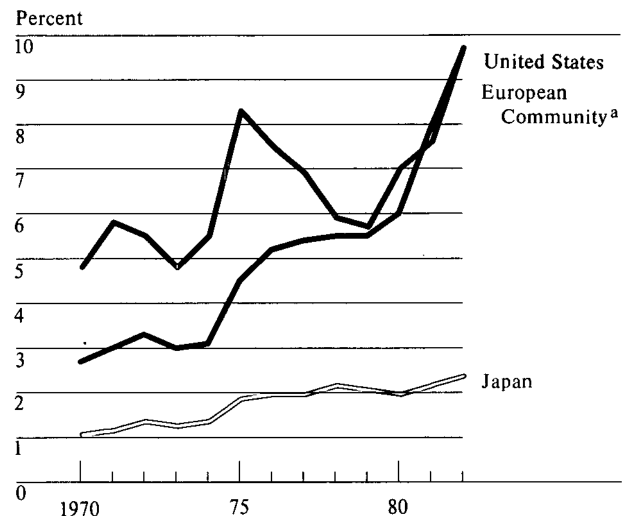
The LDC market—which accounts for 25 percent of OECD exports—probably will shrink by 1 to 2 percent in 1983. OPEC countries are scaling back their imports because of the decline in oil revenues. The financial difficulties of many nonoil LDCs and continuing weak demand for raw materials and other commodities will curb nonoil LDC imports as well.

Government Policies

On balance, the overall government policy mix this year should have a slightly positive impact on economic growth. Although most governments are tightening fiscal policies, monetary policies generally are being relaxed. In Western Europe, the attempt to tighten budgetary policy is not likely to succeed in 1983 because mounting unemployment and automatic spending increases should hold budget deficits to about the same size as last year.

Because of budgetary difficulties, we believe most OECD governments will rely on monetary policy to help pull their economies out of the economic slump. Foreign governments, however, are unwilling to push down interest rates further without a comparable reduction in US rates. West European leaders argue that unilaterally lowering their rates would lead to capital outflows and depreciated currency, which in turn boosts import costs and raises inflation. The Japanese are also concerned about defending their currency.

OECD: Unemployment Rates for Selected Countries



[a] Does not include Denmark, Ireland and Greece.

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Implications of Slow Growth

Worsening Unemployment. Despite the improved economic outlook, the OECD economies will not grow rapidly enough in 1983 to prevent unemployment from rising because increases in the labor force will outpace the creation of new jobs. For 1983, unemployment in the Big Six is expected to average 13 million—25 percent above the average 1982 level. The United Kingdom will continue to have the highest unemployment rate of the Big Six—probably averaging 13 percent for the year. With the exception of Japan, the rest of the Big Six countries likely will see unemployment rates grow to an average 10 percent in 1983. Unemployment in Japan should hover around 2.5 percent this year and next.

Although unemployment rates are lower in many of the smaller OECD countries than in the Big Six, the number of jobless still should top 9 million this year. Extensive government employment programs in the Scandinavian countries, a high number of self-employed workers in Greece, and the expulsion of foreign workers from Switzerland account for the lower rates in those countries. In both Turkey and Spain nearly 20 percent of the labor force will be jobless.

Slowing Inflation. Economic recovery is not likely to be vigorous enough to cause a renewed upsurge in inflation. We expect inflation rates to continue to

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OECD: Change in Consumer Prices *Percent*

	1982	1983 [a]	1984 [a]
OECD	**8.3**	**5.3**	**6.0**
United States [b]	6.2	3.0	4.6
Non-US OECD	**9.6**	**6.8**	**6.8**
Big Six	7.6	5.9	6.2
Japan	3.0	3.7	4.5
West Germany	5.2	2.9	3.0
France	11.6	9.5	8.6
United Kingdom	8.5	5.4	7.6
Italy	16.6	13.1	11.7
Canada	10.8	6.9	6.3
Smaller countries	15.1	9.2	8.8
Australia	11.0	8.0	6.7
Austria	5.3	3.4	4.2
Belgium	9.0	8.1	6.4
Denmark	10.0	7.0	7.3
Finland	10.3	8.2	6.9
Greece	21.0	19.2	19.7
Iceland	60.0	57.0	49.3
Ireland	16.3	13.0	11.7
Luxembourg	9.4	8.0	6.2
Netherlands	6.0	3.6	3.0
New Zealand	17.4	13.7	14.2
Norway	12.2	11.5	10.0
Portugal	22.4	22.2	20.7
Spain	14.4	13.5	13.7
Sweden	10.0	10.7	7.7
Switzerland	4.0	3.2	3.2
Turkey	30.0	24.2	19.7

[a] CIA forecast.
[b] Data Resources, Inc. forecast.

decline this year—to an average 5.3 percent for the OECD countries, less than one-half the 1981 rate. For the Big Six, inflation will drop to below 6 percent, with rates of less than 4 percent for West Germany and Japan. Inflation in France and Italy should continue to be high, although improving.

Paris's austerity package will help to contain inflation in France. Nevertheless, prices will rise at near double-digit rates, in part because of the 21 March realignment of the European Monetary System (EMS). While the franc was devalued only 2.5 percent against the European Currency Unit, it was effectively devalued 8 percent against the West German mark; the Federal Republic is France's largest source of imports. For other major OECD countries, improvements on the price front will stem mainly from weak consumer spending, moderating wage demands, weak oil and nonoil commodity prices, tight fiscal policies, and high but declining interest rates.

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The smaller OECD countries also should experience a significant drop in inflation—from 15 percent in 1982 to 9 percent this year. Switzerland, Austria, and the Netherlands will be at the low end with inflation between 3 and 4 percent. Greece and Turkey will continue to improve but should still be coping with price rises of over 20 percent.

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An Improving Current Account. Lackluster recovery in many OECD countries, coupled with lower oil prices, should help improve the current account position of the OECD as a whole this year. We expect the OECD deficit to shrink to $4 billion—a $27 billion improvement over last year. If, as we expect, the price of crude oil averages about $5 less per barrel this year than last, this decline alone would improve the aggregate OECD current account by as much as $30 billion—assuming no change in the volume of oil imports—and thus lower average OECD import prices. Moreover, we believe continued weak consumer demand will hold down other commodity import prices at least until the second half of the year.

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The lower oil prices and faster US import growth should be a boon to the current accounts of other OECD countries. For the Big Six, the balance should swing into a strong surplus—$27 billion—for the first time since 1978. Japan's surplus of $24 billion will far outpace the others. West Germany

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OECD: Current Account Balances *Billion US $*

	1982	1983 [a]	1984 [a]
OECD	**−30.9**	**−3.8**	**−9.4**
United States [b]	−8.1	−17.3	−20.8
Non-US OECD	**−22.8**	**13.5**	**11.4**
Big Six	−0.2	27.4	26.3
Japan	7.6	23.5	24.3
West Germany	3.1	10.5	12.5
France	−13.0	− 7.1	− 5.4
United Kingdom	7.2	3.0	−1.0
Italy	−7.1	−4.1	−3.8
Canada	2.0	1.6	−0.3
Smaller countries	−23.0	−13.9	−14.9
Australia	−8.6	−7.5	−8.0
Austria	−0.1	0.8	1.0
Belgium-Luxembourg	−4.0	−2.4	−3.3
Denmark	−2.0	−1.5	−1.5
Finland	0.2	0.4	0.3
Greece	−2.1	−2.2	−2.6
Iceland	−0.2	−0.2	−0.2
Ireland	−1.6	−1.1	−1.3
Netherlands	5.4	7.7	8.8
New Zealand	−1.7	−1.0	−1.4
Norway	0.4	−2.5	−2.4
Portugal	−3.3	−2.8	−2.7
Spain	−4.1	−3.5	−3.8
Sweden	−3.6	−2.2	−1.1
Switzerland	3.5	4.6	4.2
Turkey	−1.2	−0.9	−0.9

[a] CIA forecast.
[b] Data Resources, Inc. forecast.

should come in second with an estimated $10 billion surplus. The French and Italian current account deficits will improve to $7 billion and $4 billion, respectively. Declining oil prices, however, will hurt the British and Canadian surpluses. The aggregate current account position of the smaller countries will show substantial improvement but still will register about a $14 billion deficit. Only the Netherlands and Switzerland will record significant surpluses.

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Prospects for 1984

We expect OECD economic growth to pick up speed next year as a self-sustaining recovery takes hold. For the non-US OECD, GNP growth should average 3 percent in 1984, with the Big Six growing faster than the smaller OECD countries. On the policy front, measured relaxation in monetary policies should help bring down real interest rates which in turn should stimulate business and consumer spending without rekindling inflation. The pace of economic growth also should be sufficient to halt the climb in unemployment.

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We expect inflation to continue at about the same rate as this year in non-US OECD countries despite faster GNP growth. As recovery continues, unused capacity will be reemployed and businesses may attempt to rebuild profit margins; these events, however, should not increase inflation until late 1984 or early 1985. Moreover, we expect nonoil commodity prices to rise only slightly and oil prices to remain stable at around $29 per barrel. Of the Big Six, only Italy will continue to have double-digit inflation in 1984. Japanese and West German inflation rates should remain about 3 to 4 percent. Some of the smaller OECD countries will make progress in lowering inflation, but Greece, Iceland, Portugal, and Turkey are expected to be coping with inflation still above 20 percent.

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The OECD current account balance probably will deteriorate somewhat in 1984. Most of the worsening in the balance is likely to occur where economic growth is relatively stronger, such as the United Kingdom, Canada, and the United States. In these countries import growth is expected to outpace export growth. Improved price competitiveness and less-than-average real GNP growth should enable

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West Germany to boost its current account surplus again in 1984, perhaps reaching $12 billion. Japan's enormous surplus is likely to level off at about $24 billion.

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Japan: No Resurgence in Growth This Year

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Domestic policy choices, a poor investment climate, and voluntary restraints on exports will prevent Japan's economy from staging a strong recovery this year. Even now there are only tentative signs that the economic stagnation that has plagued Japan since mid-1981 may be coming to an end. We foresee 3.4-percent real GNP growth in FY 1983 (1 April 1983–31 March 1984), almost the same as last year. We also expect a significant increase in the current account surplus.

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Two Years of Stagnation

The Japanese economy initially looked as though it would rebound quickly after the oil price hikes of 1979/80, but the promising signs disappeared rapidly:

- In late 1979 the growth of government spending began to decelerate as the Ohira administration embarked on a "fiscal reconstruction" campaign to curtail the government deficit.
- With industrial production lagging, labor had to swallow real wage cuts and private consumption weakened.
- By the time consumption revived in 1982, declining world trade and rising protectionism had crippled export performance—the previous mainstay of growth.
- Large manufacturing firms also scaled back investment plans, further dampening economic growth.

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The decline in exports did not prevent an improvement in the current account in 1982. The surplus rose from $4.8 billion in 1981 to $7.6 billion, in part because higher interest rates abroad boosted investment income. Imports declined as firms drew down raw material inventories built up in 1980 when forecasters were optimistic about growth prospects.

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Signs of Recovery Prove Elusive

So far, the indicators have not given a clear view of whether economic growth is being rekindled. Japan's Economic Planning Agency's (EPA) index of leading indicators edged upward in January, only to tumble in February. Individual components of the series also reveal a mixed economic picture:

- New orders for machinery and construction remain well below year-earlier levels.
- The ratio of producers' inventories to shipments has declined from the peak reached in May 1982, but still remains above 1980 levels.
- One positive sign is that the index of hours of overtime worked in the manufacturing sector registered moderate increases in the first two months of the year.

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Reflecting the level of uncertainty, most Japanese officials are reluctant to declare the recession over. In an economic assessment issued in April, the EPA indicated labor conditions—such as the ratio of job openings to applicants—are likely to worsen and investment to remain weak in coming months. The Bank of Japan, focusing on a recent pickup in exports and on the progress made in inventory adjustment, is more confident that the worst is over and recovery is at hand. However, they caution that the upturn is likely to be moderate.

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Policy Constraints

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Japanese officials cite several obstacles blocking efforts to hasten the recovery. Bank of Japan officials have been reluctant to ease monetary policy because such a move might lead to a resurgence of long-term capital outflows. Last year's

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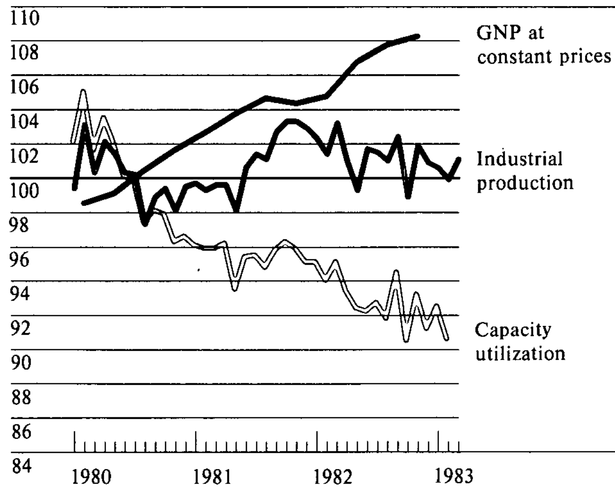
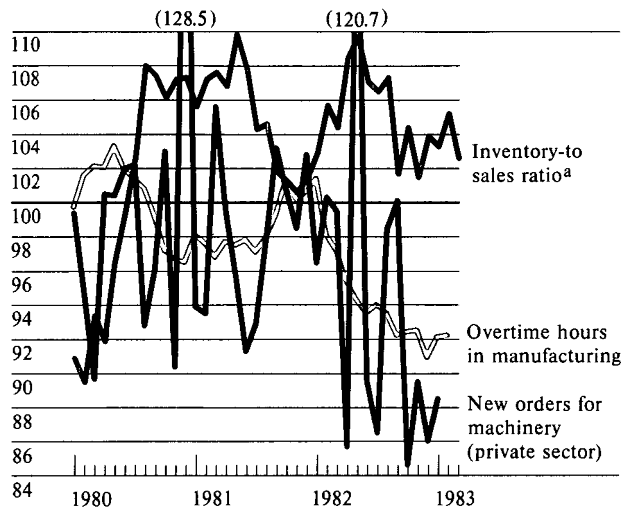
Japan: Economic Indicators





[a] Reverse cycle, so lower numbers indicate improvement.

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13-percent depreciation of the yen against the dollar resulted in part from the net outflow of $15 billion in long-term capital.

Fiscal stimulus has also been ruled out because of uneasiness over the rapid growth of the government deficit during the last decade and qualms about mounting refinancing needs.[1] General account expenditures by the central government in FY 1983 are budgeted to be only 6 percent above the austere FY 1982 spending levels.

Japan: FY 1983 Economic Forecasts

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	CIA	GOJ	EPA
GNP *(percent change)*	3.4	3.4	3.3
Consumption *(percent change)*	3.7	3.9	4.4
Contribution of foreign demand to GNP *(percentage points)*	0.7	NA	0.5
Current account balance [a] *(billion US $)*	23.5	9.0	17.0
Consumer prices *(percent change)*	3.4	3.3	2.6
Yen per dollar	227	255 [b]	235 [b]

[a] Calendar year.
[b] Exchange rate prevailing when forecasts made; forecasters made no attempt to predict the yen's future value.

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Pessimistic Forecasts Abound

We are bearish about the short-term growth prospects for the Japanese economy. Our 3.4-percent real GNP growth forecast for FY 1983 matches the official Japanese projection. Like theirs, our forecast assumes that government investment spending will be concentrated in the first half of the year and that the discount rate will be lowered; we have assumed a 0.5-percentage point cut in midsummer.

Even with these assumptions, the FY 1983 growth rate will be little changed from the rate in FY 1982 of 3.5 percent. The US Embassy in Tokyo, forecasting on a calendar year basis, has reached the same conclusion. A forecast made in March by Japan's EPA displays slightly greater pessimism—they predict the growth rate in FY 1983 will be 3.3 percent.

Prospects for Private Sector Mixed

On the positive side, falling energy prices and an expected upturn in trading partners' economies should benefit Japan this year, although not as much as might be expected. The drop in oil prices will reduce Japan's import bill by an estimated $7-8 billion this year. MITI bureaucrats, however, remain reluctant to pass these savings along to industry and households in the form of lower utility rates.

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Negative developments in the private sector seem to outweigh the positive ones. The recent record-low wage settlements, although a positive development as far as prices are concerned, will hold down personal consumption. Businessmen, aware of constraints on domestic growth and concerned by rising protectionism, are wary of investing in plant and equipment. Surveys of anticipated capital spending, conducted by a variety of banks and government agencies, are uniformly pessimistic. If these surveys prove accurate, FY 1983 growth in private investment will be the lowest in six years.

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Current Account Uncertainties

For all forecasters, the current account proved the most difficult item to predict last year for Japan; the same will likely be true for 1983. In 1982 overly

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optimistic assumptions about the growth of world import volume led to inflated estimates:

- Our forecast made in January 1982 assumed 4.5-percent world import growth (excluding Japan) and predicted an $18.5 billion surplus—$11 billion above the actual outcome. Measured in 1975 dollars, world trade increased only 1.5 percent last year.
- An OECD forecast made at the same time and positing 3-percent world import growth predicted a $14.5 billion surplus.
- In January 1982, Data Resources (DRI) was projecting a $19 billion surplus.

Our projection of a $24 billion current account surplus in 1983 assumes 2.4-percent world import volume growth. If trade picks up more rapidly than we have assumed—say by an additional percentage point—Japan's current account surplus could approach $27 billion. The current weakness of the yen and the relative strength of the dollar put Japanese exporters in a good position to garner an increasing share of world exports. We have also assumed a moderate appreciation of the yen—especially in the second half of 1983. Our best guess is that the yen will end the year around 220 to the dollar, reflecting the increase in the current account surplus and some decline in capital outflows because of lower US interest rates compared with 1982. Even with this appreciation, however, the yen would still be below its 1981 level on a trade-weighted, price-adjusted basis.

The existence of numerous export restraints, however, raises the alternative risk—that our current account forecast is too high. Estimates on the share of Japanese exports affected by restrictions range from 15 percent to 65 percent of the total. However, it is not clear that restrictions significantly alter the dollar volume of sales. In cases where restrictions limit export volume, such as Japanese auto shipments to the United States, Japanese firms are raising prices and shipping more costly cars.

While the size of the current account surplus is debatable, it is certain that it will exceed last year's level. The other major forecasters—including the US Treasury, DRI, and the EPA—are all calling for an increase. In first-quarter 1983, Japan posted a $14 billion surplus, seasonally adjusted at an annual rate.

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Expansionary Fiscal Policy?

Another area of uncertainty in our forecast concerns fiscal policy. We have assumed that the Nakasone administration will stick with its conservative, budget-cutting policies. But a poor showing in the upper house elections scheduled for 26 June might prompt the government to change course if leading indicators do not improve by midsummer.

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We believe, however, that any likely fiscal policy stimulus would not add significantly to Japanese growth. A spending increase of 500 billion yen ($2 billion) in the second half of the fiscal year would, according to our calculations, add only 0.2 percentage point to the real growth rate and would cut the current account surplus by $300 million. If Tokyo opts to cut personal income taxes by this amount rather than boost spending, the impact is even smaller because of the high propensity to save out of windfall income. We estimate that 75 percent of a tax cut would be saved, permitting less than a 0.1-percentage-point gain in real GNP growth.

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Western Europe: Implications of Energy Import Dependence

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Our analysis of recent industry forecasts indicates that Western Europe will continue to rely on imports for 40 to 50 percent of total energy supplies through the end of the century. Imports are expected to account for three-fourths of total oil demand throughout the period and as much as 50 percent of total gas requirements. As a result, Western Europe will remain extremely vulnerable to energy supply disruptions, especially if the energy market begins to tighten in the early 1990s as most of these forecasts project.

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European Dependence

Despite lower energy use and increased production of oil and nuclear power, Western Europe still relied on imported energy for more than 40 percent of its energy in 1982. This compares with about a 60-percent reliance on imported energy in 1973:

- Net oil imports of about 9 million b/d supplied about 75 percent of oil requirements in 1982 and 35 percent of energy consumption.
- Natural gas imports accounted for about 15 percent of European gas use.
- Coal imports in 1982 amounted to about 1 million b/doe or nearly 20 percent of coal consumption.

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Energy Market Outlook

We examined an array of projections completed in the past five months to assess energy requirements in Western Europe through the year 2000. Most forecasters expect soft market conditions to continue through the 1980s with gradually rising oil demand beginning to tighten the oil and energy markets around 1990. Under these conditions, surplus production capacity will be sufficient to handle a moderate oil supply interruption through most of the 1980s. As the oil supply cushion erodes around the end of the decade, Western Europe will become increasingly vulnerable to supply disruptions.

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Western Europe: Energy Supply and Demand Projections [a] — *Million b/doe*

	1980	1990	2000
Energy consumption	**25.5**	**27.7-28.4**	**30.8-34.2**
Net imports	12.9	11.0-12.7	13.9-17.4
Oil consumption	13.5	10.7-12.8	8.4-13.4
Oil production	2.4	2.7-3.3	2.4-2.9
Net imports	11.2	7.9-9.8	6.0-11.0
Natural gas consumption	3.6	3.9-4.5	4.6-5.1
Natural gas production	3.2	2.9-3.3	2.5-3.3
Net imports	0.5	0.8-1.5	1.3-2.5
Coal consumption	5.6	6.0-7.8	7.1-11.3
Coal production	4.5	4.4-4.6	4.4-5.2
Net imports	1.2	1.8-3.2	4.0-6.1
Hydro-Nuclear	2.8	5.3-5.9	6.6-7.8

[a] Based on recent industry projections.

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These forecasts indicate that the decline in energy consumption in recent years is expected to bottom out this year, and West European energy consumption is projected to rise 31-34 million b/doe by

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2000. Most of the increase in energy demand is expected to be met by nonoil fuels:

- Almost all forecasts argue that West European oil consumption will hold fairly steady or decline over the balance of the century. Forecasts of West European oil consumption in 1990 are 11-13 million b/d. Oil consumption in 2000 is projected to be 8-13 million b/d.
- Recent forecasts project that the region's gas demand will rise from 3.6 million b/doe in 1980 to about 3.9-4.5 million b/doe in 1990 and range between 4.6 and 5.1 million b/doe by 2000. Most of this growth in demand probably will occur in the residential/commercial sector.
- Forecasts of West European coal consumption range from 6 to 8 million b/doe in 1990 and from 7 to 11 million b/doe in 2000.
- Nuclear and hydro production combined are expected to rise sharply and approximate 7-8 million b/doe by 2000.

Implications for Energy Trade

Most forecasts expect Western Europe to depend on imported energy for 40 to 50 percent of total requirements in 2000. Reliance on imported energy in individual West European countries will vary widely. The United Kingdom, Norway, and the Netherlands will remain self-sufficient, while dependence on imported energy in West Germany and France is expected to approximate 50 to 60 percent. Reliance on imports in Italy is projected to exceed 80 percent through 2000.

Oil. West European reliance on imported oil is expected to fall to 8-10 million b/d in 1990 and 6-11 million b/d by 2000, or roughly 20 to 30 percent of energy requirements. Nevertheless, because Persian Gulf OPEC countries account for nearly 60 percent of Free World oil reserves, Western Europe's reliance on this region will remain substantial.

France: Energy Supply and Demand Projections [a] *Million b/doe*

	1980	1990	2000
Energy consumption	**4.0**	**4.4-4.9**	**4.8-5.6**
Net imports	3.0		
Oil consumption	2.3	1.7-2.2	1.8-2.4
Oil production	NEGL	NEGL	
Net imports	2.3	1.7-2.0	
Natural gas consumption	0.4	0.5-0.7	0.5-0.8
Natural gas production	0.1	0.1	
Net imports	0.3	0.4-0.6	
Coal consumption	0.7	0.3-0.8	0.5-0.9
Coal production	0.3	0.2-0.3	
Net imports	0.4	0.1-0.5	
Hydro-Nuclear	0.6	1.3-1.8	1.5-2.4

[a] Based on recent industry projections.

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United Kingdom: Energy Supply and Demand Projections [a] *Million b/doe*

	1980	1990	2000
Energy consumption	**4.1**	**4.1-4.4**	**4.3-5.0**
Net imports	0.2	−0.1- −0.5	
Oil consumption	1.7	1.4-1.6	1.3-1.7
Oil production	1.6	1.4-2.1	
Net imports	NEGL	−0.4- −0.5	
Natural gas consumption	0.8	0.9-1.0	0.9-1.1
Natural gas production	0.6	0.7-0.8	
Net imports	0.2	0.1-0.2	
Coal consumption	1.4	1.4-1.7	1.5-1.7
Coal production	1.5	1.5-1.7	
Net imports	NEGL	NEGL	
Hydro-Nuclear	0.2	0.3-0.4	0.3-0.6

[a] Based on recent industry projections.

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Italy: Energy Supply and Demand Projections [a]

Million b/doe

	1980	1990	2000
Energy consumption	**2.9**	**3.2-3.6**	**3.7-5.1**
Net imports	2.4	2.7-3.1	
Oil consumption	2.0	1.5-2.0	1.6-2.3
Oil production	NEGL	NEGL	
Net imports	1.9	1.5-2.0	
Natural gas consumption	0.5	0.6-0.7	0.8
Natural gas production	0.2	0.1-0.2	
Net imports	0.2	0.4-0.5	
Coal consumption	0.3	0.5-0.7	0.8-1.4
Coal production	NEGL	NEGL	
Net imports	0.2	0.7	
Hydro-Nuclear	0.2	0.3-0.4	0.5-0.6

[a] Based on recent industry projections.

West Germany: Energy Supply and Demand Projections [a]

Million b/doe

	1980	1990	2000
Energy consumption	**5.5**	**5.4-6.0**	**5.7-6.8**
Net imports	3.1	3.0-3.2	
Oil consumption	2.7	2.0-2.6	1.9-2.7
Oil production	0.1	0.1	
Net imports	2.7	1.9-2.5	
Natural gas consumption	0.9	0.8-1.1	0.9-1.1
Natural gas production	0.3	0.2-0.3	
Net imports	0.6	0.6-0.8	
Coal consumption	1.7	1.7-2.1	2.0
Coal production	1.8	1.8	
Net imports	−0.1	0.1-0.3	
Hydro-Nuclear	0.3	0.5-0.7	0.8-1.0

[a] Based on recent industry projections.

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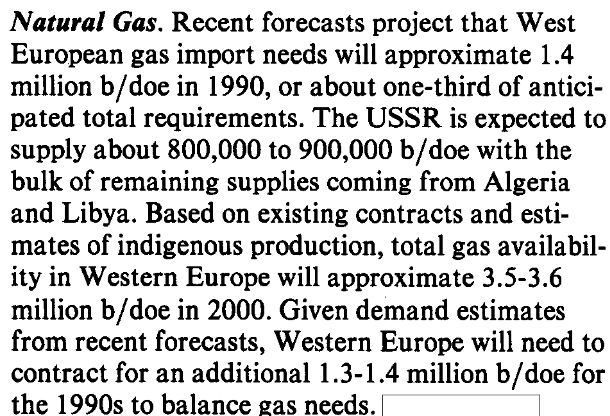

Natural Gas. Recent forecasts project that West European gas import needs will approximate 1.4 million b/doe in 1990, or about one-third of anticipated total requirements. The USSR is expected to supply about 800,000 to 900,000 b/doe with the bulk of remaining supplies coming from Algeria and Libya. Based on existing contracts and estimates of indigenous production, total gas availability in Western Europe will approximate 3.5-3.6 million b/doe in 2000. Given demand estimates from recent forecasts, Western Europe will need to contract for an additional 1.3-1.4 million b/doe for the 1990s to balance gas needs.

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Several gas producers, including Norway, Canada, Iran, Nigeria, Algeria, and the Soviet Union, are in a position to meet these gas needs in the 1990s:

- Norway has two major natural gas fields available for development in the 1990s, the Sleipner and Troll fields, whose combined production is expected to approximate 1 million b/doe by 2000. Gas from neither of these fields is currently contracted for, however, and development is likely to be quite costly compared to supplies available from other sources.

- Although committed to exports of only about 460,000 b/doe in 2000, Algeria's gas reserves could permit an additional 460,000 to 580,000 b/doe of natural gas exports by the end of the century.

- Libya could potentially export an additional 180,000 b/doe by either increasing LNG export facilities or constructing a pipeline to Europe.

- Vast natural gas reserves in West Siberia indicate that potential natural gas supplies from the USSR are probably limited only by European demand for Soviet gas. Given Moscow's willingness to price competitively because of its hard

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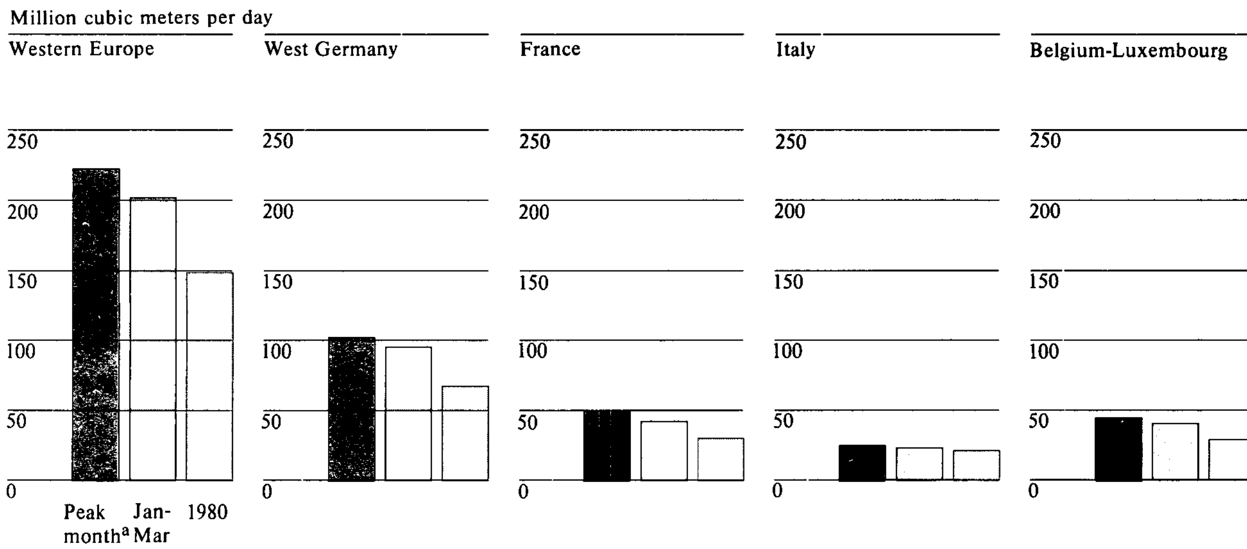
Western Europe: Gas Flows From the Netherlands, 1980



[a] The peak month is January for all countries except France-November, 1979.

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currency needs and its ability to step up deliveries in a relatively short period, the Soviet Union is capable of delivering gas to Western Europe at prices which are competitive with all other fuels.

- The Netherlands could be Europe's most reliable and economical source of additional gas. Under current government policies designed to conserve gas resources, Dutch gas for export will dwindle to zero by 2000, but contract flexibility and Dutch revenue needs could alter this situation. Even without new export contracts, the Netherlands could act as a surge supplier in the event of a disruption, but we believe the Dutch would likely demand compensation to hold strategic reserves for other countries.

Coal. Rising consumption is expected to increase West European dependence on imported coal to 4-6 million b/doe by 2000—about 15 percent of total energy requirements.

Impact of Lower Oil Prices

Should oil prices continue to fall, future energy supply/demand patterns could be considerably different from current projections. The improved competitiveness of oil initially would dampen nonoil energy demand and increase West European dependence on imported oil supplies. If oil prices fell to $25 per barrel, we believe nearly all of the increase in energy demand would be met by oil.

Lower oil prices could also lead to the delay of major new North Sea gas projects because low returns would make these large capital investment projects highly uneconomic. Such a development would enhance the Soviet Union's ability to capture a greater share of the West European gas market, especially given the surplus capacity in existing Soviet pipelines.

Policies To Increase Energy Security

To reduce reliance on imported energy—particularly oil—most West European governments have encouraged conservation, substitution, increased indigenous production, and diversification of import sources, as well as increased requirements for oil stockpiling. In response to the large and increasing share of gas imports in total gas consumption, some European countries have also begun to implement policies to minimize the impact of an interruption in gas supplies:

- In West Germany, most new industrial customers are now offered only interruptible contracts, and 20 to 25 percent of German industry now has the capability to switch from natural gas to alternative fuels—primarily oil. In the event of a gas supply disruption, utilities would require these customers to switch to alternative sources of energy. We estimate this could amount to roughly 120,000 b/doe by 1990.

- French Government plans call for doubling gas storage capacity to 66 million barrels oil equivalent (boe) by 1990. Gaz de France intends to increase the amount of gas it sells under interruptible contracts from 15 percent of sales to 20 percent in 1990 or about 100,000 b/doe.

- Italy plans to increase gas imports in this decade and shut in about 80,000 to 100,000 b/doe of domestic production for use in an emergency. Storage capacity is expected to approach 47 million boe in 1990; half of this is committed to meet seasonal needs.

Impact of Oil Disruptions

Because a large proportion of the oil used by Western Europe will continue to be imported, the region will remain vulnerable to disruptions in the oil market. There have been 14 separate oil supply disruptions since 1950, most of which have had little impact. Nonetheless, based on our survey of recent forecasts, the gradual erosion of excess productive capacity later in this decade will leave the oil market increasingly vulnerable to supply

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cutoffs around 1990 and beyond. We have examined two possible oil disruptions in 1990, each lasting six months:

- Case I—a 13-million-b/d net loss in supplies; for example, a supply cutoff from the Middle East.
- Case II—a 2-million-b/d net loss in capacity in one or more countries for technical or political reasons.

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The precise economic impacts of these hypothetical supply disruptions are difficult to gauge because of structural changes that have occurred in the relationship between energy use and economic growth and the inability to estimate psychological impacts such as consumer stockbuilding behavior. We have attempted to measure the order of magnitude of the economic impacts using the CIA's linked econometric model and the midrange of projected supply/demand levels for 1990:

- Case I—GNP loss amounts to 3.8 percentage points, and oil prices rise 52 percent above the base case level.
- Case II—GNP is reduced by 0.6 percentage point, and oil prices rise 7 percent above the base case level.

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Gas Supply Disruptions

Greater dependence on gas imports will increase Western Europe's vulnerability to a gas supply cutoff, especially since gas transmission systems are fixed and supplies are less flexible. Based on the forecasted levels of gas consumption and imports, we examined a hypothetical, six-month supply disruption from the Soviet Union and Algeria during the winter. By 1990, gas supplies from these countries could supply one-third of overall gas demand in Western Europe and a higher share in France and Italy. Further, the seasonal nature of gas requirements would tend to magnify the potential impact if a disruption occurred in the winter. West European gas consumption in the winter of 1981, for example, averaged about 720 million cubic meters per day, double the level of summer requirements. Because most of the growth in gas use is expected in the residential sector, fluctuation in seasonal demand will likely be even more pronounced in the future.

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To assess the impact of disruptions, we estimated the following possible supply offsets to determine the vulnerability:

- The level of potential surge capacity from indigenous production.
- The volume of gas available from cutting off interruptible contracts.
- Surge capacity from the Netherlands.
- Stock draws from gas storage.

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Western Europe: Natural Gas Supply and Demand Projections *Billion cubic meters*

	1980 [a]	1990 (midrange)	2000 (midrange)
Demand	218	258	297
Production	194	171	134
Netherlands [b]	85	57	32
Norway [b]	29	29	17
United Kingdom	39	47	49
Other Europe	41	38	36
Import demand	32	87	163
Non-OECD contracted supplies	32	78-86	78-86
Soviet [c]		49-55	49-55
Existing	26		
Urengoi	0	26	26
Minimum	0	24	24
Maximum	0	30	30
Libya	0	4	4
Algeria [d]	5		
Minimum	5	25	25
Maximum	0	27	27
Other	1		
Supply gap		1	77
Potential supplies			
Algeria			28-35
Norway [e]		4	50-60
Netherlands		19	17
LNG			23
USSR [f]		10-15	10-15

[a] 1980 data are actual trade. Discrepancy between supply versus consumption is stocks and losses in transformation.
[b] Export contracts plus domestic consumption. Netherlands consumption assumed to be 36 billion cubic meters in 1990 and 24 billion cubic meters in 2000.
[c] Soviet contract estimates include Italy.
[d] Algerian contract estimates do not include Spain, as contracts are being renegotiated.
[e] Norway potential includes Sleipner, Troll, and several other small fields.
[f] USSR supply potential is for existing export capacity only.

The amount of supply offsets were estimated based on government plans and/or industry projections. In the case of additional supplies from the Netherlands, we assumed export capacity is approximately equal to the historical peak in deliveries of 223 million cubic meters/day during the winter of 1979-80.

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On balance, the emergency supplies appear adequate to offset a total Soviet gas disruption in 1990, but this does not preclude some upward pressure on energy prices. Fuel switching could add upward pressure on oil prices, and, because of the linkage between oil and gas prices, the latter would increase as well. Energy prices could also be bid up because of the uncertainties regarding the length of a disruption.

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A simultaneous cutoff in Soviet and Algerian supplies would cut total gas availability in Europe by almost 25 percent and pose serious problems. Our analysis indicates that Italy would have a more difficult time than France and West Germany in coping with such a disruption because Italy's flexibility is limited by the lack of opportunity to increase Dutch imports during a disruption. Even France and West Germany would require a cutback in supplies to some customers and sharp inventory drawdowns, and both would also have to rely on incremental Dutch production to offset interrupted supplies.

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Geopolitics of Dependence

High dependence on imported energy, particularly oil and natural gas, will leave West European countries susceptible to political pressures both from within as well as outside their national borders. As demonstrated during previous major supply disruptions, West European countries tend to

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respond to intense domestic pressures by active market intervention to secure adequate oil supplies through government-to-government deals, restrictions on oil trade, and stepped-up spot purchases. As energy markets tighten, the amount of political leverage oil exporters can exert during a supply disruption would increase. Increased West European dependence on non-OECD natural gas supplies will leave European countries increasingly vulnerable to political pressure from countries like the Soviet Union and Algeria.

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Future Policy Options

In addition to measures already in place, West European countries have several other options available to them to help lessen the potential dangers of energy supply disruptions:

- To the extent possible, diversify oil supplies away from the volatile Middle Eastern region.
- Undertake a political commitment to guarantee development of indigenous gas reserves in the North Sea.
- Pay a premium to the Netherlands to extend gas contracts in the early 1990s in exchange for an equal volume of Norwegian gas later in the decade.
- European gas importers might also pay a premium to the Netherlands to maintain strategic gas reserves to be used in the event of a disruption.

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