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International Economic & Energy Weekly

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International Economic & Energy Weekly [redacted] 25X1

Synopsis

Perspective—*Eastern Europe: Still Looking to the West* [redacted] 25X1

Eastern Europe faces difficult decisions as it deals with debt servicing problems, the impact of austerity, and lagging productivity. The East European regimes will continue to approach Western governments for credits and assistance, in part because they recognize that the USSR is likely to be of little help. [redacted] 25X1

Romania: Progress in Tackling Financial Problems [redacted] 25X1

Romania has made significant progress in recovering from its debt crisis. Bucharest's determination to solve its debt problem led to deep slashes in imports and a $3 billion turnaround in the hard currency trade account since 1981. For the longer term, substantial hurdles still must be overcome; financial pressures are likely to require continued austerity, and Bucharest must begin to deal with longstanding problems, especially productivity, competitiveness, and economic management. [redacted] 25X1

Hungary: First Steps Toward Financial Recovery [redacted] 25X1

The withdrawal of credit lines from Eastern Europe following the Polish and Romanian debt crises brought Hungary to the brink of bankruptcy in early 1982. With only modest gains in Hungary's financial position expected this year and growing repayments of medium- and long-term debt through 1985, Budapest will remain on a financial tightrope.

Yugoslavia: Financial Outlook [redacted] 25X1

Given the difficulties involved in arranging this years financial package, we believe private lenders will not provide enough new loans to cover the traditional large first-half financing requirement next year of $2 billion to $2.3 billion. By early 1984—or sooner if the financial package falls apart—some Western creditors will probably try to press Belgrade to begin a formal rescheduling of its debts. [redacted] 25X1

[redacted] 25X1

India: Economic Outlook [redacted] 25X1

Bad weather, electricity shortages, and transportation tieups were the major factors behind India's near zero economic growth last year. Although more favorable weather would alleviate many of these problems, India's longer term outlook is clouded by looming financial problems. [redacted] 25X1

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International Economic & Energy Weekly [redacted] 25X1

17 June 1983

Perspective

Eastern Europe: Still Looking to the West [redacted] 25X1

Eastern Europe faces difficult decisions as it deals with debt servicing problems, the impact of austerity, and lagging productivity. Most of the countries in the region must try to secure more Western assistance and at least preserve current levels of Soviet economic support. They will need to gauge how much more austerity they can impose and still maintain political stability, and some may consider reforms to remove systemic obstacles to improved economic performance.

The East European economies are still reeling under the impact of the credit squeeze that began in 1980 and intensified in 1981 after Poland announced it was unable to repay its debt. The situation turned more desperate in early 1982 as banks decided to reduce their exposure to the region. Thus, while the financially troubled LDCs were able to increase their borrowing from banks last year, Eastern Europe suffered a reduction in credit lines of about $5 billion.

As sources of credit dried up, reserves dwindled and rescheduling negotiations dragged on, and most East European countries were forced into severe adjustment programs. All of Eastern Europe, except Bulgaria, slashed hard currency imports last year; the region ran its first hard currency trade surplus in more than 20 years and brought its current account into balance. The domestic cost of these policies, however, has been high:

- Annual growth of GNP for the region stagnated in 1982, compared with the over 4-percent rate recorded in the 1970s. We expect that GNP growth will show little if any increase this year.
- Investment dropped nearly 10 percent during 1981-82 and will show a further decline this year.
- Per capita consumption is now declining in the region as a whole, probably for the first time since the immediate post–World War II era.
- Consumer price hikes—once considered taboo by most of the regimes—are now commonplace and, in some instances, steep.

Despite some progress in lowering the external deficit, the East European regimes have done little to solve basic economic problems. Only two CEMA countries—Hungary and Bulgaria—have embarked on fundamental economic reforms, and there is general skepticism and resistance to the idea among the leaderships in the region. The dilemma is that deeper reforms

Eastern Europe

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would yield few benefits in the short run and would be difficult to implement at a time when the regimes are coping with debt servicing problems. Moreover, the regimes—many possibly facing succession struggles—also are prone to factionalism between entrenched bureaucracies, which are split on the issue of economic reform.

Eastern Europe's problems are further complicated by the potential for political fallout from austerity and reform measures. For the most part, the East European populations have quietly tolerated their repressive political climate in exchange for gradual improvements in their economic well-being. Even in the years when material rewards were meager, public reaction was often mild, apparently because of confidence that improved living standards were "just around the corner." Now the promise of a better future is suspect, and consumers are no longer patient. The Polish story is well known, and the situation there remains volatile. Romania has suffered through several sporadic, and at times violent, outbursts.

The East European countries may be left with few options but to cut consumption further. Continued reductions in investment over the next several years threaten future growth, and the Soviets will continue to press their Warsaw Pact allies to maintain—if not increase—real defense spending. As pressure on consumers mounts, the outcome is uncertain but could lead to greater repression in several countries.

In coping with the debt crisis, the CEMA members of Eastern Europe have not been able to fall back on the USSR, which is coping with its own economic difficulties. The Soviets actually have intensified the region's problems by trimming concessionary oil deliveries in 1982 and by pressing more vigorously for balanced trade. In the case of Hungary, Moscow contributed to Budapest's 1982 liquidity crisis by pulling hard currency from Hungarian banks. In addition, the USSR and its East European allies are having problems in setting up a CEMA summit that would deal with the economic malaise in the Bloc. The East Europeans continue to resist Soviet pressures for increased CEMA integration because they fear loss of both their political and economic independence. Under the best circumstances, the East Europeans hope for no further cuts in Soviet deliveries and no toughening in trade terms.

Some also hope for at least tacit approval from Moscow to experiment with economic reforms. The debt crisis, the cool East-West political climate, and the lack of help from the USSR suggest growing East European isolation. Nevertheless, some regimes are trying to expand or at least protect their ties with the West:

- Both Hungary and Yugoslavia have arranged emergency support from Western banks, governments, and international financial institutions to try to stave off formal rescheduling.
- Hungary approached the EC last month about establishing a trade pact similar to those the Community has with Yugoslavia and Romania.

- Romania arranged two years of debt relief from Western governments and banks and recently settled its emigration disputes with the United States, West Germany, and Israel in hopes of maintaining its preferential trade status.
- Poland continues to push for IMF membership and for rescheduling agreements; the leadership hopes the papal visit will lead to an easing of Western sanctions.

Eastern Europe, similar to the financially troubled LDCs, is dependent on Western economic recovery and assistance in dealing with likely payments crises in the near term. Unlike some LDCs, however, the East European countries will not stand to gain as much from recovery since they dragged their feet on measures needed to make their exports competitive or to improve economic performance. In addition, Western bankers are reluctant to increase lending to the region. As a result, the East European regimes will continue to approach Western governments for credits and assistance, in part because they recognize that the USSR is likely to be of little help.

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Briefs

Energy

Major Delays in Soviet Gas Drilling

Drilling at the Urengoy gasfield during 1982 fell reportedly well short of planned targets. The number of new wells completed last year was significantly below the number planned and may only have been slightly more than the number completed in 1981. Urengoy is the USSR's largest producing gas deposit, and virtually the entire planned increase in gas output in the current five-year plan is to come from there. [redacted] 25X1

The lags in well drilling have been caused primarily by the demands of the export pipeline construction program, which have overtaxed the West Siberian Transportation Network and compounded delays in the production and delivery of crucial drilling supplies. The shortfall, however, is unlikely to affect production in the near term or threaten gas export obligations to Western Europe in 1984. On the other hand, a shortfall in drilling for the third year in a row could affect production in 1985. This could cause problems in meeting both export and domestic requirements. [redacted] 25X1

Polish Coal Exports Up

According to the Polish Press Agency, Poland exported approximately 13.6 million tons of coal in the first five months of this year—27 percent above year-earlier levels. Shipments to the West to earn hard currency are 23 percent above the 1982 level. The Poles are regaining Western markets through price concessions, barter arrangements, and pressure on some West European governments to purchase Polish coal if they hope to receive payments on their outstanding loans to Poland. [redacted] 25X1 This year Poland plans to export 35-37 million tons of coal—7-9 million tons above the 1982 level, but because of depressed demand and high stocks in Western Europe, we do not believe the Poles will be able to achieve such a high export level. [redacted] 25X1

Japanese Contracts for Iranian Oil

Several Japanese companies recently signed new long-term contracts with Iran [redacted] 25X1 All of Iran's previous contracts with Japan, totaling some 250,000 barrels per day, will have expired by next month. [redacted] 25X1

Iran's production has slumped recently to about 2.1 million barrels per day, as compared with about 2.6 million barrels per day in the first quarter and with its OPEC quota of 2.4 million barrels. So far, Tehran has refused to give discounts because its official price is competitive with world market prices for comparable OPEC crudes. If the government is to sell enough oil to finance the budget this year, however, it eventually may be forced to shave its price by as much as $1 per barrel. [redacted] 25X1

[redacted] 25X1

International Trade, Technology, and Finance

Crucial IMF Negotiations for Brazil

Brazil has not yet provided a complete austerity package satisfactory to the IMF, resulting in mounting fears of a financial crisis and a possible debt moratorium. President Figueiredo last week warned that tougher economic measures would be imposed soon. Brazilian officials have disclosed some parts of the package, including increases in the price of petroleum products and wheat, as well as reductions in credit subsidies for agriculture and exports. Intentions regarding other issues of key concern to the IMF remain in doubt. [redacted] government fears of social unrest have delayed completion of the package. Meanwhile, Brazil has not yet been able to obtain increased financial support from foreign banks. [redacted] 25X1 25X1

The IMF is deeply concerned about Brazil's huge public-sector deficit and triple-digit inflation. It almost certainly would be disappointed with the government's unwillingness to slash state spending and to defer—at least temporarily—the indexing of wages to inflation. Unless Brazil and the IMF reconcile their differences quickly, a debt moratorium may be declared soon. Some government officials believe such a step would force foreign banks to co-operate in restructuring Brazil's debt. [redacted] 25X1

[redacted] 25X1

Israeli-Jordanian Dispute Over Water Use

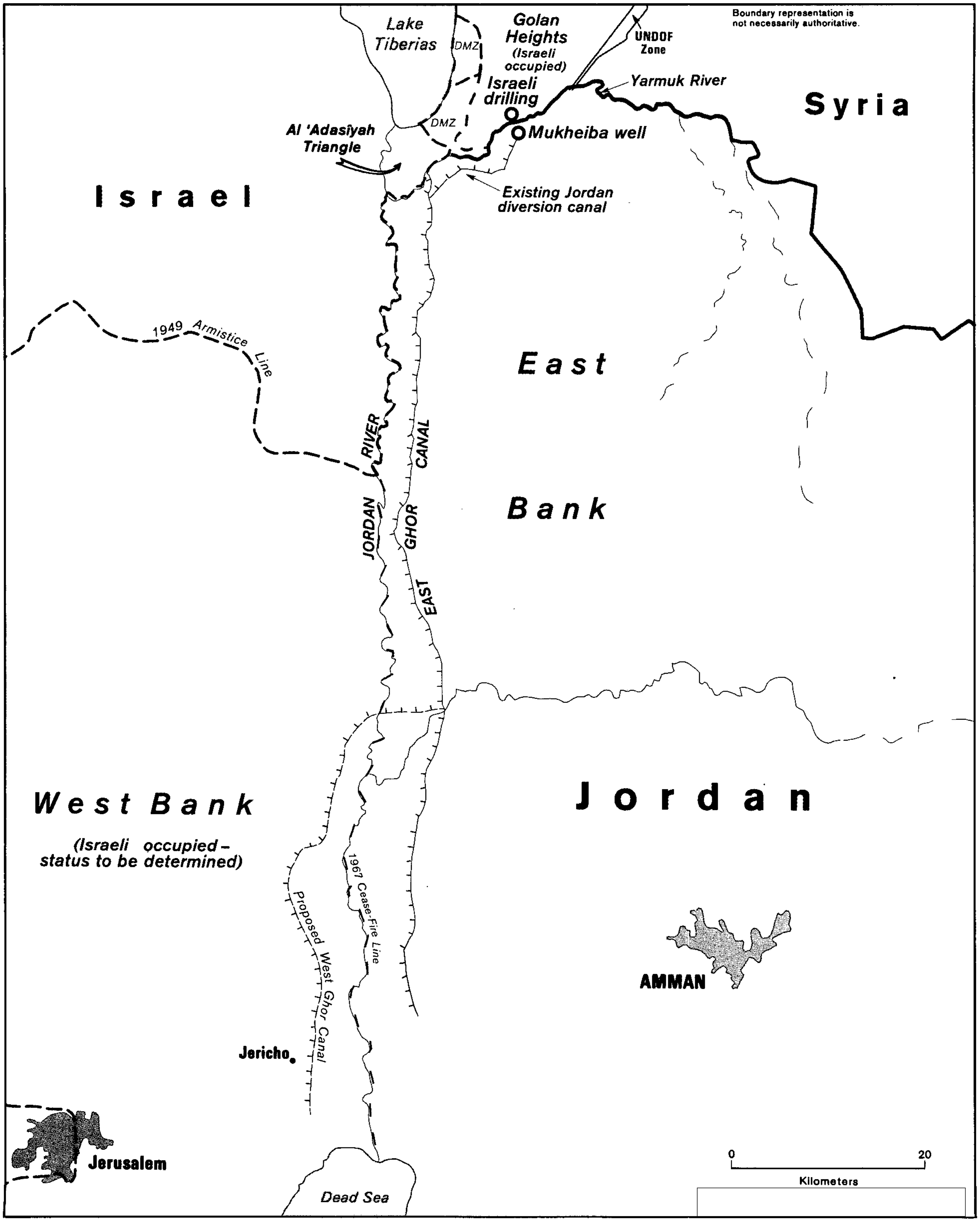
Meetings between Israeli and Jordanian water authorities have failed to resolve water-use problems along the Yarmuk River, reemphasizing that serious trouble could develop if the disagreements continue. Both Israel and Jordan [redacted] expressed concern about the other's plans for increasing its use of water from the Yarmuk River basin. Jordan plans to begin construction in September of additional diversion inlets from the Yarmuk River to the East Ghor Canal in order to expand irrigation on the East Bank. The Israeli Government says it will act to halt any Jordanian construction that is undertaken without its prior agreement. Tel Aviv does not doubt Jordan's willingness to continue providing Yarmuk River water for use in the Al Adasiyah Triangle. It maintains, however, that unilateral regulation of the river flow by Jordan would violate Israel's riparian rights. [redacted] 25X1

Jordan is deeply concerned that Israel is drilling several wells on the north side of the Yarmuk. Amman claims that the wells are in the same water source formation that feeds Jordan's important Mukheiba well and that any Israeli attempts to get water from this aquifer for use in the occupied Golan Heights would violate international law. Israeli authorities say they will accumulate test data from the wells to determine the water's origin, but they will not discuss any plans for its use. [redacted] 25X1

These two issues underscore Jordan's current inability to prevent Israel from using a larger share of the Yarmuk basin's water. Unless agreement is reached on Jordan's diversion plans, Amman will be likely to delay construction, realizing that Israel would take action to stop the work. Jordan probably will be able to meet its minimum requirements this summer because of the heavy rains last winter, but in the longer run it needs to regulate the flow of the Yarmuk River to provide water for irrigation and urban uses. Israel also has an increasing need for water but benefits from the lack of regulation of the river's flow because any water not used by Jordan enters Israeli territory. [redacted] 25X1

Possible Soviet Development Aid for Pakistan

Moscow has tentatively approved $460 million in credits for development projects in Pakistan including $300 million worth of credits earmarked for a power plant project [redacted] This amount is well below the $2 billion worth of long-term aid requested by Islamabad last March, when a high-level Soviet economic delegation visited Pakistan. If such aid is in fact forthcoming, it would represent a significant increase in Soviet economic assistance to Pakistan. [redacted] 25X1



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Pretoria Pressuring Neighboring Countries on Homelands

South Africa has warned Botswana, Lesotho, and Swaziland that it will reduce their share of receipts from the Southern African Customs Union (SACU) in September unless they accept South Africa's four so-called independent homelands as new and coequal members of SACU. Pretoria apparently sees SACU membership as a means of legitimizing the independent homelands, which South Africa created as part of its "grand apartheid" scheme but which have gained no international recognition. According to Foreign Minister Botha, Pretoria's use of economic leverage is also aimed at underlining the dependence of neighboring states on South Africa and prohibiting the antiapartheid African National Congress from operating within the region. [redacted] 25X1

SACU is currently composed of South Africa, Botswana, Lesotho, and Swaziland. Pretoria collects duties on member countries' imports—most of which pass through South Africa—and distributes shares based roughly on their percentage of total SACU imports. Pretoria provides a hidden form of foreign aid by allowing the other members to inflate their shares by overstating imports. SACU receipts in recent years have amounted to over 60 percent of the government revenues of Lesotho and Swaziland and over 30 percent for Botswana. [redacted] 25X1

National Developments

Developed Countries

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Less Developed Countries

Zimbabwean Budget Deficit Clouds Future IMF Support

Zimbabwe's budget deficit during the fiscal year ending 30 June will significantly exceed the target level agreed to by Harare as one of the conditions for receiving a $324 million IMF standby loan in March 1983. The deficit totaled $700-800 million during the first half of the fiscal year, about double the target level of 7 percent of GDP. Drought and the continuing deep economic recession in Zimbabwe have held tax revenues far below original budget projections despite increases in excise and sales taxes. The costly campaign against dissidents in Matabeleland has been an unexpected drain on resources. [redacted] 25X1

In our judgment, Minister of Finance and Economic Planning Chidzero will press for an extremely austere budget for the fiscal year beginning 1 July, despite sharply rising requirements for drought relief and pressure to increase spending on other social services. Although Chidzero's efforts will probably assuage the IMF for now, continued overspending by Harare could eventually induce the IMF to stop disbursements on the loan. [redacted] 25X1

New Jamaican Austerity Program

Prime Minister Seaga has failed to obtain a $150 million loan from Kuwaiti investors, and he will now have to implement a new austerity program in accordance with an agreement negotiated last month with the IMF. The measures include additional cuts in government spending, shifts of virtually all imports to the costly free-market foreign exchange rate, and further restrictions on government credit. Seaga told US Embassy officials on Saturday that the new measures will disrupt his recovery program and "doom" his political fortunes. [redacted] 25X1

The stringent program is essential to maintain the support of the IMF, the World Bank, and commercial lenders. The spending cuts will require major changes in the budget, thereby opening Seaga to strong criticism from the opposition. In the short term, moreover, inflation and already high unemployment are likely to rise, and the drive for increased export earnings will falter. [redacted] 25X1

Economic Protests in Costa Rica

The government is beginning to meet public resistance to an IMF-mandated austerity program. Widespread protest demonstrations and the prospect of violence have forced the government to rescind a recent increase in utility rates. Although President Monge is blaming Communist organizers, the US Embassy believes that the protests have extensive popular support. Monge had enjoyed substantial backing for his austerity policies, which are aimed at reducing the pressures related to foreign exchange shortage. The demonstrations mark the first time he has been attacked personally for poor leadership on economic matters. Future protests are likely as the public becomes more opposed to the austerity measures, and the Communist Party may seek to exploit the discontent. [redacted] 25X1

Additional Stock Market Bankruptcies in Kuwait

Bankruptcies related to the Kuwaiti stock crash market soared from 69 to 305 this past month and are likely soon to top 400. Some traders have been able to strike deals with their creditors, but many have found creditors inflexible on repayment terms. The Kuwaiti Government has provided almost $2 billion to cover losses of insolvent traders, but it has become less generous with public funds in recent weeks. Kuwait has begun to confiscate the assets of bankrupt traders and to pay creditors with government bonds. Financial observers believe the government will end up owning far more assets than it can manage effectively. [redacted] 25X1

Madagascar Liberalizing Its Economy

Despite considerable opposition within his government, socialist President Ratsiraka has decided to push ahead on some initial steps to liberalize the economy designed in past to gain Western aid. He announced plans last month to ease government controls on repatriation of foreign exchange and on distribution of rice, the country's main dietary staple. Exporters will be allowed to retain a portion of their foreign earnings for imports deemed essential for their business operations. Approval, however, must be obtained first from the Central Bank and will depend on the availability of funds. Rice farmers will be permitted to sell directly to the private sector rather than through inefficient government marketing channels. We agree with the US Embassy's assessment that these policies impinge on politically influential leftists in the government who already have indicated their intend to sabotage the reforms. Ratsiraka's more immediate concern, however, is paving the way for another IMF standby agreement after the current one expires this summer. [redacted] 25X1

Communist

Higher Priority for Consumer Sector in the USSR

Moscow has announced several resolutions calling for more and higher quality consumer goods, housing construction, and consumer services. According to *Pravda*, the target for growth this year in light industry output has been raised from 2.7 percent to 5.5 percent. In addition, two party Central Committee departments have been reorganized to improve supervision in the agricultural, food processing, light industry, and other consumer areas. General Secretary Andropov's strong public endorsement of the national Food Program is another indication of his desire to improve consumer welfare. [redacted] Andropov is determined to help the consumer and that a recent decision by the Politburo to improve agriculture and light industry output would substantially increase bilateral trade opportunities. [redacted] investment in light industry and the food processing industry will be accelerated at the expense of heavy—but not military—industries in the five-year plan for 1986-90. [redacted] 25X1 25X1 25X1 25X1

Although these actions strengthen the apparent continuity between Brezhnev's and Andropov's policies, it is not yet clear to what extent they will be backed up by increasing the investment available for consumer goods production. A substantial reallocation of resources is unlikely in the near term. The extra production that is to come from light industry this year is to be achieved through better discipline, greater efficiency, and better management. Any major changes in allocations, as suggested by Sushkov, probably would not occur before the 1986-90 period. [redacted] 25X1

Bulgaria To Expand Economic Reforms

Party leader Zhivkov told the leadership early this month that he will introduce more economic reforms in 1984. He said declining quality of industrial exports means the country has to import advanced technology, particularly machinery from the West. He also said that prices of industrial goods should reflect quality standards and that wages should take into account the quality of the goods produced as well as volume of production. Zhivkov's new stress on economic reforms comes at a time when most East European leaders are waiting for the Soviets to chart the path they will take on the issue. By urging industry to accelerate economic reforms, Zhivkov probably hopes to repeat the success he had in applying incentives to agriculture in 1979. Zhivkov this week was scheduled to visit Hungary, where he probably conferred with party leader Kadar on Hungary's experience with economic reforms. [redacted] 25X1

Budapest Expands Opportunities for Work Abroad

Budapest next month will implement a new regulation that simplifies the process of applying to work abroad and expands the categories of citizens who can do so. Hungarians have in principle had the right to work abroad since 1966, but only a relatively few privileged artists and professionals were able to take advantage of it. Under the new law, employers and local officials will have much more leeway to approve applications, and self-employed persons and pensioners as well as employees of cooperatives and state enterprises will be eligible. Permission normally will not be granted for a stay abroad of more than five years, and the worker must deposit 20 precent of his earnings in the National Bank, where they will be exchanged for forints. 25X1

A Hungarian party official told US Embassy representatives that the new legislation is designed to give Hungarian workers increased exposure to Western training and professional experience and to improve the morale of the workforce. We believe, however, that Budapest views the program as an outlet for some of its underemployed labor and as a chance to earn hard currency. The decree probably will not lead to a dramatic outflow of Hungarian workers in the near term because the government will be careful to prevent a drain of skilled workers and because high unemployment rates in the West will limit opportunities for Hungarians. The decree nonetheless sets Hungary farther apart from its Warsaw Pact allies, both in its permissiveness and in its recognition of the benefits of closer integration with the world economy. 25X1

Romania: Progress in Tackling Financial Problems [redacted] 25X1

Romania has made significant progress in recovering from its debt crisis. While Bucharest has had to reschedule its debts due in 1982 and this year, it vows to resume payments on time next year. Romania's plans for covering this year's financial needs appear to be on track. Bucharest's determination to solve its debt problem led to deep slashes in imports and a $3 billion turnaround in the hard currency trade account since 1980. Such an approach has put a considerable burden on the domestic economy. For the longer term, substantial hurdles still must be overcome; financial pressures are likely to require continued austerity, and Bucharest must begin to deal with longstanding problems, especially productivity, competitiveness, and economic management. [redacted]

Payments Difficulties Emerge in 1981

Romania's serious financial difficulties began in second-half 1981. Despite the approval of a $1.1 billion IMF standby credit in June 1981, Romania's financial situation deteriorated rapidly in the second half of the year. The financial strategy worked out with the IMF was to convert its uncomfortably high level of short-term debt into medium- and long-term debt and to rebuild Bucharest's hard currency reserves. The flaw in this strategy was its optimism about Romania's borrowing prospects. Western banks not only refused to convert short-term debt into medium- and long-term debt, but Bucharest had to spend scarce hard currency reserves to repay a large part of obligations coming due. Arrears to suppliers and banks mounted to $1.1 billion by the end of the year, leading the IMF to suspend credit drawings under the standby arrangement and forcing Romania to seek debt relief. [redacted] 25X1

Financing Sources Fell Short in 1982

Bucharest's 1982 financing requirement totaled $4.4 billion, primarily in principal payments and arrearages overdue since 1981. Romania's midyear expectation that it could come up with nearly $4.9 billion in debt relief and new credits was overly optimistic, and Bucharest was unable to cover a gap of $500-600 million at year's end. This gap mainly reflects arrears to suppliers for which no agreement was reached, and it also includes some unrescheduled obligations to Paris Club members overdue at the end of the year. [redacted] 25X1

Rescheduling Agreements. After 11 months of negotiations, Romania and Western banks signed an agreement on 7 December to reschedule 80 percent of arrears from 1981 and principal payments due in 1982; the remaining 20 percent was to be paid in two installments in January and March 1983. [redacted] Bucharest was able to secure only $1.3 billion in debt relief from banks in 1982, about $1 billion less than requested at the outset of rescheduling talks. Firms had balked at the Romanian request to convert their short-term loans into six-and-a-half-year credits, and several banks managed to obtain payments and avoid rescheduling. [redacted]

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Western governments began talks on debt relief after the IMF restored Bucharest's access to drawings under the standby arrangement in June. The Paris Club quickly agreed to reschedule 80 percent of principal and interest payments due in 1982 and arrears from 1981, providing debt relief of $400 million. A key difference between the bank and government agreements is that the Paris Club

Romania: Rescheduling Agreements

Agreement	Date of Agreement on Terms	Date of Signature	Obligations Covered	Amount of Debt Relief	Repayment Terms		Comment
					Interest Rate	Repayment Period	
1982 bank agreement	February 1982	7 December 1982	80 percent of principal payments on all debt, including short term.	$1.3 billion	LIBOR plus 1.75 percentage point	1985-88	Unrescheduled principal paid in January and March 1983. Agreement covered much less than originally planned because suppliers and many banks refused to participate.
1982 Paris Club agreement	June 1982	28 July 1982	80 percent of principal and interest payments on medium- and long-term debt.	$400 million	Varies with creditor, generally 1 percentage point above domestic government borrowing rate.	1985-88	FRG has not yet signed bilateral agreement.
1983 bank agreement	February 1983	20 June 1983	70 percent of principal payments due in 1983 on medium- and long-term debt.	$600 million	LIBOR plus 1.75 percentage point	10 percent of rescheduled amount due in 1984; remainder to be paid 1987-89.	Amount not being rescheduled due August-December 1983.
1983 Paris Club agreement	18 May 1983	18 May 1983	60 percent of principal payments on medium- and long-term debt.	$130 million	Varies with creditor, generally 1 percentage point above domestic government borrowing rate.	1986-90	Of the 40 percent not rescheduled, 30 percent due within one month of original due date, 10 percent due on 30 November 1983.

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agreed to reschedule only medium- and long-term debt and required that $260 million in short-term credits be paid. Failure to pay these short-term obligations delayed for months conclusion of bilateral agreements with the 15 signators to the Paris Club agreement.

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Credit Problems. IMF data show that loans fell $470 million short of the $1.7 billion target agreed with the IMF early in the year:

- Short-term trade credits totaled $350 million—nearly all from oil-exporting countries—some $150 million less than planned.
- New medium- and long-term credits of $550 million were some $100 million less than expected.

In December, the IMF decided to allow Bucharest to draw $330 million, despite loose ends such as unsigned bilateral agreements with Paris Club members, refusal by some banks to accept rescheduling, and no agreement with suppliers. 25X1

External Account Surplus. The shortfall in financing forced Bucharest to cover its financing needs by running a current account surplus of $655 million—an improvement of $1.5 billion compared with 1981. The $1.5 billion hard currency trade surplus was achieved by cutting imports by one-third. The import cuts intensified widespread shortages of food, gasoline, and other consumer goods. In data presented to the IMF, Bucharest acknowledged that payments-induced problems caused consumption to fall after many years of rapid growth in the 1960s and 1970s. In addition, the rate of growth of industrial production fell to a postwar low of 1 percent. 25X1

Romania: Projected Sources and Uses of Financing in 1983 *Million US $*

Financing requirement	**4,221 to 4,506**
Debt payments due	3,810 to 4,095
Payments under rescheduling agreements	391
Principal under original loan contracts	2,919 to 3,104
Arrears	500 to 600
Increase in reserves (IMF target)	250
Net credit extensions	161
Financing sources	**4,030**
Current account	800
Debt relief	1,069
Banks	601
Paris Club	130
Supplier	300
CEMA banks	38
Credits	995
IMF	400
IBRD	250
Suppliers credits	145
Short-term oil credits	200
Rollover of short-term debt	850
Drawdown of IMF disbursement	316
Gap	**191 to 467**

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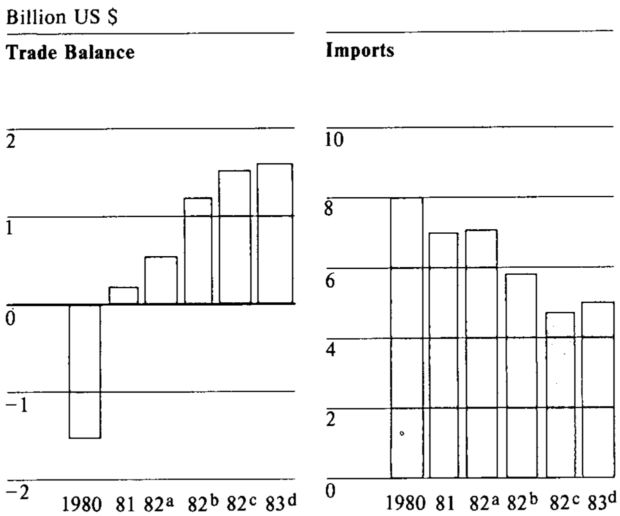
Improved Prospects for 1983

The 1983 financial picture looks much better than last year. Based on incomplete and inconsistent data supplied to the IMF and Western banks, our estimates show that Bucharest has lined up most of its financing requirements of $4.2-4.5 billion. The shortfall of up to $500 million could be covered by more credits, better trade performance, or some easing in the IMF target for reserves. Improvement stems mostly from Bucharest's crossing the hump in its debt maturity structure. Nearly two-thirds of the debt contracted through 1980 came due in 1981-82, and beginning this year the payments schedule stretches out considerably. The improvement would be greater were it not for the need to cover overdue obligations from 1982. The picture also looks bright because debt relief negotiations appear to be proceeding well, and Bucharest's credit needs are modest. The major uncertainties are whether Bucharest can meet its ambitious trade surplus target and can roll over its short-term debt. If creditors are spooked by political problems in Romania or by financial developments elsewhere and they choose to reduce further their short-term exposure, Bucharest would have difficulty in meeting its obligations. 25X1

Continued Trade Adjustment. Romania is holding to its strategy of painful adjustment by forcing a net flow of resources out of the economy. In a letter to the IMF accompanying the review of the standby arrangement in March, Finance Minister Gigea pledged to meet tough external account targets even at the expense of not fulfilling growth goals. Bucharest projects a current account surplus of $800 million on the strength of another huge trade surplus of $1.6 billion, up $75 million compared

Romania: Hard Currency Trade



[a] Spring projection
[b] Fall projection.
[c] Actual.
[d] Target.
[redacted]

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with 1982. Not only will this target be difficult to achieve, but perhaps risky as well, given the impact on the economy of the adjustments already made. Imports are set to rise by 6 percent to $5 billion—still far below the 1980 peak of $8.1 billion. Plans call for further reductions in imports of crude oil and grain and substantial increases in imports of machinery and equipment and metals. Bucharest has told the IMF that the 6-percent growth rate projected for exports will come from a 17-percent increase in sales of refined petroleum products and a 2-percent gain in nonoil exports. The small increase projected for nonoil exports should be manageable, but the boost in exports of oil products seems overly optimistic, given the soft energy market and Romania's own energy problems. [redacted] 25X1

Status of Rescheduling. Bucharest's effort to reschedule its 1983 debt to the banks appears to be moving smoothly, especially compared with the 1982 negotiations. Creditors were uncertain about whether debt relief would be needed this year, but at the end of 1982 Bucharest informed its creditors that payments due in 1983 would be suspended pending conclusion of a rescheduling agreement. In only their second negotiating session—held in early February—Romania and the nine major Western banks that led the 1982 rescheduling effort agreed on tougher terms: only 70 percent of some $900 million in principal payments to banks is to be rescheduled instead of the 80 percent in 1982, and short-term debt is not covered. Moreover, all the unrescheduled principal is due in the second half of this year, and some of the rescheduled amount is due next year. [redacted] 25X1

[redacted] 25X1 creditors have responded favorably to the terms, and the agreement is set to be signed on 20 June. Several factors account for the rapid progress this year:

[redacted] 25X1 25X1

- The amount to be rescheduled is less than half the amount of debt relief from private creditors in 1982.
- Treatment of short-term bank debt is not an issue because most of it was either paid or rescheduled last year.
- Some of the banks most opposed to the 1982 agreement have little or no debt due this year. [redacted] 25X1

The Paris Club got off to a slower start because of Romania's continuing problems in wrapping up bilateral accords with Western governments to conclude the 1982 Paris Club agreement. On 18 May the Paris Club met and quickly agreed to reschedule 60 percent of principal due this year on medium- and long-term guaranteed credits. Although Bucharest's original request last December called for debt relief to cover 75 percent of 1983 principal and interest, the Romanian Finance Minister readily accepted the terms. [redacted] 25X1

Credits. Romania expects to receive about $1 billion in new credits this year, two-thirds of which are to come from the IMF and World Bank. The IMF approved Romania's performance in the December 1982 and March 1983 reviews of the three-year standby arrangement and has continued to disburse funds. The Fund continues to watch Romania's situation closely, however, and will conduct further reviews in July and November. The prospects now appear good that Bucharest will receive the $400 million it has requested this year. A World Bank team visited Romania early this year to consider projects for financing. The Romanians also hope to obtain $350 million in loans to finance imports of oil and other raw materials. While Romania's credit rating is still poor, Bucharest should be able to obtain this modest amount of credit.

Romania: Principal Due on Medium- and Long-Term Debt *Million US $*

1981	1,133
1982	2,081
1983	1,319 [a]
1984	1,170 [a]
1985	1,584 [a]
1986	1,346 [a]

[a] Due on loans received through yearend 1982.

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Outlook for 1984 and Beyond

Assuming that Bucharest manages to cover most of its 1983 financing requirement so that only small amounts of arrearages are carried into 1984, continued gradual improvement in the financial situation is possible. We judge that Romania's financing requirement next year is small enough—about $2.2 billion—that the goal of avoiding rescheduling can be achieved. It is too early to predict this with much confidence. According to IMF projections, more than $2 billion in principal payments are due next year including payments on short-term, debt. The remainder of the financing requirement is $200 million in credit extensions to support Romanian exports.

Bucharest plans to cover $850 million of the requirement by earning a current account surplus, largely on the strength of a $1.7 billion trade surplus, which we believe may be difficult to achieve. If drawings this year proceed on schedule, about $300 million will be available from the IMF under the third and final year of the standby arrangement. The Fund projects that another $400 million in loans will be provided by the IBRD and suppliers. This projection for loans seems realistic, and Bucharest should have little trouble borrowing this amount, especially if it demonstrates continued success in dealing with its financial problems. 25X1 25X1

The breathing space associated with the rescheduling ends in 1985 when Bucharest must begin to repay obligations rescheduled in 1981. By that time the IMF standby arrangement also will have expired. Both of these factors will put pressure on the regime to continue earning large trade surpluses in order to cover external obligations and to deal with underlying economic problems that hurt competitiveness and continue to prevent sustainable and balanced growth. On the other hand, it seems likely that creditors will take into account Bucharest's success in overcoming its debt woes and that access to commercial credits should improve somewhat.

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Hungary: First Steps Toward Financial Recovery [redacted]

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The withdrawal of credit lines from Eastern Europe following the Polish and Romanian debt crises brought Hungary to the brink of bankruptcy in early 1982. Emergency loans provided by the Bank for International Settlements (BIS) and the IMF stanched the hemorrhaging of Hungary's hard currency reserves and forestalled the need for rescheduling. This gave Budapest time for remedial action, but it did not correct fundamental weaknesses in the balance of payments. With only modest gains in Hungary's financial position expected this year and growing repayments of medium- and long-term debt through 1985, Budapest will remain on a financial tightrope. To restore its financial health, Hungary must:

- Slow the growth of domestic demand and run current account surpluses.
- Lengthen the maturity structure of debt and build up reserves in order to reduce its vulnerability to the withdrawal of short-term credits.
- Implement reforms to improve efficiency and export competitiveness. [redacted]

In order to succeed, Hungary also needs a revival of growth in its Western markets, falling international interest rates, and increased lending by Western banks that remain wary about increasing their exposure in Eastern Europe. [redacted]

The Crisis of 1982

The Hungarians were vulnerable to a loss in banker confidence because of reliance on short-term borrowing to cover their financing needs. The pullout of $1.3 billion in short-term credits by Western, OPEC, and CEMA banks; Hungary's inability to roll over $200 million in maturing medium-term credits; and a current account deficit of $200 million nearly exhausted Hungary's foreign exchange holdings in first-quarter 1982. Budapest had to sell or put up as loan collateral nearly all of its gold stock. [redacted] 25X1
liquid reserves fell from $1.8 billion to less than $400 million, or little more than one month's worth of imports, during January-March. As a result, a growing number of Western suppliers reported delayed payments from Hungarian importers. [redacted] 25X1

The Hungarians parlayed their good relations with the West and their reputation as sound managers into enough emergency support from Western governments, the BIS, and the IMF to prevent a debt rescheduling. The Hungarians argued that a financial crisis would undermine their economic reforms and gratify those in the USSR and Eastern Europe who want to tie Hungary more closely to the East. This argument convinced West European central banks and governments in April to provide $210 million in short-term bridge loans through the BIS to shore up Hungary's reserves. The BIS indicated that additional credits would be available later in the year if Hungary made progress in negotiating a standby agreement with the IMF. Several West European governments also extended guaranteed trade credits. This show of official Western support and some arm-twisting by Western governments convinced 14 commercial banks to arrange a $260 million loan for Hungary in August. [redacted]

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Although the regime temporized for several months over the need to reduce imports, the BIS and IMF pressured Budapest to tighten adjustment measures in return for emergency loans. [redacted] During second-half 1982, the Hungarians responded by raising prices and cutting subsidies on some consumer goods and services, tightening domestic credit, imposing controls on hard currency imports, and devaluing the forint. The BIS lent

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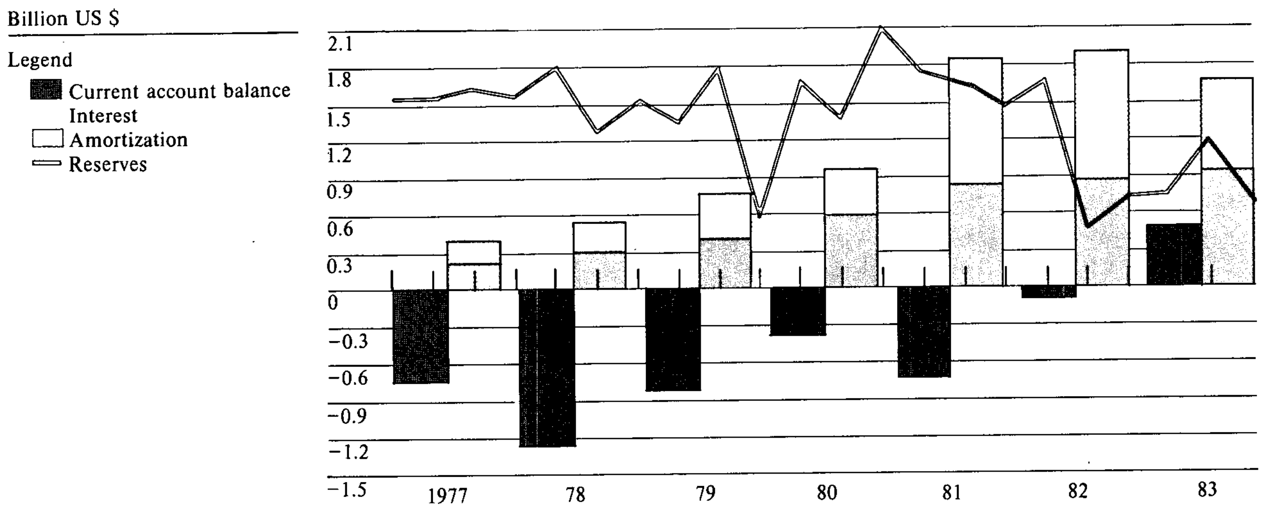
Hungary: External Financial Indicators[a]



[a] IMF International Financial Statistics.

[redacted] 25X1

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another $300 million in September, and the IMF approved $610 million in credits in December. About one-third of the IMF funds were disbursed immediately to repay the April BIS loan, and the remainder is to be drawn this year. These loans and a growing trade surplus enabled Hungary to meet its debt service obligations, clear up its arrearages, and redeem much of its collateralized gold. By the end of 1982, Hungary had rebuilt its foreign exchange reserves to nearly $1.2 billion. [redacted]

Financial Goals for 1983

The IMF and Hungary project that the country will cover its $2.6 billion in debt repayments and increase its reserves by $500 million with the help of:

- A $600 million current account surplus.
- $250-300 million in trade credits (primarily government-backed).
- $60-70 million in drawings on World Bank loans.
- $200-260 million in untied commercial bank loans.
- $366 million in IMF credits.
- $1.6 billion in short-term borrowings.

The Hungarians hope to increase their trade surplus from nearly $770 million to over $1.1 billion and benefit from a $400 million decline in net interest costs. Hungary does not envision a significant lengthening of its debt's maturity structure because Western banks remain reluctant to extend medium-term loans. Nonetheless, the Hungarians hope to reduce their vulnerability to a reduction in short-term credits by use of more medium-term trade credits in place of borrowing Eurodollar deposits. [redacted]

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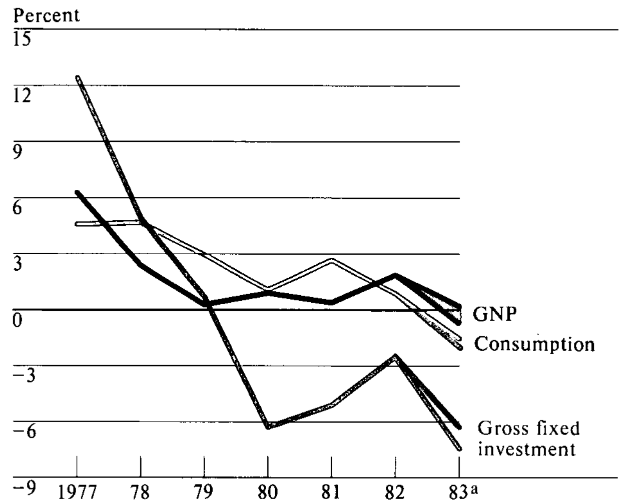
Hungary: Financing Requirements *Million US $*

	1982 [a]	1983	
		Hungarian Projection	CIA Projection
Financing requirement	**4,160**	**2,071**	**2,196**
Current account balance	−79	600	475
Trade balance	766	1,142	1,015
Exports	4,876	5,252	5,125
Imports	4,110	4,110	4,110
Net interest	−976	−580	−580
Other	131	38	40
Repayments of medium- and long-term debt	843	936	936
Repayments of short-term debt	2,849	1,371	1,371
Repayment of BIS credits	210	300	300
Export credits, net	−179	−64	−64
Borrowing sources	3,271	2,571	2,366
Medium- and long-term credits	1,154	579	500
Short-term credits [b]	1,371	1,626	1,500
IMF credits	236	366	366
BIS credits	510		
Change in reserves	−889	500	170

[a] National Bank of Hungary statistics.
[b] Includes net errors and omissions and change in net short-term trade credits.

[redacted]

Hungary: Domestic Economic Indicators



a Projected.

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Adjustment Policies and Reform

The need to produce a current account surplus has forced Budapest to tighten its adjustment policies. Beginning in 1979 Budapest shifted economic priorities from promotion of growth to gradual reduction in the country's current account deficit. The growth of demand was dampened mainly by sharp reductions in investment. Although increases in consumption slowed, the regime tried to maintain living standards. IMF statistics show that during 1979-1982 investment fell by more than 3 percent annually while consumption rose by nearly 2 percent annually. [redacted]

The need to accelerate adjustment in 1983 has forced Budapest to place a greater burden on the consumer. Hungary's targets envision a 3- to 4-percent decline in real domestic demand to be accomplished by a 1.5- to 2.0-percent reduction in consumption, a 6.5- to 7.5-percent fall in investment, and a 3.5- to 5.5-percent reduction in government outlays. The Hungarians hope to hold real GDP at the 1982 level by growth in net exports. [redacted] 25X1 25X1

Hungarian economists have told the US Embassy in Budapest that the IMF is likely to press harder for more structural reforms—probably a more comprehensive policy linking wages to productivity—if Hungary requests a second standby program later this year. While the current program focuses on demand restraint to address the immediate balance-of-payments problem, a sustainable improvement will require more efforts to strengthen the efficiency and competitiveness of the Hungarian economy. This year the regime has already

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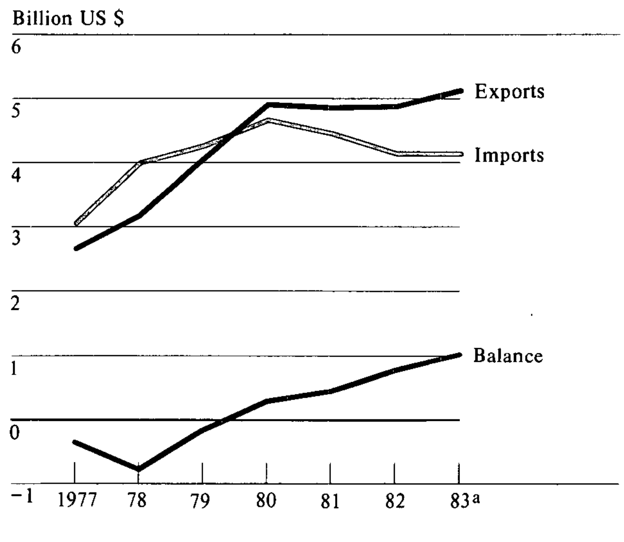
pushed ahead with additional reforms that link wage incentives more closely with enterprise profitability, encourage the elimination of excess labor, and reduce subsidies to inefficient producers. [redacted] 25X1

Prospects for 1983

Current Account. The measures now being implemented will lead to further improvement in the current account but will not be enough to ensure Budapest's projected $680 million gain. Hungary may fall short of its goal of nearly 8-percent growth in exports despite its commitment to continued devaluations of the forint. Export growth of 5 percent, for example, would produce a trade surplus of $1 billion and a current account surplus of only $475 million. In first-quarter 1983, hard currency exports were up 6.5 percent over the same period last year, but Hungary may have difficulties sustaining this growth rate. Exports in early 1982 were exceptionally low but revived late in the year thanks largely to a record harvest that probably will not be repeated this year. Although nascent economic recovery in the OECD should increase demand for Hungary's industrial exports, Hungarian officials recently complained to the US Embassy that growth in key West European markets is lagging behind their initial projections. Cash shortages in developing countries—particularly Middle Eastern oil producers that have been a rapidly growing market for Hungary's food exports—probably will slow Budapest's export offensive. Hungary also needs more sales to socialist countries, which account for nearly one-fourth of hard currency exports.[1] This will depend not only on Hungary's

Hungary: Hard Currency Trade



a Projected.

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ability to supply increased quantities of meat and grain to the USSR, but also upon Moscow's willingness to continue paying hard currency. As softer oil prices limit Soviet hard currency earnings, the USSR may become more insistent that Hungary deliver goods now sold for hard currency in ruble trade. [redacted] 25X1

So far in 1983 Budapest has cut imports by 5 percent, but the Hungarians have claimed in press articles, IMF documents, and Embassy reporting that after reducing imports by 11 percent over the past two years, they have little scope left for more cuts without impairing industrial production and consumer supply. Since Hungary has been successful recently in lining up trade financing, Budapest probably will bring imports back up to at least last year's level and trust in continued growth of exports to ensure a large current account surplus. 25X1

[redacted] 25X1

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[1] Although most of Hungary's trade with CEMA countries is conducted on a clearing account basis, approximately 15 to 20 percent of imports and exports involve hard currency transactions or exchanges of goods otherwise salable in Western markets (so-called hard goods). Most of this trade is with the USSR and, according to Hungarian officials, mainly involves the exchange of Hungarian grain, meat, and other agricultural products for Soviet oil outside planned soft currency deliveries. [redacted] Budapest and the IMF include these surpluses in Hungary's overall hard currency balance of payments. [redacted]

Borrowing. Hungary is making progress toward covering its borrowing needs, but success is uncertain:

- In April, Budapest received a $200 million loan with three-year maturity from a syndicate of Western banks, including two Soviet-owned banks.
- A group of Arab banks also arranged a $100 million credit early this year.
- The Hungarians appear to be in compliance with the IMF program targets, which will ensure continued drawdown of standby credits.

[redacted]

- Budapest also hopes that the World Bank soon will approve $200-250 million in project credits despite objections that Hungary is not poor enough to qualify for World Bank financing. [redacted]

[redacted] the Hungarians have also been lining up short- to medium-term trade financing from commercial banks, particularly in the form of bankers' acceptances. [redacted] efforts to arrange over $500 million in medium-term loans apart from the IMF credits may be too ambitious in the current lending climate. Indeed, the failure of attempts to expand the $200 million syndicated loan indicates many banks remain nervous about medium-term lending to Hungary. Furthermore, some bankers are concerned that Hungary is still losing short-term credit lines. [redacted]

Reserves. The uncertainties surrounding the size of Hungary's current account surplus and financing sources make a $500 million buildup of reserves appear doubtful. By the end of the year we estimate reserves will increase by only $170 million to over $1.3 billion. In early 1983, when efforts to complete the $200 million syndication were faring poorly, senior Hungarian bankers broached the possibility of renewing the $300 million loan with the BIS to preclude a renewed drawdown of reserves. Completion of the syndication made a rollover of the entire credit less necessary. Nonetheless, according to press reports, Hungary's low level of reserves induced Western central bankers to grant a two-month extension on $100 million of the BIS credit. This loan is to be repaid out of IMF credits scheduled to be disbursed in June. [redacted]

Hungary: Debt Service Payments *Million US $*

	1981	1982	1983	1984	1985
Total	**1,840**	**1,847**	**1,667**	**2,096**	**2,101**
Amortization of medium- and long-term debt	826	843	936	1,385	1,409
Gross interest payments	1,014	1,004	731	711	692
Debt service as a share of earnings from exported goods and services *(percent)*	32.7	33.4	27.5	32.7	30.4

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Outlook Through 1985. Hungary must address its fundamental balance-of-payments problems more effectively because the country needs a growing hard currency trade surplus to cover rising debt service payments. According to IMF estimates, repayments on medium- and long-term debt and gross interest payments will rise to $2.1 billion in both 1984 and 1985 compared with $1.7 billion this year. Hungary will also have to roll over $1.5-2 billion in short-term credits each year. Since banks probably will remain reluctant to extend new medium-term credits, the Hungarians will continue to face the problem of bunched maturities for the next several years. Because of continuing liquidity problems, Budapest is certain to require a second IMF standby program in 1984 to obtain additional

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medium-term credits to reinforce its reserves. Indeed, the Hungarians indicated the possibility of another $500 million standby credit in documentation given to banks participating in last year's $260 million loan. [redacted] 25X1

Structural reforms, while necessary, will not be sufficient to ensure improved balance-of-payments performance. Hungary also needs a continued fall in international interest rates and sustained growth in its major Western markets. But even projected current account surpluses will leave Hungary far short of covering its financing requirements over the next several years. Thus, the Hungarians will remain dependent on large borrowings from Western banks and the IMF to meet all their obligations or face the unpleasant option of reschedulings. [redacted] 25X1

[redacted] 25X1

Yugoslavia: Financial Outlook [redacted] 25X1

Since late 1982 Western governments, banks, and international financial institutions have been trying to arrange a financial rescue package to restore Yugoslavia's solvency without a debt rescheduling. The package aims at refinancing all maturing loans this year and providing enough new credits to cover arrearages, an IMF-projected $500 million current account deficit, and a hoped-for $630 million IMF-projected increase in reserves. [redacted]

Progress in completing the package recently stalled because the Yugoslavs claim the bankers are making demands that infringe on their national sovereignty. Even if the Yugoslavs and International Coordinating Committee (ICC) are able to reach some sort of accommodation, we doubt that the package will allow for a reserve buildup of more than $420 million. In addition, the Yugoslavs probably will not earn enough through exports and invisibles to hold the current account deficit below $725 million, even with a $1 billion cut in imports. [redacted]

Given the difficulties involved in arranging this year's financial package, we believe private lenders will not provide enough new loans to cover the traditional large first-half financing requirement next year of $2-2.3 billion. In addition, lenders will be wary because we believe the balance-of-payments performance this year will fall short of the IMF projections. By early 1984—or sooner if the financial package falls apart—some Western creditors will probably try to press Belgrade to begin a formal rescheduling of its debts. In the meantime, Yugoslavia has been unable to make sufficient adjustments to stabilize the balance of payments, leaving Belgrade little choice but to continue policies that cut demand and real incomes. The deteriorating economic situation will increase strains on Yugoslavia's fragile political system. [redacted]

The Rescue Package

By late 1982 Yugoslavia clearly did not have sufficient reserves and could not raise enough credits to cover $4.5 billion in maturing loans and pay off $600 million in arrearages. Belgrade, however, steadfastly refused to consider a formal debt rescheduling. Fears that a rescheduling would prove politically divisive in Yugoslavia prompted 25X1
the US Government and the IMF to initiate a financial rescue package. The effort grew into a complicated, interconnected package that includes:

- $1.4 billion in pledges by Western governments involved in the "Friends of Yugoslavia" effort.
- $3.8-4.0 billion from Western banks, including $600 million in new loans, $1.8-2.0 billion in short-term debt rollover, and $1.4 billion in medium- and long-term debt rollovers.
- $620 million from the IMF as the final tranche under a three-year standby arrangement.
- $400 million from the World Bank, including a $275 million structural adjustment loan for raw 25X1
material imports.
- A $500 million bridging loan from the Bank for International Settlements. [redacted] 25X1

Although some parts of the package are being implemented—the Yugoslavs have already begun to draw on the BIS, IMF, and government credits—the current impasse between the banks and Yugoslav negotiators could derail the whole package. Belgrade objects to the banks' proposed plan because it calls for the Yugoslav National Bank and government to assume responsibility for the debt and in effect recentralize the financial system. [redacted] major points of contention include: 25X1

- The right of a Western bank to seize Yugoslav deposits to pay off arrearages.
- The cross-default clause. 25X1

Yugoslavia: Hard Currency Financing Requirements

Million US $

	1982	1983	
		IMF [a]	CIA [a]
Financing requirement	**5,585**	**5,700**	**5,950**
Current account balance	−1,420	−500	−725
Trade balance	−3,779	−2,300	−2,525
Exports	5,858	6,300	6,150
Imports	9,637	8,600	8,675
Net invisibles	2,359	1,800	1,800
Net invisibles, excluding interest	4,319	3,800	3,750
Net interest	−1,960	−2,000	−1,950
Repayment of short-term credit	2,300	2,000	1,800
Repayment of medium- and long-term debt	1,690	2,500	2,625
Credits extended (net)	−175	−200	−200
Arrearages [b]	NA	500	600
Financing sources	4,573	6,328	6,370
Hard currency			6,170
IMF			620
IBRD			400
Government loans			1,350
Financial credits			300
Export credits			1,050
Banks			3,800
New loans			600
Short-term rollover			1,800
Medium- and long-term rollover			1,400
Other			200
Change in reserves	−1,012	628	420

[a] Projection.
[b] Arrearages as of 1 January 1983.

[redacted]

- Waiver of sovereign immunity, which would give banks the right to sue the Yugoslav Government to enforce terms of the agreement.

[redacted] the ICC insists that these clauses are standard for any loan agreement and necessary to protect the banks relative to other Yugoslav creditors not participating in the refinancing. It is important that the Yugoslavs and the banks resolve their differences because the IMF funds and at least some of the other credits in the package are contingent on Western bank participation in the rescue effort. [redacted] 25X1

Additional hurdles remain even if the banks and Belgrade iron out their differences. Some Western governments have yet to provide credits pledged as part of the package. [redacted] 25X1 Yugoslavia must continue to meet IMF performance criteria, which will probably be toughened at the midyear review, to be able to continue drawing on the three-year standby. [redacted] 25X1

Even if all these hurdles are overcome, the credits will be less than originally envisioned and will be disbursed later. The bank package will not be completed until late summer at the earliest and disbursement of credits will probably lag the implementation of the package. Furthermore, $350 million of the "Friends of Yugoslavia" credits are tied to purchases of capital goods that Yugoslavia probably will not buy. [redacted] 25X1

Foreign Exchange Earnings

Boosting exports is a key part of the Yugoslav effort to ease its financial problems. Yugoslavia, however, will be unable to redirect enough of its declining industrial production to the export sector, and growth in Western markets will not be strong enough to attain its ambitious goal of increasing exports 20 percent. Export growth will be no more than the IMF projection of 7.5 percent, and it could even fall below 5 percent. Although hard currency sales were up 28 percent in January and February, March and April sales were 1 percent below last year's level. [redacted] 25X1

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The IMF performance criteria include the following provisions:

Monetary Policy

- *Money supply and net domestic assets are to increase by 12 percent.*
- *Real interest rates are to be raised to positive levels for nonpriority sectors.*
- *Yugoslavia is to pass legislation to control interenterprise credits by imposing stiffer penalties for failure to meet payment obligations. By September 1983 outstanding interenterprise credits are to be 50 billion dinars below the 169 billion dinars outstanding in September 1982.*

Exchange Rate Policy

- *Monthly devaluations of the dinar to offset inflation and improve the competitiveness of Yugoslav exports.*

Foreign Debt Management

- *New loans are limited to $1.5 billion for 1983, excluding rollovers and new loans to replace maturing debt.*

Fiscal Policy

- *Revenues and expenditures are to increase 13 percent and transfer payments are to increase 18 percent. If revenues rise more than expected, they will be frozen in a blocked account at the National Bank until 1985.* 25X1

Price Policy

- *Prices are to be realigned with international prices and relative price distortions are to be eliminated. The current price freeze will continue until the end of June, although adjustment for dinar depreciation and the mandated price increases will be allowed. Specifically: (1) electricity, coal, railway fares, live animals, and meat prices have been increased 25 to 35 percent; (2) petroleum products are up 25 percent; and (3) rent increases of 30 percent have been recommended.* 25X1 25X1

Incomes Policy 25X1

- *Real incomes are to fall 7.5 percent in 1983. Enterprises are to limit payments of personal income to current net enterprise income rather than engaging in the past practice of basing payments on the expected income stream.* 25X1 25X1

Tourist earnings are unlikely to rebound significantly from last year's low level. Three-fourths of tourist revenues are collected during the second half of the year, and advanced bookings for tour packages—35 percent of Yugoslavia's foreign visitors—were reportedly down 25 to 30 percent as of the end of February compared with the same period last year. Moreover, reports of shortages, especially of gasoline and food supplies, could again scare potential tourists. Belgrade has tried to polish its image by introducing a special dinar check that gives a 10-percent discount for tourist services, exempting foreigners from gasoline rationing, and allocating hard currency to improve supplies in the tourist areas.

We expect remittances from Yugoslav workers abroad, another important source of foreign exchange, to decline in 1983. Limits on withdrawals from hard currency accounts imposed last year and fears of new restrictions are deterring workers from sending money home. The restrictions are limiting somewhat the outflow of already existing deposits. We estimate that net inflows will fall by 30 percent. 25X1

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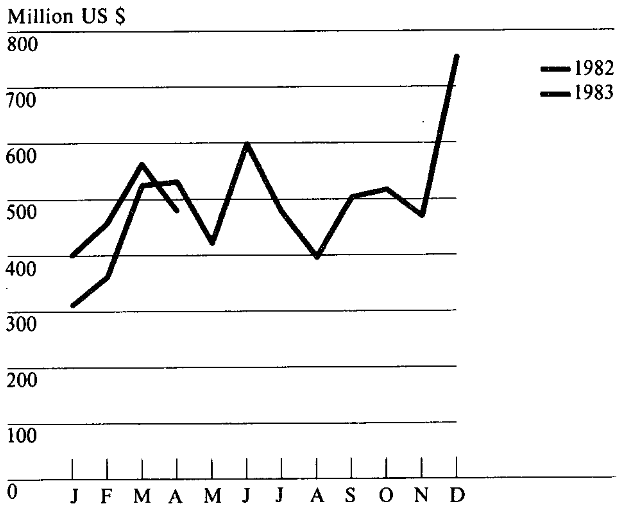
Yugoslavia: Hard Currency Exports (f.o.b.)



[redacted]

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Import or Build Reserves

Belgrade will not earn enough foreign exchange or get sufficient financing to allow both an increase in reserves and imports at planned levels. We believe Belgrade will lean toward rebuilding reserves because it is concerned about its future liquidity and lender attitudes. [redacted]

Reserves. The size of the Yugoslav National Bank's reserve holdings is the key indicator of the country's liquidity. The lack of a foreign exchange market and the tendency of the better managed banks to hoard their reserves force illiquid banks to depend on the National Bank for hard currency. Assuming the ICC and Yugoslav negotiators are able to work out a compromise, by the end of the year the National Bank's effective reserves—those reserves that are available to meet liquidity needs—probably will range between $300 million and $700 million. Their size will depend on Yugoslavia's ability to use the $350 million in Western government capital goods credits and on how much the National Bank replenishes other foreign exchange accounts that cannot be used for general liquidity. If the bank package falls apart, effective reserves will be exhausted quickly and arrearages will increase. [redacted] 25X1

Imports and Industrial Production. The inability to line up financing has forced the Yugoslavs to cut imports drastically. From January through mid-April, imports declined by 18 percent, a sharp drop after the 15-percent decline from 1980 to 1982. Even if credits from the Western package are disbursed, imports will still fall by 10 percent this year. [redacted] 25X1

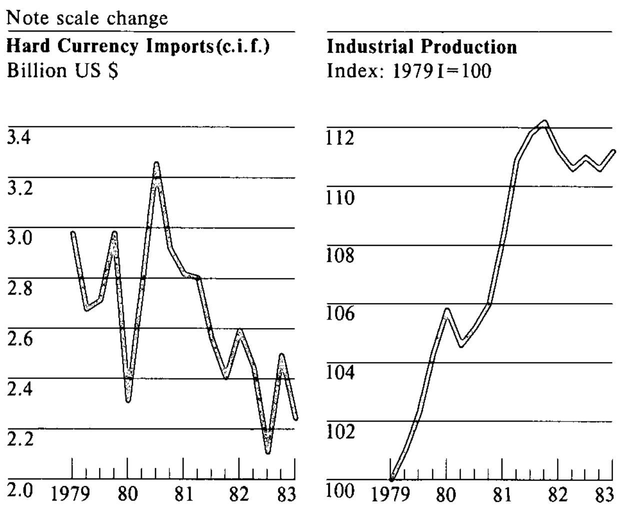
The cut in imports has hurt industrial output and consumer supplies. The growth in industrial output has slowed markedly since 1979 when Belgrade first moved to stabilize the balance of payments. Last year industrial output fell for the first time since 1952. Production in the first four months of this year was down 0.9 percent compared with the same period last year, primarily because of shortages of raw materials and intermediate goods. We expect that by the end of the year the drop in industrial output will be about 5 percent. [redacted] 25X1 25X1

Stabilization Program

Since the record hard currency current account deficit of $3.3 billion in 1979, Belgrade has tried to stabilize the economy with tight monetary policy, dinar devaluations, and price controls. The aim has been to slow economic growth and inflation, reduce demand for imports, and spur exports. Yugoslavia's efforts have been supported by two IMF programs, the first of which began in 1980 and was replaced by the current three-year standby agreement in 1981. This year's IMF program imposes tough requirements that will cut domestic demand and living standards. The IMF remains concerned about continued high inflation and is likely to require additional interest rate hikes and may tighten other requirements at the midyear review. 25X1

[redacted] 25X1

Yugoslavia: Hard Currency Imports and Industrial Production [a]



[a] Quarterly data; seasonally adjusted.

[redacted]

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The Yugoslavs have been somewhat successful in cutting imports, but little progress has been achieved in stabilizing the domestic economy or in dealing with longstanding systemic problems. While monetary policy was tightened as one of the IMF conditions, the rising use of interenterprise trade credits has added to inflationary pressures. Even with price controls, inflation is currently above 30 percent, similar to last year's rate. [redacted]

First-Half 1984 Balance-of-Payments Outlook

Assuming the bank package is implemented and Western bankers maintain their short-term exposure, as they pledged, Yugoslavia probably will have a financing requirement of $2-2.3 billion in first-half 1984. The IMF projects that Yugoslavia will repay $1.2 billion in medium- and long-term loans while extending $100 million in trade credits during this period. The IMF estimates the current account deficit will be $700 million; but we believe it could run as high as $1 billion. [redacted] 25X1

Even if the Yugoslav National Bank exhausts its holdings of uncommitted foreign exchange to meet the financing requirement during the first half of the year, external financing of some $1.3 billion to $2 billion will be required to prevent major arrearages. [redacted] the Yugoslavs should be able to draw some commercial and government-backed trade credits [redacted] Bankers will remain cautious about new lending because of: 25X1 25X1

- Yugoslavia's likely failure to meet the 1983 IMF current account target of a $500 million deficit.
- Belgrade's inability to curb inflation and deal with other domestic economic problems.
- Uncertainties about a new IMF stabilization program and lending facilities.
- Widespread belief that the country needs more debt relief. [redacted] 25X1

We believe some Western creditors may be inclined to force Belgrade into a formal rescheduling in 1984. Because of the problems in this year's rescue effort, commercial bankers seem increasingly convinced that rescheduling is the only way to ensure equitable burdensharing among all creditors. Western governments that reluctantly accepted the present package [redacted] may insist that Yugoslavia's problems be addressed in the Paris Club. [redacted] 25X1 25X1 25X1

If the package falls apart, the Yugoslavs will probably declare a moratorium on debt repayments. This could lead some creditors to press for a declaration of default to force the Yugoslavs to request a debt rescheduling. Some elements in Yugoslavia have raised the specter of debt repudiation, but we believe they are not strong enough to overrule more pragmatic leaders. The current impasse, however, will generate internal debate that will place further strains on Belgrade's delicate political structure. [redacted] 25X1 25X1

[redacted] 25X1

India: Economic Outlook

25X1

Bad weather, electricity shortages, and labor unrest were the major factors behind India's near-zero economic growth last year. Widespread drought not only hurt crops, but it also cut sharply into hydroelectric power generation. Although more favorable weather would alleviate many of these problems, India's longer term outlook is clouded by looming financial problems. A likely reduction in concessional aid will coincide with rising debt repayments, putting growing strains on the balance of payments in the mid-1980s. Moreover, a gradual retreat from import liberalization will reduce hoped for gains in efficiency, and internal unrest could adversely impact on investment and production.

Coping With a Difficult Year

India experienced near-zero overall growth during the year that ended March 1983. Poor weather during the summer of 1982 led to a fall of about 6 percent in foodgrain production and reduced generation of hydroelectric power. Moreover, an upsurge in strike activity cut into production, particularly in the textile industry. Nonetheless, industry was still able to record a small increase in output. A bright spot was increased production of crude oil from the offshore Bombay High Field.

Despite weather induced problems in the domestic economy, India's international financial position improved modestly last year, largely because of sharply lower net petroleum imports and stepped up support from the IMF. IMF lending jumped by $1.2 billion, enabling India to increase its reserves by $500 million; reserves fell by $2.4 billion during the previous year. We estimate that net petroleum imports probably dropped by almost $800 million because of increased domestic production and lower international prices. Gains in manufactured exports resulted from larger sales to Communist countries and the Middle East, while growth in the volume of industrial imports reflected the gradual liberalization of licensing controls over the last several years and purchases for the petroleum industry. 25X1

With favorable weather, the trade balance should improve slightly again this year. We expect another decline in net petroleum imports that should more than offset a possible increase in grain purchases and a decline in exports to the Soviet Union. Moreover, capital receipts will remain high as a result of IMF loans, concessional aid, and commercial borrowing already arranged. If the June-September monsoon is poor again this year, however, 25X1
New Delhi has little leeway to cope with the increased import requirements and reduced export supplies that would result. 25X1

Backsliding on Liberalization

Although liberalization of domestic economic controls, apparent since Prime Minister Gandhi returned to office in 1980, [1] has been broadened, policymakers appear to be having second thoughts about encouraging imports and foreign commercial borrowing. Gandhi had hoped that liberalization 25X1
would increase the efficiency of India's industries and promote greater competitiveness of exports, but concerns about future balance-of-payments problems as well as the percieved need to protect domestic industry and boost government revenue has caused some weakening in support for the

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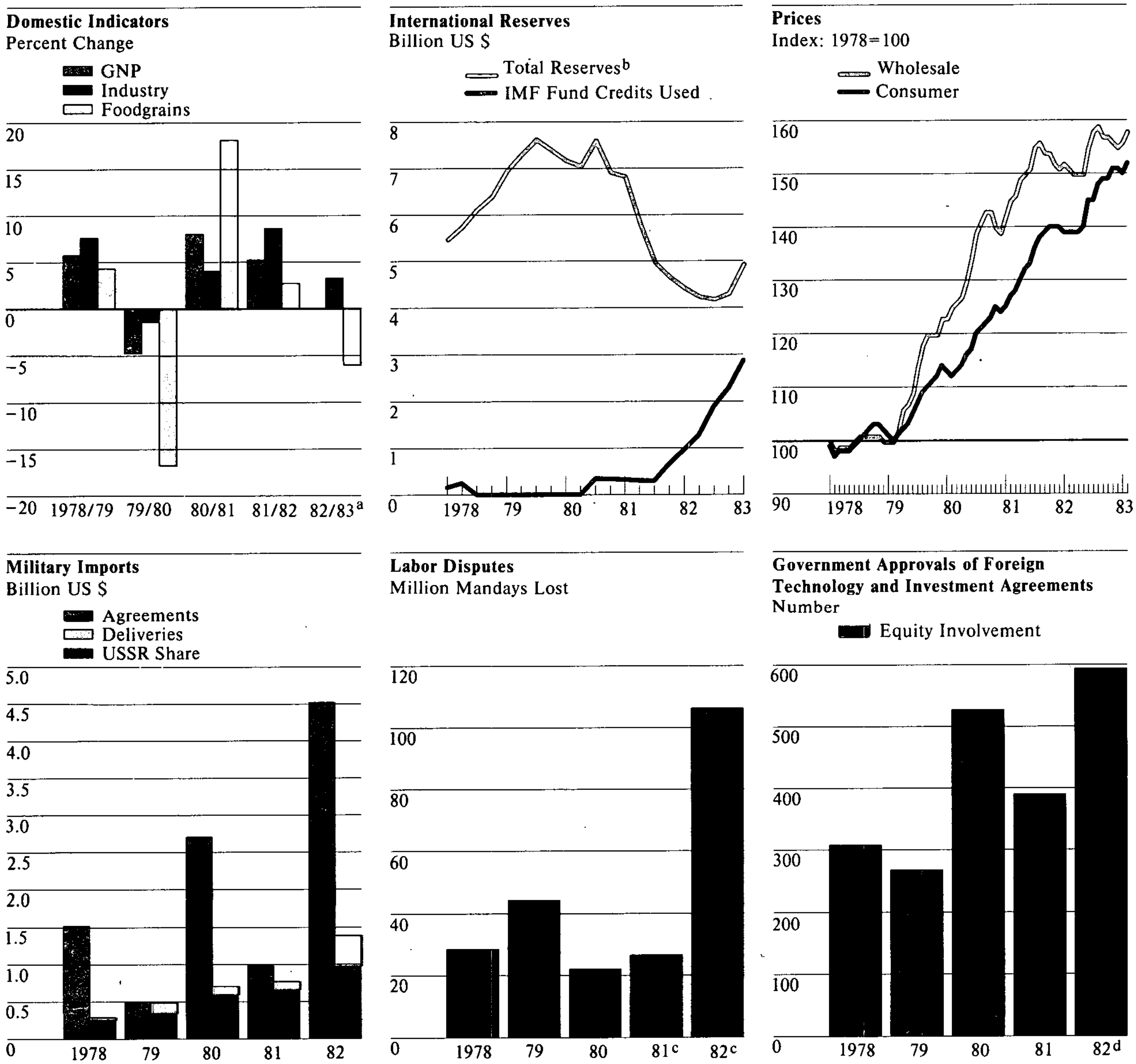
India: Economic Indicators



[a] Estimate.
[b] Excluding gold.
[c] Provisional.
[d] Data on number of agreements with financial participation in 1982 not available.

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The Soviet Trade Problem

India's trade relations with the Soviet Union complicate management of overall international payments problems even though most or all bilateral payments are made through a rupee account and do not directly require the use of hard currency. Most of the growth in India's nonoil exports during the past three years results from a surge in sales to the Soviet Union. The bilateral trade surplus has been more than enough to cover current payments due for military equipment. Unfortunately, the resulting payments surplus is of dubious value to India. It cannot be used to pay for imports from other countries, and India has not wanted to increase purchases of inferior Soviet machinery. As a result, rupee earnings equivalent to about $300-600 million have accumulated; they are, in effect, an interest-free loan from India to the USSR. Efforts to restore a balance in bilateral payments are now hurting Indian exporters.

Current problems may be reversed within three years. Payments due for purchases of Soviet military equipment that has already been ordered will increase sufficiently to sustain trade at previous peak levels. If New Delhi signs any large new agreements with the USSR, it will have to adjust the nonmilitary trade balance.

program. Even so, incentives have been added to increase production and exports, and special restrictions on very large private companies have been further relaxed. An increase in the number of approvals for foreign collaboration agreements shows continuing strong interest in acquiring advanced Western technology.

Political and Social Constraints

The changing political scene complicates management of the economy. Increasingly important state parties opposed to Gandhi base their appeal, in part, on the offer of additional consumer subsidies and resistance to Gandhi's centralized control. Farmers have become more vociferous in their demands for higher prices, preferential allocations of electricity, and a moratorium on repayment of government loans. Gandhi can ill afford to compete with opposition parties in populist appeals. She must also maintain control of resources such as electricity, water, and grain that must be shared among the states. 25X1

At the same time, India has been hit by a marked erosion in internal security. Last spring's well-publicized riots in Assam left 7,000 dead. Potentially more troublesome problems in the prosperous state of Punjab could disrupt economic activity there. In a wider vein, conflict seems to be spreading between Hindus and Muslims and among Hindu castes. These developments may divert government attention from the economy and sour the investment climate. 25X1

India has the potential to move beyond extreme poverty and lacklustre growth. Political trends 25X1 among opposition parties and interest groups could be beneficial if they expedite local development projects and ensure continuing support for agriculture. The threat of growing instability has not yet negated the contribution of liberalized economic controls to the investment climate. Over the next several years, the balance between improving and merely coping will be heavily weighted by India's 25X1 ability to avoid severe balance-of-payments constraints. 25X1

Longer Term Financial Prospects

International payments problems will mount sharply by 1985 or 1986. Disbursements from the International Monetary Fund and the International Development Association will drop, and repayments of the Extended Fund Facility credit and 25X1 recent commercial borrowing are scheduled to begin. Payment for military imports will climb to $0.8-1.2 billion, double or triple the level of the early 1980s. The decline in new contracts for projects in the Middle East that is already under way will probably reduce worker remittances and

India: Selected Policy Measures

December 1982	*Import licenses for some steel products canceled; government firms will offer substitutes at international prices.*	*Tightening of import policy to protect domestic industry.*
	Most import duties raised.	*Primarily a revenue measure, provides additional protection.*
February 1983	*Central government budget: tax incentives for production and exports increased; import taxes raised; business depreciation allowances increased; minimum corporate tax imposed despite other concessions.*	*Mixture of measures to raise government revenue, stimulate economy, and protect domestic industry.*
April 1983	*Import/export policy: manufacturers who export most or all their production entitled to additional import licenses and income tax concessions; restrictions on imports of components and spare parts reimposed.*	*Export promotion efforts extended. Import restrictions to ease trade deficit and protect domestic industry.*
	Additional subsidies and concessional finance offered to industries that invest in "backward" areas.	*Dispersion to area with poor infrastructure raises business costs and lowers efficiency.*
	Industrial license no longer required if investment cost below $5 million and imports less than $400,000 (previous exemption limit $3 million).	*Extends domestic liberalization; no concession on imports.*
	Exporters permitted to deduct 1 percent of their turnover from taxable income.	*Supplements export incentives in February budget.*
	Offshore oil exploration and services become subject to income tax. Customs duty proposed for imported exploration equipment.	*Apparently effort to stimulate domestic production and curb imports in this major investment sector.*
May 1983	*Barriers to large company expansion in industries such as fertilizer, pig iron, electronic components, and chemical machinery eased.*	*Implements major liberalization announced earlier.*
	Limits on value of technical designs and machinery that may be imported without special permission raised for manufacturers who export a substantial share of production.	*Provides additional export incentives.*
	Importers of capital goods required to request foreign currency loans from government financial institutions before seeking foreign suppliers' credits.	*Effort to curb total commercial borrowing from abroad. Likely to result in higher interest cost for some industries.*

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consultancy fees. These foreseeable lower receipts and increased obligations—compared to 1982/83—total roughly $3.5 billion. In addition, larger petroleum imports may be needed to meet rising requirements since domestic production from known fields will level off after 1985. Substantially greater recourse to commercial borrowing, an option now, may not be possible if financial strains become obvious.

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We believe that India will be hard pressed to cope with so great a worsening in its external accounts without curtailing development efforts. Increased

India: Balance of Payments [a]

Million US $

	1979/80	1980/81	1981/82	1982/83	1983/84
Trade balance	−3,435	−7,615	−6,745	−6,000	−5,700
Exports [b]	7,948	8,504	8,730	10,000	10,200
Petroleum	30	11	220	1,200	900
Imports,[b] c.i.f. [c]	11,383	16,119	15,475	16,000	15,900
Petroleum	4,046	6,671	5,800	6,000	5,000
Private transfers	1,850	2,700	1,550	1,500	1,500
Current account balance	**−250**	**−2,940**	**−3,845**	**−3,500**	**−3,400**
Aid disbursements [c]	1,685	2,100	1,927	2,130	2,035
IDA	547	650	761	1,084	
Other medium- and long-term borrowing [c d]	281	288	798	644	
IBRD	149	175	408	346	
Receipts from IMF	155	1,035	690	1,885	
Amortization [c d]	693	733	685	642	847
Change in reserves	224	−344	−2,398	502	
Military payments [e]	Less than 400	Less than 400	Less than 400	300-700	300-700

[a] Estimates, based on IBRD, IMF, and Indian Government data.
[b] Trade (not payment) values.
[c] Excluding military transactions.
[d] Data on private-sector borrowing are probably incomplete. [redacted] 25X1

[redacted] 25X1

exports and import substitution will help, but only large new petroleum discoveries, consistently good weather that permits a resumption of large-scale grain exports, or an increase in concessional aid receipts would significantly brighten India's outlook. [redacted]

If oil exploration efforts fail and aid prospects remain bleak, Gandhi would have few options but to retreat from her liberalized import policy. She may tighten quantitative controls sooner or more harshly to appease businessmen hurt by foreign competition and to respond to a revived interest in self-reliance. We believe Gandhi is unlikely to pursue massive foreign investment unless it is accompanied by technology transfer. [redacted]

Relations With the United States

Indian policymakers see an anti-Indian bias in a number of US policy decisions that they believe harm Indian interests. US military support for Pakistan underlies much of the continuing friction. 25X1 Both countries are now trying to resolve disputes about US barriers to the shipment of parts for the Tarapur Atomic Power Reactor and export controls that limit advanced technology for Indian industry. Policies toward multilateral lending institutions are also a major factor in Indian distrust of the United States. The United States abstained on India's 1981 request for an Extended Fund Facility and

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Indian officials now fear opposition to full drawing of the last tranche. They argue that the United States has reneged on its commitment to provide funds for the International Development Association, seeks to lower India's share of amounts available, and has actively campaigned against Indian borrowing from the Asian Development Bank. In the Indian view, the United States is trying to force New Delhi to turn to commercial money markets while the country is still extremely poor, its financial prospects uncertain, and the perils of international debt are especially obvious. [redacted] 25X1

Despite Prime Minister Gandhi's distrust of the United States, she is still interested in improving bilateral relations, in our judgment. India seeks improved access to US markets and technology as well as greater financial support from multilateral institutions. Besides, current trade problems with the Soviet Union make Indian comparisons of support from the superpowers more favorable to the United States. Countering government-to-government frictions is a strengthening of private links—many middle class and elite families, for instance, now have close relatives who have studied in the United States or work here as professionals. [redacted] 25X1

Resentment of US policies combined with the economic opportunities and constraints India faces is likely to reinforce Gandhi's widely supported policy preference for self-reliance. Domestically, this implies a greater willingness to sacrifice opportunities for growth and relief of poverty in order to reduce vulnerability to changes in the policies of other countries. Internationally, New Delhi's traditional emphasis on nonalignment will be strengthened. If India is able to avoid severe financial strains, however, the impetus for self-reliance will again weaken and New Delhi will increasingly seek to expand commercial relations with Western countries. [redacted] 25X1

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Next 1 Page(s) In Document Denied

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