Directorate of
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International Economic & Energy Weekly

25X1

16 September 1983

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DI IEEW 83-037
16 September 1983

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International Economic & Energy Weekly [redacted]

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Comments and queries regarding this publication are welcome. They may be directed to [redacted] *Directorate of Intelligence,* [redacted] 25X1

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International
Economic & Energy
Weekly [redacted] 25X1

Synopsis

Perspective—*Oil Market: Threatening Clouds on the Horizon* [redacted] 25X1

The oil market has continued to firm in recent months. In addition, the widespread inventory drawdowns that contributed heavily to downward price pressures have now subsided. The calm market outlook could change virtually overnight, however, if Iran and Iraq carry out recent threats to escalate attacks against oil targets. [redacted] 25X1

World Grain Market: Preliminary Assessment [redacted] 25X1

World grain production during the marketing year ending 30 June 1984 (MY 1984) is expected to fall by 5 percent—the first decline in five years. Even if continuing drought leads to additional crop losses, as seems likely, record stocks will ensure adequate supplies. [redacted] 25X1

The World Sugar Market: Opportunities for Soviet Influence [redacted] 25X1

Poor sugar harvests in the USSR during the past few years have made Moscow the world's largest sugar importer. Soviet officials know that the prospect of Soviet purchases looms large to prospective sellers in a glutted market, particularly for financially strapped LDCs. [redacted] 25X1

South Korea: Managing a Large Foreign Debt [redacted] 25X1

South Korea—with the fourth-largest debt among LDCs—is unlikely to face financing problems over the near term. Over the next two or three years, however, South Korea will need to borrow about $4 billion per year in new funds and to maintain its short-term credit lines if it is to avoid a financing crunch. [redacted] 25X1

Qatar: Reacting to the Soft Oil Market [redacted] 25X1

The soft oil market has prompted Qatar to cut government spending, postpone major development projects, and attempt to slow aid outflows. Although most Qataris are little affected by the retrenchment, cutbacks could aggravate resentment of the greed, corruption, and privilege of the ruling Thani clan. [redacted]

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[redacted]

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16 September 1983

Perspective

Oil Market: Threatening Clouds on the Horizon [redacted]

25X1

The oil market has continued to firm in recent months. Although oil sales remain weak in Western Europe, economic recovery in the United States has boosted August oil sales 5 percent above 1982 levels. In addition, the widespread inventory drawdowns that contributed heavily to downward price pressures have now subsided. [redacted] 25X1

Encouraged by the strengthened market, a number of OPEC countries are producing above their individual quotas. Although output rose above 18 million b/d in July and August, in general enough restraint has been applied to keep prices in the spot market near or slightly above official levels. Rising demand for OPEC crude oil—which could exceed 19 million b/d in the fourth quarter, according to many industry estimates—has spurred several OPEC members to call for a revision in quotas to enable OPEC to capture demand generated by higher consumption. [redacted] 25X1

The calm market outlook could change virtually overnight, however, if Iran and Iraq carry out recent threats to escalate attacks against oil targets. We believe that the risks of a major disruption will be increased significantly by Iraq's acquisition of five super Etendard aircraft from France. These aircraft will give Baghdad a much improved capability to attack oil tankers calling at Khark Island. Tehran recently has renewed public threats to attack Iraq's pipeline through Turkey—Baghdad's sole remaining export outlet—and has threatened to close the Gulf to all oil exports if its own flow is disrupted. According to our analysis, closure of the Strait of Hormuz—either by mining or attacks against shipping—and shutting down the Iraq-Turkey pipeline could remove some 13 million b/d of Free World productive capacity. [redacted]

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Despite the Strategic Petroleum Reserve and considerable supplies of oil outside the Persian Gulf, the United States would not be insulated from a sizable interruption in Persian Gulf oil. Heavy Western dependence on Gulf oil would disrupt US supply patterns and drive up prices worldwide. If oil exports through the Strait of Hormuz were cut off, presently operating pipelines in Saudi Arabia and Iraq could still export about 3 million b/d. Remaining capacity from the Gulf—about 12 million b/d—would be lost, and, even with the addition of 3 million b/d in surplus capacity outside the region, oil supply

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would fall far short of demand, possibly leading to a doubling or tripling of prices. Judicious use of stocks could slow price escalation, especially if consumers anticipated a fairly quick reopening of the Strait, but the cost of such a disruption to the world economic and financial system would nevertheless be substantial. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

OPEC Production Update

OPEC production in August averaged 18.4 million b/d, nearly 1 million b/d above the cartel's self-imposed ceiling established in March. Saudi Arabia's production continued to rise, boosted by direct marketing of Saudi crude by the Swiss trading company Norbec and Riyadh's continued war assistance to Baghdad in the form of crude sales to Iraq's customers. Iraq was able to maintain its production at about 1 million b/d by using chemicals to enhance the oil flow through its export pipeline through Turkey. We believe Iran exceeded its OPEC-mandated quota in August as a result of increased Japanese liftings. [redacted] 25X1 25X1 [redacted] Nigeria—under fire for

OPEC: Crude Oil Production, 1983 *Million b/d*

	Quota	1st Qtr	2nd Qtr	July [a]	August [a]
Total	**17.5**	**15.9**	**16.8**	**18.2**	**18.4**
Algeria	0.725	0.7	0.6	0.6	0.6
Ecuador	0.2	0.2	0.2	0.2	0.2
Gabon	0.15	0.2	0.2	0.2	0.2
Indonesia	1.3	1.1	1.4	1.4	1.4
Iran	2.4	2.6	2.3	2.4	2.5
Iraq	1.2	0.8	0.9	1.0	1.0
Kuwait	1.05	0.8	0.7	0.9	0.9
Libya	1.1	1.3	1.1	1.1	1.1
Neutral Zone	[b]	0.2	0.4	0.5	0.5
Nigeria	1.3	0.8	1.4	1.7	1.3
Qatar	0.3	0.2	0.3	0.3	0.3
Saudi Arabia	5.0 [c]	3.9	4.4	5.1	5.5
United Arab Emirates	1.1	1.2	1.2	1.2	1.2
Venezuela	1.675	2.0	1.7	1.7	1.7

[a] Preliminary.
[b] Neutral Zone production is shared equally between Saudi Arabia and Kuwait and is included in each country's production quota.
[c] Saudi Arabia has no formal quota; it will act as swing producer to meet market requirements.

[redacted] 25X1

flagrantly violating its quota in June and July—cut back output dramatically in August and limited production to its 1.3-million-b/d ceiling. [redacted] 25X1 25X1

Spot Market Price Trends

Most spot crude oil prices firmed in August. North Sea and North African prices have now risen by about $1 per barrel to about $31 per barrel since late July and are now $1 above official prices. Spot prices of Persian Gulf crudes with the exception of Arab Light are now at or above official levels. Higher prices in part reflect a rebound in US oil consumption, a near end to destocking, and general compliance with the OPEC quota system. According to preliminary data, US oil consumption in the four weeks ending 26 August averaged about 5 percent above year-earlier levels. Firming spot prices caused Egypt to raise official crude oil prices between 25 cents and $1 per barrel effective 1 September. The move followed an earlier announcement by the Soviet Union that raised crude prices by $0.50 per barrel effective 15 August. [redacted] 25X1

Weakness in Arab Light spot crude prices—prices fell to $28.70 per barrel—reflect growing volumes of Saudi spot sales. Press reports indicate Saudi Arabia established Norbec, Ltd., a Swiss-based trading company, to market some oil on the spot market. Some analysts believe increased Saudi spot crude sales in recent weeks were intended to give Riyadh more flexibility in marketing crude and dampen pressure for oil price increases. [redacted] 25X1

Chinese Gas Discovery

Atlantic Richfield's recently confirmed discovery of natural gas in the Yinggehai Basin, south of Hainan Island, may be a substantial find. [redacted] 25X1 25X1 If developed, such a discovery 25X1 could add as much as 40 percent to China's currently meager output of natural gas. [redacted] 25X1

Because of high offshore development costs, however, most Western firms have expressed little interest in the expected gas-bearing potential of the Yinggehai Basin. ARCO's contract, in fact, was not specific with regard to gas development, thus difficult negotiations on the allocation of the gas would have to precede development. The company hopes that a Chinese market for the gas might be developed on Hainan Island or in southern China, possibly as a feedstock for a petrochemical or fertilizer industry. [redacted] 25X1

Italian Government Promotes Solar Energy Use

The Italian Government and ENEL, the state-owned electric utility, are collaborating to promote the use of solar energy for domestic hot water. Under a trial program, the government will pay 30 percent of the cost of the home installation of a solar-heated hot water unit and ENEL will finance the remainder of the cost. Homeowners are expected to repay these costs over a seven-year period out of savings on their electric bills. Although the success of the program is uncertain, we believe ENEL and the government are trying to generate increased use of solar energy in an effort to hold down growth in electricity demand. ENEL has run into numerous problems in siting, constructing, and financing new electric power plants, and increased use of solar energy for hot water heating could help avoid electricity shortages in the late 1980s or early 1990s. [redacted] 25X1

Indonesian Oil Contract Problems

Pertamina—the national oil company—has not yet reached agreement with Caltex, the country's largest crude oil producer, on terms of a production-sharing agreement to replace the existing contract arrangement that expires on 28 November. Caltex has already agreed to a government share of 86.5 percent, as compared with the 85-percent share applicable to all other existing contracts, but Pertamina continues to demand a higher percentage. [redacted] 25X1 25X1 the government probably will dictate the final terms, but Jakarta's insistence on a larger share will weaken Caltex's ability to secure capital for exploration, development, and enhanced recovery operations and could discourage other oil companies from investment spending. [redacted] 25X1

International Finance

Yugoslavia Requests CCC Financing

Yugoslavia has requested $341 million in credit quarantees from the US Commodity Credit Corporation (CCC) for the purchase of US agricultural commodities in FY 1984. The CCC-backed loans are normally for a three-year period with interest rates set by US banks at a fraction above the US prime rate or LIBOR. With Western banks having cut back sharply on lending to Yugoslavia, Belgrade needs the credits to assure adequate market supplies (vegetable oils, soybean/meal products) and to assist the export sector, which depends heavily on imported raw materials (cotton, hides, and skins). In FY 1983 Yugoslavia received roughly $240 million in CCC export guarantees, much of which went toward financing US sales of wheat to Yugoslavia. Because of this year's excellent wheat crop, Belgrade does not intend to use any CCC credits for wheat purchases in FY 1984. [redacted] 25X1

Growing Financial Strains in the Philippines

[redacted] Manila's financial position 25X1 has deteriorated since the assassination of Benigno Aquino. Although large US banks are continuing to renew short-term credits as they mature, [redacted] 25X1 25X1 several banks suspended negotiations for new loans when Aquino was shot. Several large private Philippine firms reportedly are rapidly falling behind in their payments on government-guaranteed foreign loans. Last week the IMF determined that Manila is out of compliance with the terms of its $375 million standby loan and intends to suspend further disbursements until Manila makes major changes in economic policy. [redacted] 25X1

Manila's trouble with the IMF and the failure of private borrowers to make payments on government-backed loans increase the likelihood that the government will become critically short of liquid funds in the next few months. Manila may try to accommodate the requirements of the IMF, but the latter probably will not resume disbursements until mid-November at the earliest. In the meantime, the government's economic policy offices appear in disarray, as Manila remains preoccupied dealing with the repercussions of Aquino's assassination. 25X1

Mexico Extends Export Credits to Cuba

Mexican and Cuban financial officials last week signed two export credit agreements totaling $55 million. According to US Embassy reporting, about half of the proposed trade financing is an extension of a previous Mexican credit line and does not represent new commitments. The credits will be managed by Mexico's foreign trade bank, which will pay exporters in pesos, while Havana incurs a dollar liability to the Mexican Government. To try to keep its trade account balanced, press sources report Havana has begun negotiations to extend similar export credits to Mexico City. The US Embassy reports Cuban officials plan to visit Mexico later this month to discuss the proposed credit and pricing issues. Mexico City will wait for Cuba to adjust its high export prices before agreeing to any trade package, according to Embassy sources. We believe the trade credits will have little commercial impact, but they serve as important adjuncts to Mexico's diplomatic and political support of Cuba. 25X1

Hanoi Seeks Debt Relief From Paris Club

The US Embassy in Paris recently was informed by the Paris Club that Vietnam has made a second plea for help in rescheduling debts. The Paris Club turned down Hanoi's first request in June 1982 pending an agreement between Vietnam and the IMF that calls for a reduction in budgetary deficits—19.7 percent of GDP last year—and a devaluation of the dong. Hanoi says that such an agreement is still not possible because of a poor balance-of-payments situation but cites recent gains in production and export performance as justification for renewing the application. 25X1

According to the IMF, Vietnam's hard currency debt at the end of 1982 was $1.4 billion, including $335 million owed Paris Club members and $718 million owed Middle East and African countries for oil bought during 1976-81. Vietnam's hard currency arrears currently total $247.4 million. Because Hanoi's debts are small by current international standards, creditors probably will continue to allow arrears to accumulate without declaring default, and we expect the Paris Club again to turn down Hanoi's request. 25X1

France Calling for International Monetary Reform

The French Government is disappointed about the lack of progress on international monetary reform—an issue discussed at the Williamsburg Summit—and will raise the topic at the industrial nation group, or G-10, meeting in Washington on 24 September. French Finance Minister Delors, who will chair the G-10 meeting, will seek to use his influence to get agreement for some concerted action on the part of the 10 members. Although the French want to keep the issue of international monetary reform within the G-10, it is also an issue supported by the LDCs who might for their own reasons seek a broader forum for debate. According to French Treasury Director Michel Camdessus, France's primary areas of concern are:

- Developing a formal procedure for coordinated discussions within the G-10.
- Instituting surveillance techniques for monitoring exchange market instability.
- Diversifying international exchange reserves and reassessing the role of the IMF's special drawing rights.
- Studying medium-term financing mechanisms for the IMF, which according to Camdessus, face a financial crunch during 1985-86. [redacted] 25X1

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Global and Regional Developments

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Progress on Japanese-US Trade Issues

The Japanese are prepared to extend voluntary restraints on auto shipments to the United States for one year and are prepared to enlarge but not eliminate their beef and citrus import quotas over the next four years [redacted] the Japanese auto industry is pleased with its profits under the current export restraints but wants an expanded quota for 1984. MITI realizes that refusal to agree to continued auto restraints could lead to increased trade friction with the United States. [redacted] 25X1 25X1

The Ministry of Agriculture, Forestry, and Fisheries hopes to persuade the United States to soften its demand that Japan end restrictions on farm imports and accept a compromise. [redacted] Tokyo's inability to establish a time for elimination of beef and citrus quotas, despite strong US pressure, reflects the powerful influence that farm interest groups have in the bureaucracy and the ruling Liberal Democratic Party. Only a political decision by the Prime Minister to defy these groups could make such a schedule possible. [redacted] 25X1 25X1

Chinese Trade Restrictions Against the United States Lifted

Beijing last week announced that it was lifting prohibitions against purchases of US cotton, synthetic fibers, and soybeans and restrictions on imports of other US agricultural products. These measures had been in effect since January, when Beijing retaliated against US quotas on textile imports. A new bilateral textile trade agreement was signed last month, allowing the Chinese, who have reduced their excess inventories of fiber, to begin buying US polyester and nylon. Purchases will not, however, reach the level of last year, when they bought nearly $100 million worth. China reentered the US market for small quantities of wheat two weeks ago, the first purchases since late 1982. Good domestic harvests, however, have reduced China's need for US cotton and soybeans. [redacted] 25X1

EC Consumer Confidence Improving

Midyear surveys conducted by the EC Commission show that consumers are less pessimistic about economic conditions in the Community than they were at the end of last year but still are wary about making major purchases. West German and Danish consumers led the improvement from the low point in confidence reached at the end of 1982; British, Italian, Belgian, and Dutch consumer sentiment also posted clear gains. In contrast to the rest of the Community, the austerity measures adopted by Paris and Dublin last spring further weakened economic confidence in their respective countries. [redacted] 25X1

Consumers' attitudes should continue to improve during the rest of this year because most West European economies have already passed the trough of the recession. Together with the robust economic performance in the United States, recently announced second-quarter gains in real GNP in West Germany, France, and the United Kingdom should brighten confidence in those countries. Nonetheless, growth of private consumption, which accounts for about 70 percent of EC GNP, probably will remain sluggish compared with past recoveries until fears of continuing layoffs recede. [redacted] 25X1

Canadian–East German Long-Term Grain Agreement

Canada and East Germany last week signed a long-term grain agreement that calls for East German purchases of 1 million tons of grain per year for three years beginning in 1984. The agreement, involving two-year commercial credits guaranteed by the Canadian Government, will enable Canada to make further inroads into the East German grain market, largely at the expense of US sales. East Berlin has not been able to obtain two-year financing from US bankers and recently has made new efforts to diversify its grain sources. The agreement will satisfy roughly one-third of East Germany's annual grain import requirements. [redacted] 25X1

At the same time, both countries agreed to confer most-favored-nation status on each other's goods. East Berlin probably took advantage of Canada's interest in penetrating East European markets to press for more favorable treatment of its own exports. East Berlin hopes to use MFN to help market its manufactured goods in an effort to help ease its hard currency trade problems. It may also be seeking to influence other countries, including the United States, to give its exports more favorable treatment. [redacted] 25X1

China Seeking Additional Japanese Funds

Beijing reportedly will request $1.5 billion from Japan's Export-Import Bank to develop coal mines in China. The Chinese probably will ask for an interest rate of about 7 percent and up to 15 years to repay the loan, preferably in coal although Japanese officials have stated a willingness to conclude the agreement on a cash basis. If extended the loans would bring Japan's commitments to China since 1979 to $15 billion, nearly half the Western credits committed to China. [redacted] 25X1

China: Credit Extensions From Japan

Type of Credit	Million US $	Date Signed
Total	**15,400**	
Commercial	8,000	May 1979
Eximbank	1,700	May 1979
Overseas Economic Cooperation Fund (OECF)	1,500	December 1979
Eximbank	400	September 1980
Commercial	300	September 1980
OECF	2,000	August 1983
Eximbank	1,500	Pending

[redacted] 25X1

National Developments

Developed Countries

New Greek Finance Minister

Prime Minister Papandreou last week indicated that he envisaged no major policy changes following the resignation of Finance Minister Koulourianos. Although Koulourianos cited personal reasons for his move, he may have wanted to dissociate himself from policies that have contributed to the country's economic problems, including a 20-percent rate of inflation and 10-percent unemployment. The new Finance Minister, Alternate National Economy Minister Pottakis, is a longtime supporter of state planning and controls and is expected to maintain the current import and credit restraints and price controls. He also is likely to stick with the government's restrictive incomes policy. The business and financial communities have been quite discouraged by Papandreou's economic policies, and private investment is likely to remain depressed. [redacted] 25X1

Less Developed Countries

Zimbabwe Institutes Further Economic Adjustment Measures

In an effort to conform to IMF guidelines, Harare recently announced price increases, ranging up to 50 percent, for maize meal, milk, bread, beef, and oils. The government's goal is to reduce and eventually eliminate food subsidies, which are now costing nearly $200 million annually, [redacted] 25X1 25X1 In a related move, Harare earlier had announced higher minimum producer prices for crops to be delivered in 1984-85. This effort to stimulate production in the face of a severe drought also will push up food prices. To compensate, the government granted small pay raises for workers earning $300 or less per month in both the public and private sectors. In addition, the government announced a freeze on government hiring. [redacted] 25X1

The actions follow Finance Minister Chidzero's presentation in July of a tough budget for 1983-84 that cut public programs and increased taxes. The limited wage increase appears to be a compromise that grew out of intense debate in the Cabinet and demonstrates the continued moderating influence of Chidzero. Several ministers had argued forcefully for an immediate across-the-board 10-percent increase in the minimum wage, but this apparently will now be delayed until at least January 1984. [redacted] 25X1

Rampant Smuggling Sustains Syrian Economy

The recent implementation of austerity measures designed to conserve chronically scarce foreign exchange has given added impetus to already large-scale smuggling in Syria. While a significant amount of smuggling is carried on by individuals—through purchases abroad or by use of willing taxi drivers—most is conducted, or at least facilitated, by the Syrian military. Organizations such as the Military Housing Establishment and the Military Construction Establishment—exempt from customs duties, letters of credit, and inspection formalities—are importing goods for private-sector businessmen or for resale to less influential public-sector organizations. [redacted] 25X1 additional Syrian military units stationed in Lebanon as well as friendly Lebanese political groups are probably involved. [redacted] 25X1

Even though such large-scale smuggling—imports outside regular channels are believed to total between $750 million and $1 billion annually, according to US Embassy sources—is depriving Damascus of substantial customs revenues, it provides the Assad government with an important cushion against potential sources of discontent. Private-sector importers are using their overseas accounts to pay for needed manufactures and desired luxury goods, while income from lucrative smuggling activities is helping to keep the military in line. [redacted] 25X1

Zaire Seeking To Eliminate Parallel Exchange Market

Zaire's decision last week to devalue its currency by 80 percent is the latest in a series of steps it has taken to comply with IMF conditions for a $350 million standby loan. The new exchange rate, which equals the parallel market rate on which the bulk of the economy has operated, aims to eliminate unofficial exchange transactions that have deprived the government of at least $100 million annually in foreign exchange. [redacted] 25X1

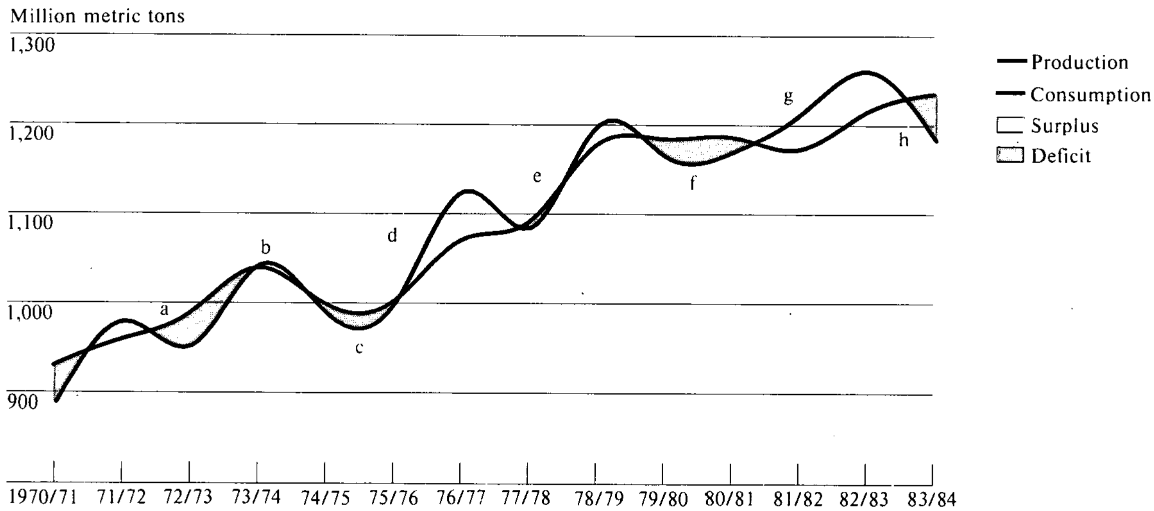
The US Embassy in Kinshasa believes the devaluation will have little impact on the country's already financially pressed urban population, but we are less sanguine. Government efforts to mitigate the inflationary impact through tariff reductions on imported foodstuffs, subsidized diesel fuel prices, and a 45-percent wage increase for government employees risks pushing the government's budgetary deficit beyond limits acceptable to the Fund. At some point, we expect Kinshasa will have to rescind or substantially modify these measures. Moreover, we anticipate that the devaluation will do little toward eliminating the black market that has dominated Zaire's economy for almost a decade and will, in fact, provide a pretext for merchants and other commodity speculators to charge higher prices. Finally, the government will be restricted in it foreign exchange allocations and unable to compete with the parallel market's ability to provide merchants with easy access to foreign exchange. President Mobutu will be quick to blame Western creditors for any failure in the latest IMF-dictated reforms. [redacted] 25X1

Communist

Yugoslav Electricity Problems

Belgrade is growing increasingly alarmed about shortfalls in electric power production and the potential for serious power outages, especially as consumption picks up with the onset of colder weather. Production of hydroelectricity—normally about 40 percent of total electricity output—has dropped because of a severe drought that has lowered reservoirs to their lowest levels in 40 years. Attempts to offset this shortfall by boosting output at thermal power plants are being hindered by shortages of railcars to transport coal, reduced oil imports because of the hard currency crunch, and shutdowns of some power plants for maintenance. Several republics have handled their electricity shortfalls by scheduling regular power outages for households, lasting from four to eight hours every other day. [redacted] 25X1

World Grain Production and Consumption



a. January 1972, Soviet purchased record amounts of grain.
b. 1973/74, US corn output decreases by 17.1 percent (36 million tons).
c. 1975, Soviet output fell by 50 million tons, imports rose 26 million tons.
d. 1975/76, Soviet grain production increased by 80 million tons−65 percent of the total increase that year.
e. 1977/78, China and the USSR accounted fo 55 percent of the increased production.
f. January 1980, US partial embargo on grain to the USSR.
g. 1981, grain production increased 42 million tons, US up 62 million, others down by 20 million tons.
h. 1983/84, set-aside programs and drought conditions in the US decreases corn output by 44 percent (96 million tons).

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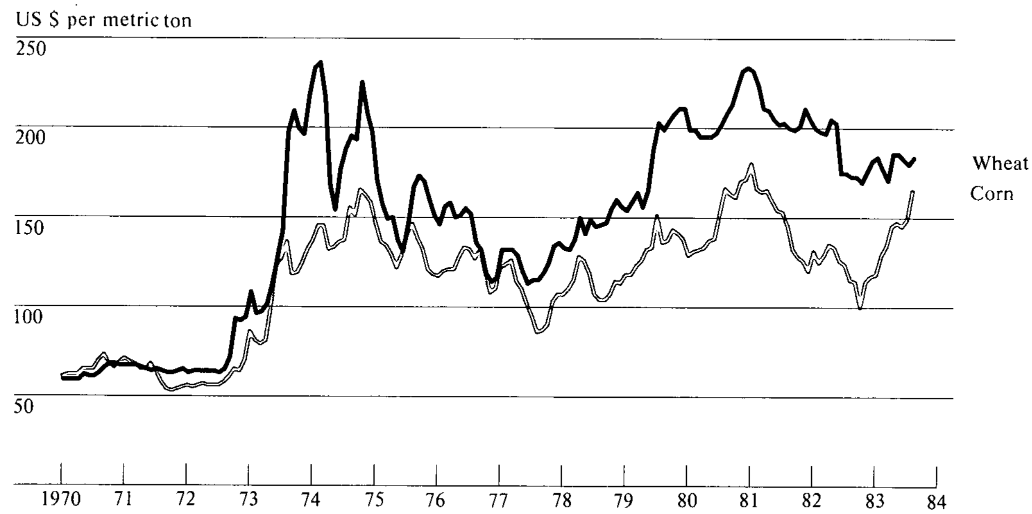
million tons. The harvest, already about three-fourths complete, has been progressing well, and the grain appears to be of good quality. 25X1

The major trouble spot this year is the United States. Extended drought in the Midwest corn belt and a one-third reduction in sown area will result in a sharply reduced crop—down more than 110 million tons, according to USDA. Virtually all of the decline will be in coarse grain production. If the drought continues, the US corn crop could fall an additional 10 million tons, according to some private forecasts. 25X1

While *coarse grain* crops outside the United States generally are doing well—we expect them to increase about 45 million tons—others facing difficulties because of bad weather include the EC and Eastern Europe. Dry conditions in key producing countries in the EC have reduced corn and barley crop prospects. In Eastern Europe, overall grain production is expected to be down some 7 million tons—more than one-half of which will be in coarse grains. Also South Africa, traditionally a major corn exporter, will need to continue importing corn well into 1984. 25X1

The global outlook for *wheat* production calls for a near-record crop of about 485 million tons. However, setbacks can still occur because wheat crops in the Northern Hemisphere have not been fully

US Grain Export Prices[a]



[a] C.i.f. Rotterdam, monthly averages through August 1983.

[redacted] 25X1

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harvested while those in the Southern Hemisphere are still being planted:

- Canada—Hot, dry weather in August has caused greater losses than earlier predicted, putting the expected 30-million-ton crop out of reach. Nonetheless, wheat production should reach last year's record 28-million-ton crop.
- Australia—The wheat crop is forecast at a near-record 17 million tons, almost double the size of last year's drought-stricken crop.
- China—Because of improved yields, China's wheat crop may have increased nearly 10 million tons to a record 78 million tons, the third consecutive year that production has increased.
- Argentina—Recent timely rains have greatly improved Argentina's wheat crop prospects. While much could happen before the harvest in January and February, a wheat crop of 11.5 million tons is in the making, according to USDA estimates. [redacted] 25X1

Global Demand Outlook

According to USDA estimates, global grain consumption in MY 1984 is expected to reach about 1.2 billion tons, up 2 percent over last year's level. Most of the increase will be in coarse grain consumption in the LDCs and Communist countries. Some expansion in feedgrain use is expected in South Korea, Indonesia, and some Middle Eastern countries. [redacted] 25X1

Even 2-percent growth may be optimistic. Because of higher corn prices, livestock raisers in the United States are starting to plan for smaller herds and reduced feed usage. Moreover, financially strapped LDCs, particularly in drought-stricken Africa, may find themselves priced out of the feedgrain market. Corn prices have increased nearly $50 per ton since January. If farmers continue to withhold their grain from the market in anticipation of yet higher prices, corn prices could reach the record level of $172/ton set in December 1980. [redacted] 25X1

USSR: Grain Imports *Million metric tons*

	MY 1983	MY 1984		
		Estimated	Purchases To Date	Additional Commitments
Total	**33.1**	**25-30**	**8.5**	**14.0**
United States	6.2	8.0-9.0	2.4	6.6 [a]
Canada	9.3	7.5-8.0	3.7	1.8
Argentina	9.4	5.5-7.0	1.0	4.0
Australia	1.0	1.0-1.5	0	0
European Community	4.3	1.5-3.0	1.4	0.1
Other	2.9	1.5	0	1.5

[a] Based on US-USSR grain agreement minimum of 9 million tons which must be bought during October/September.

[redacted] 25X1

Although USDA expects global grain consumption this year to exceed output by 50-55 million tons, large carryover stocks from last year's record harvests will assure the world of adequate grain supplies. Global wheat stocks, for example, should total about 110 million tons, the second highest in history, and overall world grain stocks, while dropping by 50 million tons, would still be the third largest in the past 15 years. [redacted]

Global Trade Outlook

World grain trade will increase by a scant 2 percent or 3 million tons more than last year's depressed levels, according to USDA's estimate. This estimate assumes, however, that the Soviets and Chinese cut back only slightly from last year's import levels. The continuing bullish prospects for their crops may cause them to cut imports more than expected. In any case high grain prices may cause them to postpone some grain purchases. Problems with farm-to-city grain distribution will probably force China to import about 15 million tons of grain from all sources. Whether or not Beijing fulfills its LTA commitment to purchase and take delivery of a total of 6 million tons of US grain by 1 January 1984 is still uncertain. Earlier the Chinese had indicated that once difficulties over the bilateral textile agreement, signed last month, were resolved they would resume purchases of US grain to fulfill their remaining 3.0-million-ton commitment. [redacted] 25X1
[redacted] high prices may dissuade them from reentering the US market until later in 1983 when they believe grain prices will be lower. [redacted] 25X1 25X1

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Likewise, prospects for a much improved crop will enable Moscow to reduce imports. So far, the Soviets have bought about 8.5 million tons of grain from all sources. They have additional commitments for up to 14.0 million tons, including up to 6.6 million tons from the United States under the terms of the new US-USSR long-term agreement signed in late August, and may not purchase much, if any, more. [redacted] 25X1

The impact of the new US-Soviet grain agreement will fall on all the major non-US exporters in years of good Soviet grain harvests such as this one. Prior to the new accord, strained trade relations between

A Comparison of the New US-USSR Long-Term Grain Agreement With the Previous Accord

	Previous Agreement	New Agreement
Quantity	The USSR is authorized to purchase from private commercial firms a minimum of 6 million metric tons and a maximum of 8 million tons of grain without additional approval.	The USSR is authorized to purchase from private commercial firms a minimum of 9 million metric tons and a maximum of 12 million tons of grain without additional approval. Up to 1 million tons of the minimum purchase requirement can be satisfied by Soviet imports of up to 500,000 tons of US soybeans or soybean meal.
Duration	The agreement was signed for five years beginning 1 October 1976. It was extended by two, one-year agreements, the second ending 30 September 1983.	The agreement will be in effect for five years beginning 1 October 1983.
Shipping arrangements	The agreement required that shipments meet the provisions of the US-USSR Maritime Agreement which called for one-third of the grain to be shipped in US bottoms, one-third in Soviet bottoms, and the remainder in third-country vessels.	No shipping arrangements are specified at this time. Negotiation of a new US-USSR maritime agreement could affect this provision.
Escape clause	The agreement allowed the United States to suspend the guaranteed minimum if US grain supplies fell below 225 million tons.	The agreement does not allow the United States to suspend sales because of crop shortages.
Type of grain	The LTA called for a minimum of 3 million tons each of corn and wheat to be purchased.	The agreement requires a minimum purchase level of 8 million tons—split equally between wheat and corn—if the Soviets exercise their option to purchase 0.5 million tons of soy products. If Moscow does not exercise this option, then they must purchase a minimum of 9 million tons of grain, at least 4 million tons each of corn and wheat.
Consultation arrangements	The agreement required that the United States and the Soviet Union hold semiannual consultations to discuss the status of bilateral grain trade.	The agreement also requires semiannual consultations between the two countries.

[redacted] 25X1

Moscow and Washington since the 1980 US grain embargo meant that any reduction in Soviet import needs fell primarily on the United States. Last year, when Soviet grain imports fell by 12 million tons, Soviet purchases of US grain dropped 9 million tons to the 6-million-ton minimum LTA commitment. Imports from other suppliers fell much less sharply, and most retained or increased their market shares. [redacted]

This year we expect Soviet grain imports to decrease 3-8 million tons to 25-30 million tons. US competitors could have supplied most, if not all, of Moscow's imports. Without the new agreement, US sales might have fallen substantially below 6 million tons rather than the 8-9 million guaranteed in the new pact. [redacted] 25X1

Argentina probably stands to be hurt most by the new US-Soviet agreement, particularly in corn where the United States is its main competitor. With limited storage capacity, Argentina had a ready outlet in the USSR for its exportable grain 25X1 surpluses, shipping the Soviets 50 to 75 percent of its total grain exports during the past three years. While Moscow will probably continue to purchase large amounts of Argentine grain to maintain a diversity of supply and to score political points, the Soviets are now in a stronger position to press Buenos Aires on issues such as their unfavorable balance of trade.

Implications for the United States

While the US-USSR LTA helps shore up the US position, the decline of the United States as a force in world grain markets is likely to continue. According to USDA, the United States will again account for slightly over half of world grain exports, but its share of the export market has slipped since 1980 when it hit nearly 60 percent. Moreover, US dominance of the world export market for grains is likely to be eroded by this year's crop situation because:

- US corn exporters will be hit hard by sharply higher prices. Livestock feed importers are likely to turn to increased purchases of wheat, grain sorghum, and barley—grains in abundant supply in other exporting countries this year.

- The United States can expect no cooperation to cut back production from other exporters, who are under intense pressure to expand exports. While enough latent demand exists in major importing nations to significantly increase grain exports if economic conditions improve and demand for meat picks up, this will not happen rapidly; indeed, higher feedgrain prices will suppress the recovery in meat consumption in the near term.

- This year's expected tighter corn supplies and higher prices will provide only temporary relief from an otherwise glutted market; beyond the current crop year, US and foreign corn growers alike will probably boost corn acreage sharply in response to current market conditions. 25X1

The continued willingness of non-US exporters to sell grain on credit will also work against the United States. With the exception of Argentina, most of the major exporters offer government-guaranteed loans to encourage grain sales. Canada and France have provided East Germany with such credit guarantees despite its troubled financial situation. Canada has reportedly made available a $1 billion line of credit to the USSR for grain purchases in the 1984 marketing year. Grain traders believe that such moves will become increasingly important in determining exporters' market shares. 25X1

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The World Sugar Market: Opportunities for Soviet Influence

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Poor sugar harvests in the USSR during the past few years have made Moscow the world's largest sugar importer. In 1982, the USSR imported more than 7 million tons of raw and refined sugar, about 30 percent of total world sugar trade. Soviet officials know that the prospect of Soviet purchases looms large to prospective sellers in a glutted market, particularly for financially strapped LDCs.

World Sugar Outlook: Chronic Overproduction

With the exception of a handful of years when major crop failures have occurred, world sugar production has consistently outpaced consumption since World War II. Over the past 10 years consumption has exceeded production only twice—in 1979 and 1980. The gap has been widened by production subsidies, designed to bolster farmers' incomes and minimize sugar imports, as well as by exporter attempts to maintain sugar earnings in the face of falling prices. As a result, output has failed to respond as effectively to surpluses and low prices as it has to shortages and high prices.

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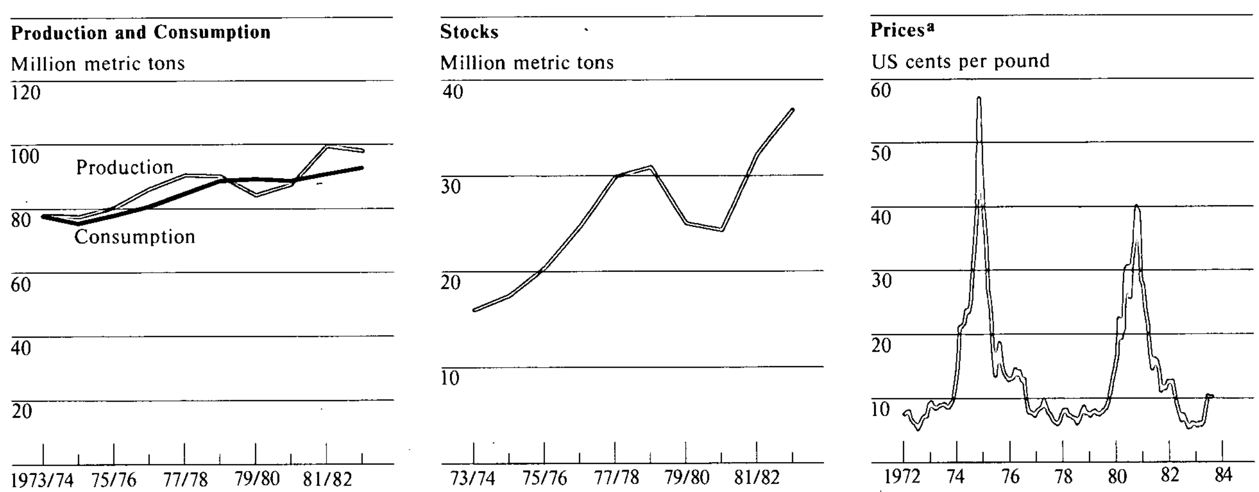
This year's production/consumption picture is likely to show little change. The USDA estimates world sugar production in 1982/83 at nearly 99

World Sugar Statistics



[a] Monthly average through August 1983, world raw bulk prices.

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million tons. Although heavy spring flooding has cut the Cuban crop by a million tons or more, a record Brazilian crop and near-record production in India have largely offset these losses. World sugar consumption in 1982/83 is expected to grow again by only 2 percent, not enough to bring the market into balance. Consumption gains in the LDCs are being offset by stagnating consumption in the key markets—the United States, Western Europe, Canada, and Japan. [redacted]

The large imbalance between production and consumption during the last two years has led to record world sugar stocks. According to USDA estimates, sugar stocks rose by an additional 5 million tons by season's end (31 August), reaching 37.0 million tons or some 40 percent of annual global consumption. According to sugar traders, a 25-percent stock level is adequate and anything above 35 percent is burdensome. [redacted]

World sugar prices, until recently, were limping along at roughly 6 cents per pound, the lowest level in 10 years and only 15 percent of their October 1980 high. Although prices were buoyed by news of poor Cuban and EC crop prospects, the large stock overhang effectively capped the price rebound. After reaching nearly 13 cents per pound in late May, sugar prices have settled back to the 10- to 11-cent range. [redacted]

The USSR's Role in the World Sugar Market

Import Trends. While Free World sugar demand has flattened, sugar imports by the USSR have been rising rapidly as a result of four consecutive poor sugar beet harvests. In 1982, Soviet purchases of raw and refined sugar reached a record 7.4 million tons, 40 percent higher than in 1981 and about double the 1976 level. Havana continues to be the USSR's chief supplier, although its share of the Soviet import market has fallen from more than 80 percent in 1976 to less than 60 percent in 1982. [redacted]

The increase in Soviet sugar import needs has translated into a dramatic rise in Soviet purchases in the free market, from an annual average of 450,000 tons in 1975-79, to nearly 2.4 million tons in 1980-82. Six countries—Thailand, Brazil, the Philippines, the Dominican Republic, Australia, and Argentina—and the EC accounted for about 95 percent of these imports. The EC alone provided more than 40 percent. [redacted] 25X1

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Current purchasing behavior suggests that the USSR has remained a major sugar importer in 1983. Total deliveries from Cuba are expected to reach roughly 3.5 million tons, a reduction of 700,000 tons from last year. Purchases from remaining suppliers are likely to total 2.5 million tons. [redacted] the USSR is likely to purchase 1 million tons from the EC again this year. This level of trade coupled with a 400,000-ton increase in purchases from Brazil suggests that imports from other suppliers could decline considerably. [redacted]

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Import Projections. Beyond 1983, Soviet imports from countries other than Cuba will be determined by Moscow's plans for slow increases in sugar consumption and the size and quality of its domestic sugar beet crops. Long-range Soviet plans call for annual growth in per capita consumption of less than 0.5 percent. Based on consumption trends, however, we believe that per capita consumption will rise by about 1 percent per year. [redacted]

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We estimate that Soviet sugar production will fall consistently short of plan through the 1980s, resulting in a continuing demand for imports from both Cuba and the international market. Judging from past export trends and current production goals for the 1980s, we believe Cuba is likely to be able to provide the USSR with an average of 3.5-4 million tons annually through 1990. Imports from non-Cuban sources could be as high as 2.5 million tons. [redacted]

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USSR: Sugar Imports *Thousand metric tons*

	1975	1976	1977	1978	1979	1980	1981	1982
Total	**3,237**	**3,760**	**4,776**	**3,993**	**4,080**	**4,981**	**5,204**	**7,363**
Cuba	2,964	3,067	3,652	3,797	3,707	2,647	3,090	4,224
Free market	271	644	1,082	147	315	2,220	2,107	2,916
Of which:								
Argentina	0	0	0	12	0	13	150	127
Australia	51	0	0	0	0	0	0	157
Brazil	95	0	24	83	69	466	347	362
Canada	0	0	0	0	0	0	14	22
Colombia	0	0	0	0	0	11	12	36
Dominican Republic	0	0	0	0	0	33	14	194
European Community	0	298	249	40	235	856	873	1,263
El Salvador	0	0	0	0	0	0	0	0
Gabon	0	0	0	0	0	0	5	0
Guatemala	0	0	0	12	0	15	0	64
Guyana	20	0	0	0	0	0	0	0
Mozambique	0	0	0	0	0	0	0	25
Nicaragua	0	0	0	0	0	13	0	5
Peru	105	0	0	0	0	24	0	0
Philippines	0	224	635	0	0	333	281	216
Swaziland	0	0	0	0	0	10	0	0
Thailand	0	0	0	0	11	140	266	429
United States	0	0	0	0	0	0	40	0
Zimbabwe	0	0	0	0	0	15	0	0

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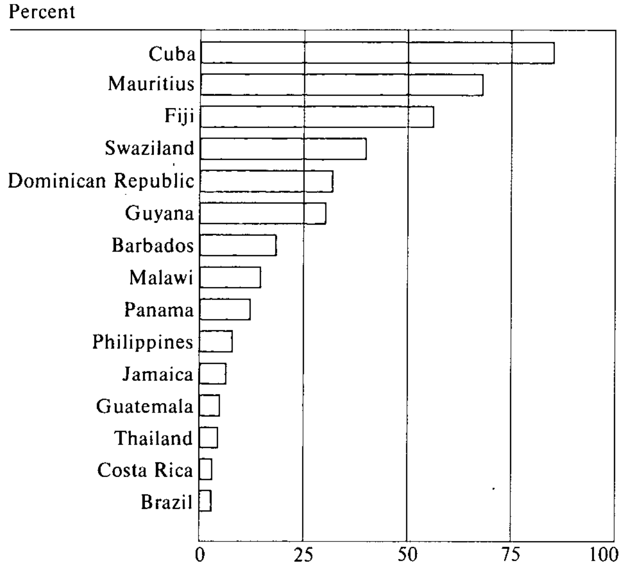
The Sugar Lever—A Political Perspective

Moscow's ability to move among suppliers in the sugar market carries with it a potential for creating political gains from commercial transactions borne of necessity. The fact that it can buy sugar and political good will simultaneously apparently has not escaped Moscow's attention. Nevertheless, Soviet exercise of economic leverage for political purposes has always been cautious—restrained by a realistic assessment of the limits of such leverage and by the desire not to put at risk assets already in hand.

The extent to which the USSR plans to use sugar as a policy lever in the future is not known. For the LDCs, the prospect of large Soviet sugar purchases takes on increased importance in a glutted market. Even relatively small Soviet purchases are helpful at the margin for financially strapped LDCs. 25X1

In the case of new *leftist-leaning* regimes such as Nicaragua, the ability of the United States to hurt the Nicaraguan economy by reducing its sugar import quota in 1983 from 53,000 tons to only 5,400 tons has been defused by a standing offer 25X1

Sugar Exports as a Share of Total Exports, Average 1978-81



[redacted]

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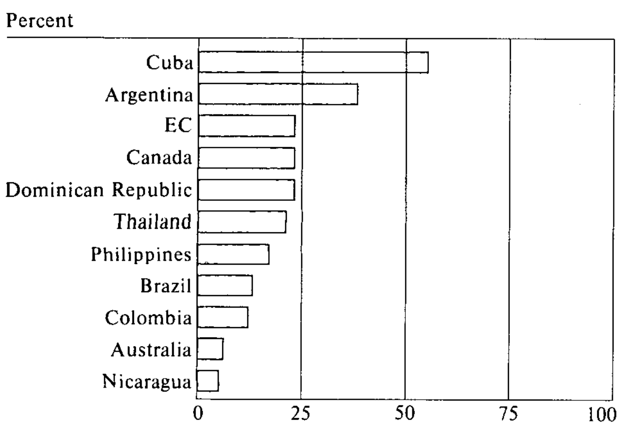
Share of Sugar Exports to the USSR, 1982



[redacted]

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from Moscow to purchase any unsold sugar resulting from this sanction, [redacted] 25X1 25X1 25X1 To the extent that leftist-leaning countries believe that a trade weapon is being used by Washington or its allies, Moscow can play on that fear. In most cases the Soviets can provide, if they desire, a guaranteed market, underwriting a portion of a country's economy as they have in Mozambique. [redacted] 25X1

In dealing with *sugar-surplus* countries that also have serious economic problems, Moscow, by providing a market for their sugar, could buy some political good will. Such transactions would be unlikely to change the basic position of a regime, but they could influence it. In a country like Guyana, whose economic prospects are deteriorating rapidly, a Soviet offer to take a large quantity of sugar could help improve a relationship that has been lukewarm. Moscow would likely play up the fact that the United States, in contrast, reduced its Guyanese sugar purchases by some 35,000 tons when it imposed a sugar import quota system in May of last year. 25X1 The quota system reduced total US imports from an average of 4 million tons to 2.8 million. [redacted] 25X1

Moscow could also use sugar purchases to influence *US allies*. In the case of Thailand, the US import quota system has come at a time when Bangkok has undertaken a spectacularly successful export diversification program. Thailand's sugar exports nearly doubled in 1982, making sugar the third-leading export earner after rice and tapioca. While the US sugar quota reduced purchases from Thailand by nearly 200,000 tons, the USSR boosted its Thai sugar purchases by more than 160,000 tons. A mid-1982 trade agreement between Bangkok and Moscow, which calls for an expansion of bilateral trade and the setting of trade targets, could provide the basis for long-term Soviet sugar purchases. [redacted] 25X1

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A Case for Political Purchases

Although the majority of Soviet sugar deals are transacted in normal commercial fashion, reflecting primarily supply and demand factors of the sugar market, some seem to exhibit astute political timing or a convergence of political and economic interests. Over the past eight years, Soviet sugar purchases from Peru, for example, occurred in only two years—1975 and 1980. In both of those years, there was a change in government. Although there is no evidence as to Moscow's motivation, it seems unlikely that the timing of the sugar purchases was coincidental with these major political events. They may have been linked with earlier Soviet arms sales.

Zimbabwe is another case in point. The only recent Soviet sugar purchase occurred in 1980, the first year of independence. Moscow, which had backed the losing faction in the civil war, apparently felt the need to make a goodwill gesture toward the Mugabe regime by trying to improve trade relations. Certainly the small amount of sugar it purchased—15,000 tons—could have been acquired more conveniently from another supplier. Moscow's gesture apparently had little impact, however, as Mugabe did not establish diplomatic relations with the USSR until March 1982, and political ties remain generally cool. 25X1

As for other examples, the only Soviet sugar purchase from Guyana occurred in 1975, the same year that Moscow's first resident diplomatic mission arrived in that country. The Soviets first purchased Nicaraguan sugar in 1980, just after the current leftist regime came to power. 25X1

Finally, Moscow's opportunism may also be reflected in the Soviet response to the imposition of smaller sugar import quotas by the United States in May of 1982. A country-by-country comparison of decreases in US sugar imports during 1981/82 with increases in Soviet sugar imports by country in the same period shows that in some cases—particularly in Thailand, Nicaragua, the Dominican Republic, and Guatemala—virtually identical offsets occurred. This suggests that politics may have played a role in Soviet purchasing decisions. 25X1

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Changes in US and Soviet Sugar Imports: Selected Countries, 1982

Thousand metric tons

	Changes in US Purchases [a]	Changes in Soviet Purchases [b]
Total	**−2,008**	**545**
Argentina	−284	−23
Australia	−567	157
Belize	−13	0
Brazil	−564	15
Colombia	−128	24
Costa Rica	−15	0
Dominican Republic	−185	180
Ecuador	−7	0
El Salvador	47	0
Guatemala	−58	64
Guyana	−35	0
Honduras	−57	0
Malawi	−48	0
Mozambique	−10	25
Nicaragua	−4	5
Panama	−25	0
Peru	115	0
Philippines	147	−65
South Africa	64	0
Swaziland	−107	0
Thailand	−190	163
Zimbabwe	−84	0

[a] Maximum imports allowed by 1982 quota compared with actual 1981 imports.
[b] 1982 imports compared with 1981 imports.

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Other targets of opportunity may include *non-aligned states* such as India, Argentina, and Peru. While the sugar lever is not powerful enough by itself to pry any country off the fence, Moscow could nevertheless use it together with other incentives to nudge a regime in its direction. Moscow may find India a particularly attractive target. With high production the last two years, India finds itself with rapidly mounting supplies of unsold sugar. [redacted] 25X1

How the USSR will play its hand with the LDCs is uncertain. Moscow does not hold all the cards, however. In the longer term it is constrained to some degree by a shortage of hard currency. Moreover, its course of action will continue to be influenced by the size of future Cuban sugar crops as well as its own. Nevertheless, the recent shift in Soviet sugar import needs, while creating additional foreign exchange pressures, presents Moscow with a new set of possible opportunities for increased influence. [redacted] 25X1

[redacted] 25X1

South Korea: Managing a Large Foreign Debt

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South Korea—with the fourth-largest debt among LDCs—is unlikely to face financing problems over the near term. Despite closer scrutiny by the international financial community, Seoul has retained a good credit rating because of bankers' confidence in the country's economic management capabilities. International bankers readily provided funds for South Korea's most recent Eurodollar loan at favorable terms, and the IMF has endorsed the country's economic performance and policy.

Over the next two or three years, however, South Korea will need to borrow about $4 billion per year in new funds and to maintain its short-term credit lines if it is to avoid a financing crunch. If, as seems likely, the international financial community is willing to provide these funds, Seoul will be in a good position to achieve its growth and industrialization goals. If, on the other hand, bankers clamp down on lending to Korea, growth would slow dramatically, the possibility of political unrest would increase, and Seoul would undoubtedly look to the United States for assistance.

South Korea: Composition of Foreign Debt, Yearend 1982 *Million US $*

Total	**37,312**
Long-term debt [a]	22,609
Public loans	9,440
Commercial loans	6,195
Bank loans	5,352
Bond issue	362
IMF credit	1,259
Medium-term debt [b]	488
Short-term debt [c]	14,215
Trade credits	3,339
Borrowing for oil imports	447
Refinancing	5,038
Deposits	245
Other	1,238
Foreign bank branches, interoffice accounts	3,908

[a] Maturity of more than three years.
[b] Maturity of one to three years.
[c] Maturity of less than one year.

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Accumulating a Large Foreign Debt

South Korea's foreign debt amounted to $37.3 billion at the end of 1982, up from less than $4 billion a decade earlier. The debt rose from 35 percent of GNP in 1972 to 56 percent in 1982. Among developing countries, South Korea's debt is the fourth largest—behind Brazil, Mexico, and Argentina. According to IMF data, almost two-fifths of South Korea's total debt has a maturity of less than one year.

Much of the growth in South Korean indebtedness can be traced to the government's decision in the early 1970s to use foreign borrowings to speed economic development. Even with a strong increase in domestic savings, Korean officials realized the need for foreign capital to help finance economic growth and industrialization. Most studies of Korean development identify foreign capital inflows as an important factor in the country's rapid economic growth.

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South Korea: Debt Service

	1979	1980	1981	1982	1983 [a]	1984 [b]
	Billion US $					
Total	**3.0**	**4.1**	**5.7**	**5.9**	**6.1**	**7.1**
Principal repayment	1.6	1.5	2.0	2.1	2.5	3.0
Interest payments	1.4	2.6	3.7	3.8	3.6	4.1
Short-term debt	0.4	1.2	1.9	1.5	1.5	1.4
Medium- and long-term debt	1.0	1.4	1.8	2.3	2.1	2.7
	Percent					
Debt service as a share of exports of goods and services	15.2	18.4	20.7	20.9	19.5	20.0

[a] Estimated.
[b] Projected.

[redacted]

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South Korean debt also accumulated in response to the increases in oil prices over the past decade. Dependent on imported oil for more than 60 percent of its energy needs, Seoul was forced to borrow heavily from abroad to pay higher oil bills in 1974-75 and again in 1979-81. [redacted]

Keeping the Payments Burden Manageable

In contrast to many of the other large LDC borrowers, South Korea has maintained a manageable financing burden. South Korea's debt service ratio was 15 percent last year compared with about 80 percent for Brazil and 63 percent for Mexico. Including interest payments on short-term debt, South Korea's debt service ratio was 21 percent last year. [redacted]

Relatively strong export growth and a government austerity program in effect since mid-1979 are largely responsible for keeping the financing burden in line. Despite the global recession, export volume increased 40 percent during 1980-82. The expansion in foreign sales reflected South Korea's progress in diversifying its export base. A doubling in ship exports last year, for example, bolstered foreign exchange earnings at a time when sales of textiles, electronics, and other consumer goods declined. South Korean exporters have proved adept at finding new markets for their products—China and Libya in recent years are cases in point. [redacted]

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Seoul's austerity program contributed to keeping debt servicing costs manageable by damping import demand and improving export competitiveness. During the past three years, the growth in government spending, the money stock, and wages have all slowed dramatically. The Chun government was willing to accept slow growth—real GNP grew by only 1.7 percent per year during 1980-82—and declining real wages to pave the way for more rapid long-term growth. The strategy has paid off in reducing Korean inflation from 30 percent to less than 5 percent, cutting the current account deficit in half, and restoring rapid economic growth—real GNP advanced 9 percent in first-half 1983. [redacted]

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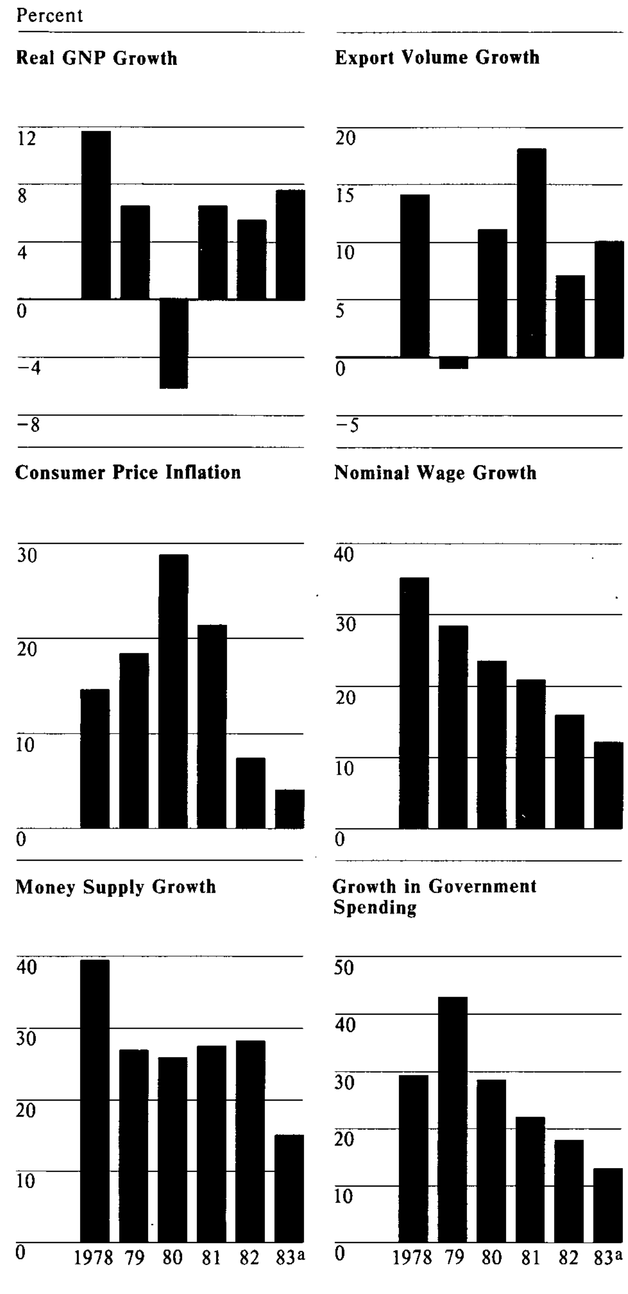
South Korea: Economic Indicators



[a] Projection.

[redacted]

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Near-Term Prospects

South Korea has already lined up loans for most of its 1983 foreign financing needs of $6.3 billion. At the same time, the current account deficit should narrow to about $2.3 billion this year. Exports, after a sluggish start, have strengthened in recent months. The won, which had been overvalued, depreciated 6.5 percent during the November 1982–March 1983 period on a trade-weighted, price-adjusted basis, restoring Korean export competitiveness. Nonoil imports have grown rapidly because of strong domestic demand, but the overall import bill is being moderated by lower oil prices. We expect the services deficit to remain near last year's level as lower interest rates offset the reduction in revenues from overseas construction work. [redacted] 25X1

The Bankers' View

South Korea has maintained a good credit rating among international bankers, who cite South Korea's record of sound economic and financial management and the country's diversified export base as reasons for their confidence. The banks, however, are watching South Korea more closely in light of their experience in Latin America. Korea's large debt, particularly the short-term debt, is a source of concern to many bankers, especially the smaller US banks. Many banks—already with heavy exposures in South Korea—have been reluctant to lend more to Seoul. [redacted] 25X1

Nonetheless, South Korea is still able to tap international capital markets fairly easily as demonstrated by the recent success of a $300 million Eurodollar loan for the Korean Export-Import Bank. The success in obtaining this loan supports the view of Korean officials and the US Embassy in Seoul that South Korea will be able to obtain the foreign capital it needs as long as it pays interest rates that reflect market conditions. A $500 million loan earlier this year for the Korea Exchange Bank ran into substantial resistance because the Koreans insisted on a narrow interest rate spread. For the

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South Korea: Balance of Payments *Million US $*

	1978	1979	1980	1981	1982	1983 [a]
Trade balance	−1,781	−4,396	−4,384	−3,628	−2,400	−2,300
Exports, f.o.b.	12,711	14,704	17,214	20,671	20,961	23,000
Imports, f.o.b.	14,491	19,100	21,598	24,299	23,361	25,300
Service balance	224	−195	−1,386	−1,518	−619	−500
Receipts	4,450	4,826	5,363	6,598	7,449	8,000
Payments	4,226	5,021	6,749	8,116	8,068	8,500
Net transfers	472	439	449	501	473	500
Current account	−1,085	−4,152	−5,321	−4,645	−2,546	−2,300
Net long-term capital	2,166	2,663	1,856	2,842	1,352	1,200
Net short-term capital	−1,171	844	1,945	−82	−98	100
Errors and omissions	−312	−329	−369	−411	−1,441	−700
Overall balance	−402	−974	−1,889	−2,296	−2,733	−1,700
Foreign exchange reserves	4,937	5,708	6,571	6,891	6,980	7,300

[a] Estimated.

[redacted] 25X1

Eximbank loan, Seoul paid a higher interest premium and found banks willing to participate in the loan. [redacted]

IMF Stamp of Approval

A recent IMF review team gave South Korean economic performance and policies high marks, and a $600 million standby agreement was signed in mid-July. Seoul agreed to IMF recommendations to reduce the short-term debt, curtail credit expansion, and maintain a flexible exchange rate to retain export competitiveness. The IMF agreement should further bolster South Korean creditworthiness among international bankers. [redacted]

Prospects Beyond 1983

The global LDC debt problem has prompted the Chun government to alter its economic policies for 1984-86 in order to reduce its foreign financing needs. Seoul has lowered its projection for the size of the debt to $49 billion for 1986—$15 billion less than earlier projections. Government authorities now hope to achieve a current account balance by 1985, rather than the $3.8 billion deficit originally forecast. Increased priority has been focused on expanding exports, and several industrial projects have been delayed or canceled to slow imports and cut foreign capital needs. Planned completion dates for nuclear power plants, subways, and railroad lines, for example, have been pushed back. [redacted]

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Alternative Scenarios

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In our judgment, two very different scenarios are possible for South Korea over the next two or three years. The more likely is that international bankers will provide the roughly $4 billion per year in new funds that South Korea will seek and that they will continue to maintain short-term credit lines. Currently, Seoul is one of the few LDCs to which bankers are willing to provide new money, largely because of their confidence in the country's long-term economic health and Seoul's ability to finance additional debt. A less likely possibility is that the banking community will not provide Seoul with the long-term funds it seeks or that they will refuse to roll over short-term credits. Such a development could be sparked by:

- A significant shortfall in Korean exports, which could result if South Korea's rapid push into skill-intensive industries fails.
- A debt crisis in the Philippines, which could lead bankers to shy away from other Asian countries such as South Korea and Indonesia.
- Political instability, which is always a possibility although Chun appears firmly in control now. [redacted] 25X1

Inability of South Korea to attract sufficient foreign capital would force Seoul to make rapid adjustments in economic policy, which would have an extremely adverse impact on the outward-oriented Korean economy. Seoul would be forced initially to draw down foreign exchange reserves; such reserves at midyear amounted to $6 billion, equal to about three months' imports. After drawing down its reserves, Seoul would have to curtail imports substantially. Because a large share of its foreign purchases are raw material inputs for its export products (20 percent) and capital equipment (26 percent), cutting imports would be difficult. Unlike many other LDCs, Seoul has little leeway to cut imports without immediately and substantially reducing economic growth. Only 6 percent of Korea's foreign purchases are consumer goods. Because the labor force is growing rapidly—3 percent per year—unemployment would certainly increase. Inflation would also accelerate as higher cost domestic products were substituted for imports. [redacted] 25X1

Under such difficult economic conditions, the possibility of political unrest would increase; the South Korean people are less tolerant of restraints on political freedoms when the economy is not doing well. In 1979, for example, the recession and rise in unemployment coincided with riots in Pusan and Masan. Seoul would almost certainly look to Washington for official assistance in dealing with a financing crunch and would probably point to US security interests in asking for help. [redacted] 25X1

[redacted] 25X1

Qatar: Reacting to the Soft Oil Market [redacted]

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The soft oil market has prompted Qatar to cut government spending, postpone major development projects, and attempt to slow aid outflows. Although most Qataris are little affected by the retrenchment, cutbacks could aggravate resentment of the greed, corruption, and privilege of the ruling Thani clan. [redacted]

Oil and the Economy

Oil dominates Qatar's economy, accounting for almost all export earnings and about 90 percent of government revenues. In response to slack world demand, Qatar reduced its crude output in early 1983 to just over 200,000 b/d, down 40 percent from 1982 levels. Production currently is running about 300,000 b/d, in line with the quota fixed by OPEC in March. Prices are $5 per barrel less than in 1982, however, and we expect that 1983 oil revenues will be about $2.9 billion—roughly 70 percent of what was earned last year. [redacted]

[redacted] reduced oil revenues during February-May forced the government to draw on foreign exchange reserves at a rate of about $30 million per month. We estimate that reserves were tapped for another $25 million in June. Qatar's reserve position remains strong, however, as total reserves stood at about $15 billion at the end of December 1982. [redacted]

Spending Cuts

Falling oil revenues have prompted the government to seek areas where spending can be reduced. With planned expenditures of about $3.9 billion, the government faces the prospect of a nearly $1 billion deficit for the 1983/84 fiscal year. Even though the budget is typically underspent by as much as 30 percent, the Amir has instructed all ministries and departments to cut administrative spending by 20 percent. According to open sources, public-sector salaries—already low by Gulf standards—will be frozen. We believe Qatar is unlikely to sharply reduce imports—estimated at about $1.5 billion in 1982. Imports consist largely of materials for development projects already in progress and consumer goods—categories that the government is reluctant to cut. [redacted]

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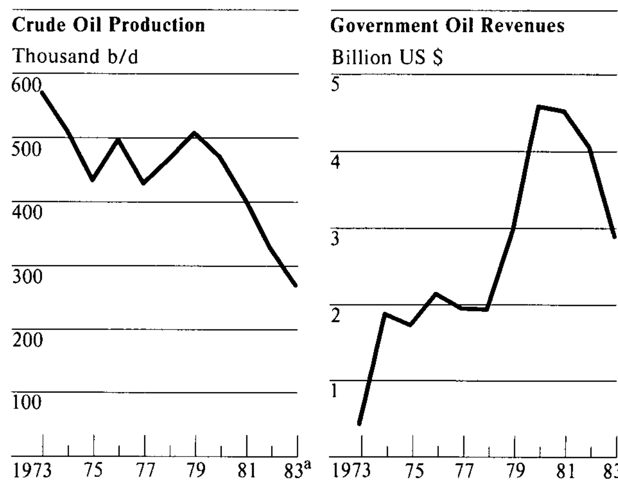
Qatar: Oil Production and Revenues



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[a] Estimated.

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According to the US Embassy, no new major development projects have been funded and some previously approved projects have been scaled back or eliminated. On the list of deleted projects is the Wasail power/desalination plant, which was widely thought to have had an assured place in spending plans because of the government's projections of severe power shortages by the middle of this decade. Moreover, gasoline and other fuel prices have been raised as much as 260 percent. The new prices, however, still are among the lowest in the world. In addition, the government is considering introducing charges for health services, electricity, and water. [redacted] 25X1

Qatari officials are also attempting to slow the flow of aid. Qatar has disbursed about $1.6 billion to Iraq since its war with Iran began in 1980. Under terms of the 1979 Baghdad agreement, Doha gives $122 million annually to Syria, $82 million to Jordan, $16 million to the PLO, and $10 million to the Jordanian-PLO Joint Committee for the Occupied Territories. The government will probably delay making Baghdad subsidy payments as long as possible. According to the US Embassies in Jordan and Syria, Qatar also may follow other Gulf states and try to sell its oil on Iraq's behalf instead of providing direct monetary assistance. [redacted] 25X1

Other Alternatives

According to the US Embassy, Qatar is experiencing cash flow problems and has been slow to pay contractors on its development projects. Some expatriate laborers report that they have not been paid for months. The government reportedly is working out barter agreements with three foreign contractors doing work for the state electricity department that would allow payments to be made with oil. [redacted] 25X1

In an effort to further reduce outflows the Amir has largely forbidden the hiring of non-Qatari staff, and many government contractors have begun to reduce expatriate staff. During April and May, Qatari contracting and construction firms terminated over 1,000 expatriate workers, mostly unskilled Asians. [redacted] 25X1

Outlook

Some members of the Doha business community believe the government has overreacted to the economic downturn and that cutbacks could damage important sectors of the economy. [redacted] 25X1 25X1 expatriate Pakistani laborers, unhappy with their working conditions, have demonstrated against the regime. Labor unrest, however, appears to be manageable in the near term. Moreover, the initial wave of concern among Qataris over spending cuts and reductions in the new budget has largely subsided. [redacted] 25X1

Even though Qataris have not yet blamed the Amir for the downturn in the economy, spending cuts are likely to increase frustrations over the uneven distribution of wealth and reveal mismanagement and corruption that more prosperous times concealed. The Amir's autocratic style of rule may also make him the focus of criticism in the longer term. Most Qataris regard the ruling Thani family with a mixture of resentment and bemusement, [redacted] 25X1 25X1 They reject the family's aristocratic pretensions and criticize it for being greedy, corrupt, and overprivileged. [redacted] 25X1

[redacted] 25X1

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