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Directorate of
Intelligence

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International Economic & Energy Weekly

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10 January 1986

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Synopsis

1 **Perspective—Libya: The Effect of Economic Sanctions** 25X1

The cutoff of US economic ties to Tripoli will have some disruptive effects, but as time passes the impact will fade without substantial involvement by other OECD countries. 25X1

3 **Western Europe: Economic Links to Libya** 25X1

Western Europe's well-known reluctance to impose sanctions against Libya is only partly due to economic considerations because overall economic relations with Libya are relatively small. West European unwillingness to apply sanctions against Libya probably is driven more by fear of Libyan reprisals, by the desire for maintaining good relations with other Arab countries, and by the belief that sanctions would be ineffective. 25X1

11 **Poland: Dim Prospects for Increasing Hard Currency Earnings** 25X1

One of the Polish Government's primary goals over the next five years is to increase hard currency earnings, but given the lack of effective export promotion policies any significant increase is unlikely. The regime may tinker with its policies, but internal pressures to increase consumption rather than exports and weak Western demand for Polish products are likely to thwart any major export campaign. 25X1

15 **Egypt: Economic Prospects and Policy Implications** 25X1

Egypt's capacity to meet its external financial obligations will become untenable in the next two years without a combination of major cuts in import growth, debt rescheduling, and significant increases in external assistance. The present government is unlikely, however, to push for sweeping reform, despite lipservice to the contrary, because it continues to believe that major restructuring of the current system of price supports, subsidies, and government controls would produce political instability. 25X1

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21 **Latin Debtors: Increasingly Competitive Labor Costs**

The five largest Latin American debtors—often as part of IMF-supported programs—have undertaken austerity measures that have resulted in generally falling labor costs since 1981. Low labor costs should attract some labor-intensive investment, as it has in the East Asian NICs, but we believe that political and economic uncertainty in the Latin American debtor countries probably will constrain significant private investment that could help fuel economic expansion.

25 **Somalia: Uncertain Prospects for Economic Reform**

Somalia made limited progress toward improving its ailing economy in 1985, but major problems remain including a growing external debt, continued high current account deficits, and slippages in implementing the 1985 IMF reform package.

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Perspective

Libya: The Effect of Economic Sanctions

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The cutoff of US economic ties to Tripoli will have some disruptive effects, but as time passes the impact will fade without substantial involvement by other OECD countries. Although most of the $300 million worth of products exported by the United States are generally available on world markets, the time needed to locate new suppliers will aggravate current shortages of consumer and industrial goods in Libya.

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The likelihood of Libya's other trading partners following the US lead is not high. Many, particularly the Europeans and South Korea, are owed hundreds of millions of dollars by Tripoli and are expecting repayment in crude oil. Others have valuable equipment, construction and service contracts with Libya.

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Tripoli will have greater difficulty replacing the $300-400 million in services provided annually by US companies. Total contracts worth as much as $3 billion with US firms will have to be relet to firms in other countries. Japanese, South Korean, or West European firms are capable of taking over the US role in the Great Man-made River Project, Qadhafi's most ambitious economic undertaking to date. Most of Libya's development program has little impact on the average Libyan, however, and the slowdown in the domestic economy has already greatly delayed the rate of project completion.

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The new sanctions probably will be disruptive to the Libyan petroleum industry over the next one to two months as US production companies disengage from Libya. US firms play a major role in Libyan operations and currently market about 200,000 b/d—roughly 18 percent of Libyan exports. As a result, oil exports could temporarily fall from the current level of 1.1 million b/d, but Tripoli probably will take prompt action, including price cuts, to regain sales. Beyond the marketing disruption, any short-term production problems in fields currently involving US oil companies could be handled by other foreign technicians and a small, but competent cadre of trained Libyan managers. Moreover, most US companies providing exploration and maintenance services operate through their West European subsidiaries, often using European personnel. The number of US oilfield workers in Libya probably is no more than 500 to 800 and replacements could be recruited from a number of countries. Most essential oil field equipment is already obtained from non-US sources.

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Tripoli could offer the US oil concessions to companies in countries such as Austria, West Germany, Italy, France, Finland, Brazil, or even Romania. Alternatively, Libya may nationalize the companies and operate them with foreign technical assistance as happened after Exxon's withdrawal from Libya in 1981.

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Qadhafi is unlikely to detain US citizens or take them hostage. Following the initial imposition of sanctions in 1982, for example, Qadhafi even helped expedite the departure of US citizens as a propaganda ploy. Qadhafi probably believes any move against US personnel would be used to justify a US military strike against Libya. The Libyan leader may offer lucrative incentives to retain the services of select, highly skilled workers, however. Some 400 to 500 US citizens did not leave Libya in 1982 because of family or cultural ties in Libya and they probably will remain. Qadhafi probably will use the US economic sanctions to marshal support for even greater domestic austerity and to blame Washington for any further deterioration in economic conditions.

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Western Europe: Economic Links to Libya

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Western Europe's well-known reluctance to impose sanctions against Libya is only partly due to economic considerations because overall economic relations with Libya are relatively small. West European exports to Libya dropped to an estimated $3.2 billion last year, less than one-third of the 1981 figure and equal to only 0.4 percent of total exports. Although imports of Libyan oil have fallen less sharply, to about 820,000 b/d last year, they only cover about 7 percent of Western Europe's oil consumption—an insignificant share given the glut in the world oil market. We calculate that even a total cutoff of EC exports to Libya would have only a minimal impact on West European economies. The West Europeans, however, fear the loss of perhaps several billion dollars of outstanding loans and unpaid bills owed by Libya. West European unwillingness to apply sanctions against Libya probably is driven more by fear of Libyan reprisals—in Western Europe or against West Europeans working in Libya—and by the desire for maintaining good relations with other Arab countries. West Europeans also continue to believe that sanctions would be ineffective and might set an unwelcome precedent.

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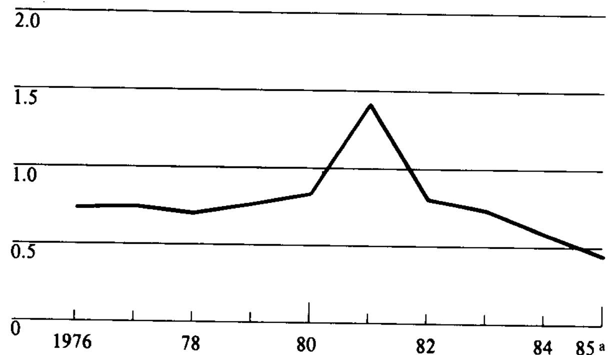
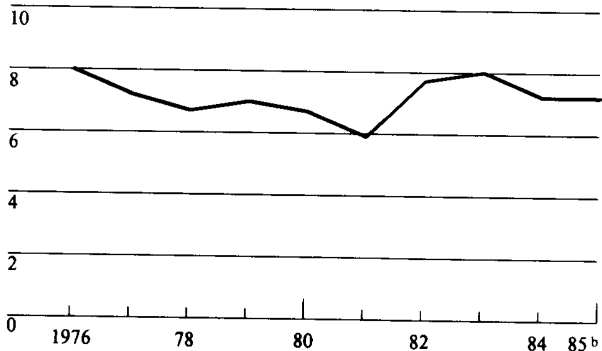
Western Europe: Economic Ties to Libya, 1976-85

Percent





a 1985 based on January-September data.
b 1985 based on January-June data.

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Exports

The decline in West European exports to Libya during the past few years is almost entirely due to Libya's financial difficulties, rather than any European effort to restrict exports. Italy remains by far the largest exporter, with an estimated 41 percent of the West European total; West Germany is a distant second. Not suprisingly, West European exports to Libya are dominated by manufactured products—more than two-thirds of the total as of 1984—with machinery and semifinished goods constituting the two largest sub-categories.

Libya's share of West European exports has dropped from 1.4 percent in 1981 to 0.4 percent in 1985. Italy is the country most dependent on the Libyan market, with 1.7 percent of its exports

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Western Europe: Military Assistance to Libya, 1980-84 [a]

Million US $

	1980		1981		1982		1983		1984	
	Agreements	Deliveries	Agreements	Deliveries	Agreements	Deliveries	Agreements	Deliveries	Agreements	Deliveries
Total	**365**	**668**	**106**	**544**	**193**	**553**	**1**	**388**	**106**	**228**
Austria			NEGL	NEGL						
Belgium	277	93		216		NEGL				
Finland		5		5		5				
France	56	104		97		395		180		60
Greece									NA	
Italy	NEGL	110	3	190	183	108	NEGL	176	97	147
Netherlands	18	18	30	8				30		
Spain	NEGL	NEGL		NA			1	1	1	1
Switzerland					1			1		
Turkey	5	3		13		3	NA			
United Kingdom	8	33	1		4	5				
West Germany	1	302	72	15	5	37			8	20

[a] DIA Estimates.

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going there last year—but this share is down from 5.7 percent in 1981. Only two other West European countries, Turkey and Greece, sent more than 1 percent of their exports to Libya last year.

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Oil Dependency

Over the last decade or so Libyan oil has typically covered about 7 percent of Western Europe's total oil consumption. Net oil import volume has fallen somewhat from about 910,000 b/d in 1983 to about 820,000 during first-half 1985. Since 1983 Italy has been the largest single West European importer of Libyan oil, followed closely by West Germany; together they account for more than half of Western Europe's oil imports from Libya.

Greece is most dependent on Libyan oil, which covered 27 percent of Greece's total oil consumption in first-half 1985. Following Greece were Turkey and Italy (15 percent each), Switzerland (11 percent) and Austria and West Germany (9 percent each). West European vulnerability to a Libyan oil embargo is presumably less than these figures suggest, however, because of the world oil glut.

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Arms Sales

Libya, which gets more than two-thirds of its military assistance from the Soviet Bloc, is a relatively small arms market for Western Europe.

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After averaging $588 million annually during 1980-1982, West European arms deliveries to Libya fell to $388 million in 1983 and $228 million in 1984. Moreover, only $107 million in new arms agreements were signed during 1983-1984, almost all of this in a single deal with Italy. With French deliveries falling off sharply, Italy became the largest West European arms supplier in 1984.

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In 1985, the value of West European arms sales agreements with Libya rose considerably, primarily because of a $500 million Greek arrangement which calls for future deliveries of various military equipment, including personnel carriers and antitank weapons. We do not believe this increase, however, will result in an appreciable jump in annual military deliveries to Libya. The Greek deal is only an agreement in principle and Athens is cautious about going ahead for fear that the United States would respond by curtailing arms sales to Greece, including F-16s. Moreover, all major West European countries have curbed sales of lethal weapons to Libya in light of Libya's occupation of Chad and the terrorist incident at the Libyan Embassy in London.

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Western Europe: Approximate Number of Workers in Libya, 1985

Turkey	35,000
Italy	16,000
United Kingdom	5,000
Greece	2,000
Portugal	1,700
Germany	1,500
France	1,200
Ireland	1,000
Netherlands	400
Austria	200

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Workers in Libya

Information on the number of West European workers in Libya is fragmentary but the total appears to be about 60,000 to 70,000. Turkey clearly heads the list followed by Italy and the United Kingdom. The Turks are mainly construction workers involved in a variety of projects contracted for by Tripoli. Their numbers have fallen sharply over the last several years and their difficulties in remitting their earnings to Turkey has been a source of great concern to Ankara. Many of the workers from other West European countries are technicians who play a key role in Libya's oil industry.

Investment and Debt

While our information is limited, Libyan investment in Western Europe appears to be concentrated in Italy. Libya's investments in industrial and commercial firms are mainly held by the Libyan-Arab Foreign Investment Bank. According to press reports the bank is worth $6 billion and has investments in 94 companies, 27 of which are in Western Europe. It now owns 14.5 percent of Fiat's stock, worth about $145 million, although control of the company remains firmly in the hands of the Agnelli family. Last November the bank purchased a 70-percent interest in Italy's 100,000 b/d Tamoil oil refinery, including about 1,000 service stations. Libya has banking interests in a number of countries, including Italy, France, Spain and West Germany.

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West European investment in Libya is concentrated in the oil industry. Three West German oil firms—VEBA, Wintershall, and Deminix—operate in Libya, two with Libyan partners. West German investment in Libya totaled $107 million in 1983. Italy's national energy corporation, ENI, has substantial investments in Libya, and AGIP, an ENI subsidiary, is a large oil producing company in the country. The French firm Elf is also engaged in oil exploration and production in Libya, while Austria's state oil company, OMV, agreed last

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Western Europe: Dependence on Libyan Oil, 1980-85
(Net Imports of Libyan Oil, Crude, and Products)

Thousand b/d

	1980	1981	1982	1983	1984	1985 [a]
Western Europe	**896**	**733**	**907**	**912**	**830**	**818**
EC	687	557	692	705	636	661
Belgium/Luxembourg	5	2	61	47	31	3
Denmark	0	0	0	1	0	0
France	41	33	51	63	74	48
Greece	56	65	50	52	49	63
Ireland	0	0	0	0	0	0
Italy	252	214	219	218	227	248
Netherlands	19	18	38	82	38	47
United Kingdom	3	9	46	30	23	49
West Germany	312	216	226	212	195	204
Other West European countries	209	176	215	207	194	157
Austria	22	15	23	13	20	18
Finland	0	0	0	0	0	0
Norway	1	1	0	0	0	0
Portugal	0	0	2	3	0	0
Spain	97	92	80	79	79	59
Sweden	19	3	23	16	0	1
Switzerland	22	12	19	35	40	27
Turkey	48	53	68	61	54	52

[a] First half of 1985.

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June to acquire 12.5 percent of Libya's largest crude producer. The United Kingdom has not had significant investments in Libya since British Petroleum pulled out in 1969.

We believe Libya may have as much as several billion dollars worth of debts and unpaid bills outstanding to Western Europe, with Italy probably the largest creditor. The arrearages on bills reportedly total about $800 million for Italy, $400 million for Turkey, $125 million for France, $80 million for Spain, and $40 million for Greece. In January 1985, Italy began taking 40,000 b/d of oil as payment on the debt, but Libya halted the oil shipments in August when Rome refused to renew a long-term LNG contract. Mainly as a result of these payments problems, West Germany and Italy have curtailed export guarantees for goods going to Libya and Italy has also cut off suppliers' credits to Libya.

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Impact on Western Europe of Imposing Sanctions on Libya

Imposing economic sanctions on Libya would have little impact on economic growth in Western Europe, but might put at risk West European investments and financial claims. In fact, according to our Linked Policy Impact Model, a total embargo on EC exports to Libya would lower real GDP by

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Western Europe: Dependence on Libyan Oil, 1980-85
(Net Libyan Oil Imports as a Share of Total Oil Consumption)

Percent

	1980	1981	1982	1983	1984	1985
Western Europe	**6.7**	**5.9**	**7.7**	**8.0**	**7.2**	**7.2**
EC	6.6	5.8	7.7	8.0	7.1	7.6
Belgium/Luxembourg	0.9	0.5	13.0	11.2	7.5	0.6
Denmark	0.1	0	0	0.6	0	0
France	1.9	1.6	2.8	3.5	4.3	2.8
Greece	22.5	27.3	21.1	22.7	20.8	27.0
Ireland	0	0	0	0	0	0
Italy	12.9	11.2	12.1	12.2	13.4	14.6
Netherlands	2.4	2.6	6.2	14.1	6.6	8.2
United Kingdom	0.2	0.6	3.1	2.1	1.3	3.0
West Germany	11.9	9.2	10.1	9.6	8.8	9.2
Other West European countries	7.1	6.3	7.9	7.8	7.6	6.1
Austria	8.8	7.0	10.9	6.4	10.1	9.1
Finland	0	0	0	0	0	0
Norway	0.6	0.9	0.2	0	0	0.1
Portugal	0.2	0	1.0	1.4	0.2	0.1
Spain	9.3	9.1	8.4	8.3	9.0	6.7
Sweden	3.8	0.8	5.3	4.4	0	0.4
Switzerland	8.6	5.0	8.6	14.3	16.8	11.4
Turkey	16.2	17.1	20.6	18.8	15.8	15.0

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only 0.2 percentage point in the first year and 0.1 point in the second year. The impact on the unemployment rate for the region as a whole would be insignificant. The Italian economy would be hardest hit with a first-year GDP loss of 0.5 percentage point and a 0.1 percentage point rise in unemployment.

While Western Europe's overall economic loss from sanctions would be small, specific firms and regions could suffer substantially. Exporters to Libya—led by Fiat—probably would be the biggest losers. Rome, for example, is counting on truck sales to Libya to help keep a troubled Fiat plant in Bolzano in operation. A cutoff of Libyan debt payments would also cause serious financial problems for several small Italian manufacturing and construction firms, and perhaps for some banks as well. And, of course, the oil companies operating in Libya could be hurt by a Libyan seizure of their assets there. All of these affected groups, along with West European arms producers, undoubtedly would lobby hard for a quick end to the sanctions.

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Western Europe: Exports to Libya, 1980-85

Million US $

	1980	1981	1982	1983	1984	1985 [a]
Western Europe	**6,689**	**10,151**	**5,567**	**5,019**	**4,158**	**3,180**
European Community	5,918	8,781	4,704	4,238	3,450	2,690
Beligum/Luxembourg	279	383	108	81	104	68
Denmark	31	55	33	51	27	16
France	671	907	428	334	212	220
Greece	168	220	113	102	89	53
Ireland	138	100	57	61	41	33
Italy	2,545	4,297	2,141	2,104	1,660	1,293
Netherlands	166	267	192	246	185	143
United Kingdom	670	1,067	460	417	328	281
West Germany	1,251	1,486	1,173	841	804	583
Other West European Countries	771	1,371	863	781	708	490
Austria	122	149	121	107	97	68
Finland	54	65	49	30	28	17
Norway	10	7	9	7	3	3
Portugal	5	5	2	2	2	3
Spain	358	427	267	276	267	151
Sweden	76	177	94	7 6	71	55
Switzerland	86	99	86	99	100	73
Turkey	60	442	235	184	142	120

[a] Estimate based on nine months of data for most countries.

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Other Considerations

We believe the West Europeans' reluctance to impose sanctions is not primarily driven by their economic ties to Libya. In our view it is more a reflection of West European governments' concern about possible reprisals against their citizens in Libya, and about increased Libyan-sponsored terrorism at home. Given Libya's support within the Arab League, the West Europeans may also fear that sanctions would endanger their more extensive economic relations with other Arab countries. Finally, the West Europeans remain convinced that economic sanctions rarely are effective and are concerned that imposing sanctions in this case might set an unwelcome precedent for the future.

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Western Europe: Exports to Libya, 1980-85

Percent of Total Exports

	1980	1981	1982	1983	1984	1985 [a]
Western Europe	**0.83**	**1.36**	**0.77**	**0.71**	**0.57**	**0.44**
European Community	0.89	1.43	0.80	0.74	0.59	0.46
Belgium/Luxembourg	0.43	0.69	0.21	0.16	0.20	0.14
Denmark	0.18	0.34	0.22	0.32	0.17	0.10
France	0.58	0.85	0.44	0.35	0.22	0.23
Greece	3.25	5.17	2.62	2.30	1.86	1.20
Ireland	1.62	1.30	0.70	0.71	0.43	0.34
Italy	3.28	5.71	2.91	2.89	2.26	1.74
Netherlands	0.22	0.39	0.29	0.38	0.28	0.22
United Kingdom	0.61	1.04	0.47	0.45	0.35	0.29
West Germany	0.65	0.84	0.66	0.50	0.47	0.34
Other West European Countries	0.55	1.03	0.67	0.61	0.51	0.35
Austria	0.70	0.94	0.78	0.70	0.61	0.43
Finland	0.38	0.46	0.37	0.24	0.20	0.14
Norway	0.05	0.04	0.05	0.04	0.02	0.02
Portugal	0.11	0.11	0.05	0.04	0.03	0.01
Spain	1.73	2.10	1.30	1.40	1.13	0.67
Sweden	0.25	0.62	0.35	0.28	0.24	0.19
Switzerland	0.29	0.37	0.33	0.39	0.39	0.29
Turkey	2.07	9.40	4.07	3.22	1.99	1.60

[a] Estimate based on nine months of data for most countries.

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Poland: Dim Prospects for Increasing Hard Currency Earnings

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One of the Polish Government's primary goals over the next five years is to increase hard currency earnings, but given the lack of effective export promotion policies any significant increase is unlikely. Incentives to export are few, and the regime does not channel adequate investment to those industries that are potential hard currency earners. The regime may tinker with its policies, but internal pressures to increase consumption rather than exports and weak Western demand for Polish products are likely to thwart any major export campaign.

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Inadequate Export Incentives

The 3-percent decline in hard currency exports in the first nine months of 1985 compared with the same period in 1984 partly reflects Warsaw's ineffective export policy. There is little incentive to export or to introduce quality products given high domestic demand. In a recent survey, more than 40 percent of all firms expressed no interest in exporting. With easier and more profitable sales available on the domestic market, few firms are willing to undertake costly overseas marketing.

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The regime has not carried through on its economic reform policy, which—at least on paper—tied a firm's imports of Western raw materials and capital equipment to its export revenues. Central allocations of export funds remain the most common method for financing imports as the programs designed to promote exports have faltered:

- The hard currency retention fund—intended to finance more than half of all hard currency imports—had little impact because the share of hard currency earnings that may be retained is too small to encourage most firms to accept the difficulties of becoming an exporter.
- The program to grant enterprises foreign trade rights has not succeeded because most firms find it easier to deal with foreign trade organizations that possess the foreign trading skill, trained personnel, and networks of established markets they lack. In addition, the Ministry of Foreign Trade excludes firms from entering markets in which foreign trade organizations already operate.
- The foreign exchange export credit system receives little use by firms because of the high interest rates charged on the limited funds available.

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Poland: Export Incentive Policies

Hard Currency Retention Funds:
- *Permit firms to keep an average 20 percent of export earnings to fund imports.*
- *Restrict purchases to raw materials and capital equipment essential to export production.*
- *Are held by 40 percent of firms.*
- *Financed 15 percent of imports in 1984.*

Foreign Trade Rights:
- *Allow firms to conduct trade directly without the aid of foreign trade organizations.*
- *Have been granted to about 300 firms.*
- *Accounted for about 7 percent of exports in 1984.*

Foreign Exchange Export Credit System:
- *Allows firms to obtain loans from Bank Handlowy, the foreign trade bank, to purchase the machinery and equipment necessary to develop hard currency exports.*
- *Funded 0.5 percent of imports in 1984, but probably about 2 percent in 1985.*

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Several other policies limit export incentives. The National Bank of Poland, for example, recently failed to implement a promised reduction in the high taxes levied on hard currency earners. The regime also delayed a reform tying wage hikes to increases in exports.

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Despite inadequate export performance, some officials have opposed additional export incentives, especially further devaluations of the zloty. The zloty has been devalued from 80 to 159 to the dollar in the last four years, but many Polish economists believe a rate of about 600 to the dollar is required to bring domestic prices in line with world prices. The regime probably is reluctant to devalue, however, because of the inflationary impact and concern that increased exports would depress consumer supplies.

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Lack of Export Options

Even with more effective policies, Poland is not well positioned in markets with high growth potential. More than three-fourths of Polish hard currency in 1984 was earned through exports of coal, copper and other metals, machinery and parts, chemicals, and processed food. Warsaw's plans to increase exports to the West by 7 percent annually in 1986-90 appear excessively optimistic, given prospects in its leading export markets:

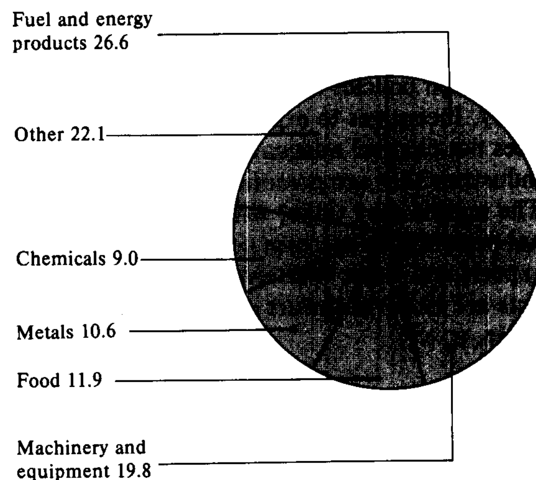
- Even the Poles see marginal growth potential for the extractive industries in the next five years. Output of coal, copper, and sulfur will stagnate, and production costs will escalate due to past inadequate investment. Moreover, pleas to conserve fuels and raw materials have been largely ignored. Stagnant demand for many raw materials on the world market, competition from other suppliers, and possible protectionist measures by West Europeans also may constrain sales of these products.

- Plans to increase exports of processed foods, especially meat, at rapid rates during 1986-90 hinge on increased production, reversal of past neglect of storage, packaging, and transport facilities, and the development of improved marketing strategies. Increasing meat exports, however, risks consumer protests against draining domestic supplies. Moreover, agricultural exports are vulnerable to the uncertainties of weather and Western import restrictions.

- A rapid expansion of exports of higher priced specialty chemicals is targeted at foreign high-growth industries, such as electronics, pharmaceuticals, fertilizers, and pesticides. The economic plan, however, does not provide the investments needed to increase output of these goods.

- Past experience suggests that Warsaw's plans to boost exports of machinery and spare parts in the next five years will prove unrealistic. In the first nine months of 1985, exports of machinery to the West were only 50 percent of the annual plan. Moreover, the newly industrialized countries, with better quality control and marketing channels than Poland, sell the same low-technology

Poland: Hard Currency Exports in 1984



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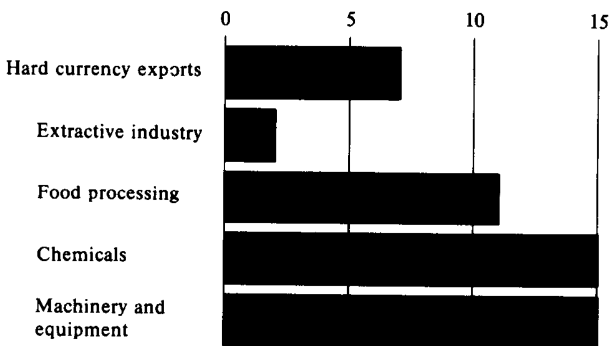
Poland: Planned Growth of Hard Currency Exports, 1986-90



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machinery. Failure to develop new products, import new industrial components on a large scale, and buy production licenses from Western firms, have widened Poland's technology gap and will continue to hamper export competitiveness.

Exports of services also will show little improvement for hard currency earnings beyond the $400 million earned in 1984. Warsaw hopes for substantial future growth in tourism earnings, but considerable investment in hotels and services is required. Most tourist agencies agree that Polish prices are high compared to other East European countries and accommodations and services fall below Western standards. While the export of construction services has some potential, given a revival of investment in the Third World, Warsaw must adapt better to demand and develop an area of expertise. Poland's geographic location offers potential for increasing transit services, but investment and marketing are required. The outlook for the export of technical know-how is even less promising—Poland's outdated technology base produces few patents that are licensed on a world basis. For example, less than 2 percent of all Polish inventions have foreign patents compared to 10 percent of East German and 60 percent of Dutch inventions.

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Outlook

We expect Poland's hard currency export earnings to increase marginally at best in the next five years. The regime shows no signs that it will redirect investment funds from outdated projects to those industries with the most hard currency export earning potential or greatly increase export incentives for firms. Nor does a drastic devaluation appear in the offing because of regime fears of a negative public reaction to large increases in domestic prices.

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The regime's proposed export incentives are unlikely to bring major improvement. For example, Warsaw plans to establish a Foreign Trade Development Bank to provide loans for developing potential exports, to raise a firm's share under the hard currency retention fund, and to grant tax and tariff concessions. The Poles also are encouraging joint ventures with the West, especially in the metals and machinery sectors, but Western firms appear reluctant to participate due to past problems and government policies. In addition, prospects for renewing old contracts, which nearly all expire by 1987, are gloomy because Western companies are phasing out the older products now made in cooperation with Poland.

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Domestic pressure to increase consumption more than exports to either the West or East is another major impediment to export growth. As in the past, the regime probably will yield to consumer demands and permit consumption to grow by more than the 2-percent annual rate planned for the next five years. Such concessions would mean even less

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Contradictory Export Policies

The Polish Government has not conducted an effective export campaign, and at times its actions have had an unintended opposite effect. For example, the regime in 1985:

- *Ordered an exporter of light bulbs to decrease sales abroad by $2 million because of domestic needs.*
- *Denied permission for a dairy to process and export long-life milk because the equipment to process the milk was leased from a Western firm rather than purchased outright.*
- *Delayed for almost two years expansion on abandoned property of a factory producing air gliders, resulting in a $100,000 loss in export revenue and penalties for breach of contract to Western importers.*

Although behavior in these examples appears irrational, in each case the regime made these decisions by focusing on other priorities, especially consumer needs.

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export revenue to repay the debt. Despite creditor demands to increase export revenues, their lack of leverage over Poland means the regime most likely will ignore the protests.

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Egypt: Economic Prospects and Policy Implications

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Egypt's capacity to meet its external financial obligations will become untenable in the next two years without a combination of major cuts in import growth, debt rescheduling, and significant increases in external assistance. The present government is unlikely, however, to push for sweeping reform, despite lipservice to the contrary, because it continues to believe that major restructuring of the current system of price supports, subsidies, and government controls would produce political instability. The leadership probably assumes that the strong US commitment to supporting a moderate regime in Cairo will guarantee major increases in financial assistance from the United States, lowering the pressure on Cairo to undertake politically risky reforms. Such support, however, would be largely invisible to the Egyptian public. If US assistance continues to grow while living standards stagnate or decline, the opposition would likely single out the United States with greater frequency as the cause, not the cure, for Egypt's economic woes.

Poor Prospects for Foreign Exchange Earnings

The combination of a weak world oil market and rapid growth of domestic consumption will almost certainly cause a decline in oil export revenues through the end of the decade. Production, according to oil industry estimates, will increase from a current level of about 900,000 b/d to over 960,000 b/d by mid-1986 and to over 1 million b/d by early 1987. It will probably stabilize at this level for at least the next two to three years before beginning to decline. By 1990 we expect oil export earnings to be down almost 40 percent from this year's level.

Remittances from workers abroad, the other major contributor to Egypt's foreign earnings, are likely to grow only marginally over the remainder of the decade. Although evidence is sketchy, the economic downturn in the oil economies of the Persian Gulf—the area employing most of Egypt's overseas workers—has probably already begun to affect expatriate earnings. We believe, however, that alarmist projections of large-scale layoffs of Egyptian workers over the next several years are unrealistic. Much of the Egyptian work force in the Gulf consists of skilled workers whose ethnic and religious compatibility and willingness to work at lower wages than Western expatriates will probably ensure their continued employment. Nevertheless, we assume that some layoffs will occur, especially among less skilled workers, and that reductions in pay and benefits are likely for many more.

Oil Price Assumptions

Our oil earnings projections are based on the premise that oil prices will decline only moderately over the next five years. This assumption could be overturned by decisions taken at the December 1985 OPEC meeting in Geneva. If OPEC countries attempt to capture a larger market share, oil prices may, according to many knowledgeable oil analysts, drop to the $20 per barrel level. A price decline of this magnitude would have disasterous implications for Egyptian revenue earnings and would entail the loss of about $700 million in hard currency during 1986 alone.

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Egypt's other traditional foreign exchange earners are unlikely to provide much help. Recent increases in procurement prices for cotton may stimulate production and exports, but not enough to make a significant difference in overall foreign exchange earnings. Suez Canal revenues have stabilized at

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Egypt: Balance of Payments, 1985-90[a] *Billion US $*

	1985	1986	1987	1988	1989	1990
Current account balance	**−1.9**	**−2.0**	**−3.4**	**−3.8**	**−4.1**	**−4.4**
Trade balance	−6.4	−6.7	−7.4	−8.0	−8.6	−9.2
Exports (f.o.b.)	3.7	3.9	3.7	3.7	3.7	3.7
Oil	2.2	2.3	2.0	1.8	1.6	1.4
Nonoil	1.5	1.6	1.7	1.9	2.1	2.3
Imports (c.i.f.)	10.1	10.6	11.1	11.7	12.3	12.9
Service balance	3.6	3.3	3.1	3.3	3.6	3.9
Receipts	7.4	7.3	7.3	7.7	8.2	8.7
Remittances	2.8	2.7	2.6	2.7	2.9	3.0
Suez Canal earnings	0.9	0.9	0.9	1.0	1.1	1.2
Tourism	0.4	0.4	0.4	0.5	0.6	0.7
Other	3.3	3.3	3.4	3.5	3.6	3.8
Payments	−3.8	−4.0	−4.2	−4.4	−4.6	−4.8
Official transfers	0.9	1.4	0.9	0.9	0.9	0.9
Capital account	0.6	1.2	1.3	1.2	1.0	0.9
Financial gap	**−1.3**	**−0.8**	**−2.1**	**−2.6**	**−3.1**	**−3.5**

[a] Egyptian fiscal year is 1 July–30 June.

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just under $1 billion during the past few years, and any growth will remain constrained largely by sluggish economic activity in the Gulf region.

Tourist revenues recently have sunk, according to US Embassy sources, and prospects over the next several years do not appear bright. Aside from a few luxury hotels in Cairo, the Egyptian tourist industry is plagued with inadequate infrastructure and notoriously poor service, characteristics that do not encourage return visits. Terrorist hijackings in the Middle East also have influenced tourists, particularly US citizens, to avoid the area.

Nonoil exports also face bleak prospects. Egyptian industry is dominated by public-sector enterprises whose low productivity, orientation to the home market, and dependence on government pricing policies make them poor vehicles for export expansion. 25X1 25X1 textiles will face severe international competition and protectionist policies abroad. Moreover, industrial exports are largely uncompetitive and likely to remain so for some time. 25X1

Policy Options

Given the bleak prospects for most of Egypt's traditional foreign currency earners and the unlikely development over the next several years of new sources of revenue, we believe that Egypt's foreign payments position will become untenable without a 25X1

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combination of major cuts in import growth and significant increases in external assistance. Even with some moderation in import growth,[2] Egypt will experience an unsustainable deterioration in its foreign payments position. Cairo will continue to explore various policy options to help reduce its payments deficits and avoid crippling import cuts.

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Non-US Financial Assistance. The Gulf Arab states are in the midst of their own financial crisis because of falling oil revenues and would not be inclined, we believe, to provide the additional aid Egypt will require. Moreover, a policy shift designed to attract Gulf assistance, such as a deemphasis of the Camp David accords, would jeopardize current US assistance levels of about $2.3 billion annually and leave Cairo no better, and possibly worse off, than before. Financial assistance from Libya or the Soviet Union would require an even more fundamental political reorientation and would not, in our judgment, provide anywhere near the level of funding Egypt would lose by abandoning its relationship with the United States.

Debt Rescheduling. The Mubarak government's only viable option with regard to civilian debt relief appears to be in multilateral rescheduling of long- and medium-term liabilities under IMF auspices. An IMF standby agreement would come at considerable cost. In exchange for new lines of credit and extended repayment terms on bank-syndicated and bilateral loans, Egypt would have to adhere to strict financial and monetary guidelines, including much more rigorous subsidy reforms and more rapid movement toward a unified exchange rate. Such adjustments, however, would almost certainly force substantial increases in consumer prices and probably provoke political unrest.

Accelerated Reform. From an economic perspective, a substantial self-initiated acceleration of economic reform is the most effective option available to Egypt. It is, however, no more palatable than an IMF standby agreement, from Cairo's political viewpoint. Current plans envision a five-to-seven-year period for the elimination of most subsidies, a pace that will yield few dividends in the near term. To Egyptian policymakers, however, a speedup in reform over the next one to two years entails too many political risks with no tangible economic benefits. Accelerated price increases, reform of the bloated bureaucracy, divestment of inefficient public-sector industries, and exchange rate unification are all recognized by the leadership as inherently important goals. They are aware, however, that such adjustments would initially entail large jumps in living costs and displacement of workers before there is any visible improvement in the economy.

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Egypt: Estimated Foreign Debt, December 1985

Billion US $

Civilian	24.0
Medium- and long-term	16.5
Short-term	7.5
Military	7.0
US FMS debt	3.7
Total	**31.0**

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Outlook

We believe that the Mubarak government lacks confidence in its ability to survive during a period of rigorous economic adjustment. Egypt's low- and middle-income urban population already see their economic status eroding and would regard a rapid reduction in subsidies as intolerable. Moreover, a strong consensus within Egyptian society holds the government responsible for providing affordable

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[2] We have assumed for purposes of analysis that the government will be willing and able to limit import growth to 5 percent per year over the balance of the decade.

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goods and services to the public. These attitudes act as powerful constraints to any accelerated reform effort.

The government's gradualist approach to economic reform has some major drawbacks. By delaying needed price adjustments or by stretching them out into increments acceptable to the general public, a sense of urgency is lost and much of the shock value of reform is dissipated. Cairo's excessively cautious approach to reform provides little incentive for consumers, producers, and investors to shift gears and adopt new modes of behavior that might result in increased productivity and investment. Instead, it is business as usual for most Egyptians, despite the burden of price hikes. Finally, by not providing incentives (for example, higher wages, increased access to consumer goods) and by attempting to slip price increases through in a furtive manner, the regime confirms in the minds of most Egyptians that reform can only be injurious to their long-term economic well-being.

Nevertheless, in the absence of large increases in US aid, Cairo probably cannot delay much beyond 1987 the introduction of an IMF standby agreement. A Fund-supported program, while onerous and politically dangerous, would provide the government with some means of deflecting criticism from itself. It and an accompanying rescheduling agreement would also provide immediate economic relief. Moreover, given recent experiences in IMF standby agreements, the positive benefit of rescheduling would remain intact even if Egypt, at a later date, fell out of compliance.

Implications for the United States

We believe that Egypt will push hard for FMS debt rescheduling. The $3.7 billion in military debt obligations owed to the United States will require annual payments of about $550 million over the next several years. The Egyptians are $470 million in arrears on these payments and are constantly pushing up against the one-year arrearage limit that could trigger a Brooke amendment cutoff in all US assistance. Cairo has requested debt relief in past meetings with US officials and will almost certainly press harder for forgiveness, or substantial rescheduling, during the next year. Egypt's special military relationship with the United States and shared concerns over the role of the Soviets, Libyans, and Iranians in the Middle East will undoubtedly be cited by Cairo as justification for FMS relief.

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The Mubarak government also will strongly argue for conversion of more Economic Support Funding (ESF) into cash transfers, as well as an increase in total ESF, which currently is $815 million annually. During the current US fiscal year about $300 million of ESF for Egypt has been allocated by the United States for balance-of-payments support; the remainder is distributed as project assistance through USAID. Cairo will probably attempt to persuade US officials to convert more project assistance into grants, citing as justification the cash grant status of all ESF under US assistance to Israel. The Egyptians have long maintained that the United States promised aid parity with Israel. Egyptian officials may also cite growing political and social tensions caused by the large US presence in Egypt and argue the desirability of lowering the US profile by channeling more project assistance directly into Egyptian hands.

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In addition to regular ESF, Egypt is receiving from the United States $500 million in supplemental grant assistance—all of which will be disbursed during the current Egyptian fiscal year (1 July–30 June). Our analysis of Egypt's 1985/86 budget suggests that Cairo has already incorporated this amount into the capital transfer and investment portions of its budget, leading us to believe that the Egyptians assume this one-time funding, or the equivalent in new ESF, will be made available to them on an annual basis after 1986.

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Given current financial trends, Egypt could easily require, in the absence of an IMF standby program and a rescheduling agreement, an additional $1 billion in balance-of-payments support by 1987.

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This would necessitate a more than threefold hike in US aid designated solely for payments support and, in the absence of any general aid increases, would require converting most current US assistance, military and civilian, into cash grants. An IMF-supported standby program for Egypt undoubtedly would ameliorate, to some extent, the need for greater direct financing but would probably entail additional costs for the United States in the form of supporting the IMF program and deferring loan obligations.

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Latin Debtors: Increasingly Competitive Labor Costs

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The five largest Latin American debtors [1]—often as part of IMF-supported programs—have undertaken austerity measures that have resulted in generally falling labor costs since 1981. According to our estimates, Latin American labor costs have fallen 14 percent in domestic terms and 48 percent in US dollar terms between 1981 and 1984. We expect existing and growing labor surpluses in the debtor countries to continue to restrain realwage increases throughout this decade. Low labor costs should attract some labor-intensive investment as it has in the East Asian NICs,[2] but we believe that political and economic uncertainty in the Latin American debtor countries probably will constrain significant private investment that could help fuel economic expansion.

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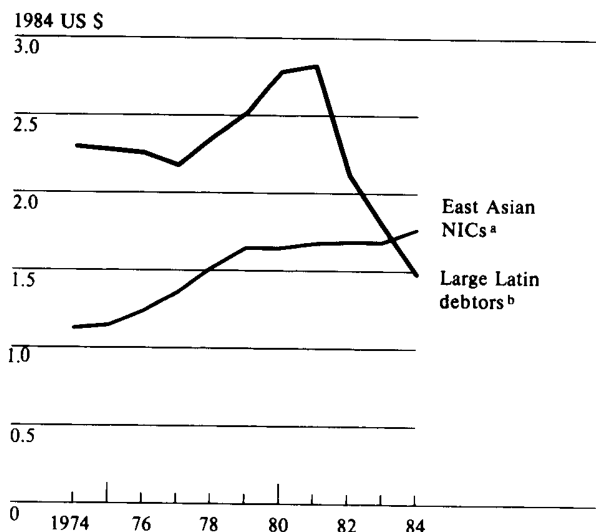
Trends in Real Hourly Manufacturing Labor Costs: Large Latin American Debtors and East Asian NICs, 1974-84



a The East Asian NICs include Hong Kong, South Korea, Singapore, and Taiwan.
b The large Latin American debtors include Argentina, Brazil, Chile, Mexico, and Venezuela.

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Austerity Drives Domestic Wages Down

Before the debt crisis, real labor costs were increasing at an average annual rate of 4 percent in domestic currency terms in what are now the five largest Latin American debtors. Since the onset of the debt crisis in 1982, these countries have implemented various austerity measures, often as a part of debt rescheduling agreements with the IMF and other financial institutions. Debt-related policies have dramatically reversed the previous trend. Increases in nominal wages actually lagged increases in inflation in four of the five largest Latin American debtors between 1981 and 1984; we estimate that real domestic labor costs fell 14 percent on average during this period.

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Although complete data for 1985 will not be available for several months, we believe that real wages fell in four of the five largest debtors last year. Brazil had the only increase for 1985; hefty hikes in minimum salaries, a trend toward quarterly pay adjustments, and major wage concessions resulting from large-scale strikes in the Sao Paulo industrial belt led to an average real wage increase that exceeded 10 percent in cruzeiro terms. Venezuela and Mexico will report mild declines for 1985. Venezuela has focused more on increasing employment than on increasing real wages, and

[1] The five largest Latin American debtors are Brazil, Mexico, Argentina, Venezuela, and Chile.
[2] The East Asian newly industrializing countries (NICs) are Hong Kong, Singapore, South Korea, and Taiwan.

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Labor Compensation Costs

Labor compensation costs are used rather than earnings comparisons because they better reflect the true cost of employing labor, and, therefore, the competitiveness of labor inputs in manufactured goods production. In contrast to earnings, this broader definition includes items such as: unemployment insurance costs, contributions to pension plans, all bonuses and special payments, pay for time not worked (that is, holiday, vacation, and sick pay), payment in kind (that is, housing allowances) and payroll taxes that are paid by the employer but that do not necessarily benefit the worker directly.

Mexico has continued its attempts to control inflation by suppressing real wage growth. Argentina and Chile will show the most severe declines for 1985; both economies continue to be stalled by their high dependence on depressed commodity revenues in the agricultural and mining sectors, respectively.

Dollar Labor Costs Decline Even More Dramatically

Because movements in real exchange rates increased the value of the US dollar against all of the largest Latin American debtor currencies during the past four years, the debtors have enhanced their labor cost competitiveness vis-a-vis the OECD countries by even more. We estimate that the US dollar labor cost of employing manufacturing labor in Latin America fell by 48 percent between 1981 and 1984, with the real average hourly cost falling from the equivalent of $2.83 in 1981 to $1.48 in 1984. We estimate that three-fourths of this decline was due to real depreciation of the debtor currencies against the US dollar with about one-fourth due to the fall in domestic labor costs. Although currency devaluations were not undertaken specifically to lower relative labor costs, that has been perhaps its most significant result.

Prospects For Low-Wage-Induced Investment

Low labor costs have been a key element in attracting foreign investment and in producing competitive manufactures for export in the highly praised development of the East Asian NICs. These Asian countries had US dollar labor costs that were 41 percent lower than the five largest Latin American debtors four years ago, which provided a large incentive for labor-intensive producers to invest in Asia. The East Asian NICs have now lost that labor cost advantage over the largest Latin American debtors. Asian labor costs were 20 percent higher than the average Latin American debtor costs in 1984, and the Latin American debtor advantage continues to grow.

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Cost and supply factors regarding the labor force should have attracted greater labor-intensive investment from both domestic and foreign sources, but other considerations have acted to prohibit the Latin American debtors from fully realizing the benefits of their competitive labor position. Among the deterrents to new investment are rampant inflation, high real interest rates, stringent price controls, restrictive exchange controls, erratic tax policies, and protected domestic markets. All of these factors tend to raise, and more important to make unpredictable, the costs related to doing business in the Latin American debtor countries.

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Although current trends are slowly swinging toward a more favorable business environment, abrupt turnarounds in the past have made investors wary, and they will withhold their capital until they are convinced that new favorable changes are more than transitory. Brazil and Mexico have both made moves away from their better-than-average adherence to austerity programs in favor of more growth-oriented policies. Argentina has implemented an aggressive plan to control inflation, but many observers believe that it may soon be abandoned.

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Individual Country Trends

***Mexican** real wages plummeted the most severely among the largest debtors between 1981 and 1984; manufacturing labor costs fell by 28 percent. The US Embassy reports that organized labor offered the ruling PRI, during the 1982 elections, its cooperation in holding down wage hikes in return for increased representation of labor leadership in government. The Mexican workers received assurances that certain basic commodities would be subsidized and held at low prices although wages would not keep up with inflation.*

***Chile** realized a 20-percent decline in real domestic labor costs between 1981 and 1984. Chile has yet to fully recover from the domestic banking crisis and the drop in international copper prices that contributed to the economic recession that began mid-1981. Labor legislation that had effectively created a real wage floor was removed in 1982 because government officials believed that wage inflexibility was reducing product competitiveness, increasing unemployment, and aggravating the recession.*

*Labor costs fell 18 percent in **Brazil's** manufacturing sector from 1982's peak by 1984. The government of Brazil passed a salary decree law in 1983, as part of an austerity program agreed upon with the IMF, that indexed labor costs well below the cost of living, according to the US Embassy. In late 1984, officials began attempts to preserve worker purchasing power with a new salary law that called for wage indexation equal to inflation and for semiannual adjustments.*

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***Venezuela's** real domestic labor costs fell 18 percent between 1978 and 1984. During this period, real manufacturing wages rose only in 1980 when a large general increase was mandated by the government, but the subsequent rise in consumer prices offset most of the nominal increase in wages. Falling real wages reflect the more general deterioration in nonpetroleum-sector performance in Venezuela. This deterioration in large part is due to inept government policies that were adopted between 1979 and 1983 that kept the bolivar overvalued while liberalizing import procedures.*

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*While **Argentina's** manufacturing labor costs have yet to reach 1975's peak levels, it was the only debtor to have rising real wages in 1983 and 1984. The military appeared to be making an effort to improve its image with the Argentine public prior to the transition to a popularly elected civilian government in 1983, and Raul Alfonsin made good on his campaign promise to raise real wages in 1984.*

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Real Wage Outlook

We believe that the labor cost competitiveness of the largest Latin American debtors will continue to expand throughout the decade:

- Increasing labor reserves will restrain labor cost increases, preventing domestic real wages from recouping the losses incurred with the onset of the debt crisis until after the end of the decade. These reserves are already large with unemployment rates generally well into the double digits and underemployment rates even higher. Moreover, rapidly expanding labor forces will ensure an ample supply of labor in the future.
- Depreciation of domestic currencies by the Latin American debtors against their OECD trading partners will probably continue in an attempt to stimulate even more exports and to reduce capital flight.

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Falling labor costs have boosted the competitiveness of Latin American exports. We expect, however, that interventionist government policies and powerful labor unions will attempt to prevent further declines in domestic purchasing power, which in some cases may already be at subsistence levels for many workers. As a result, we believe that

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**Largest Latin Debtors:
Real Manufacturing Labor Costs,
1974-84**

	Hourly Labor Cost (1984 US $)						Average Annual Growth (percent)	
	1974	1976	1978	1980	1982	1984	1975-81	1982-84
Argentina	1.87	0.91	1.03	2.41	0.63	0.91	−1.6	−18.3
Brazil	1.74	2.08	2.33	1.96	2.32	1.23	3.2	−17.2
Chile	0.81	0.72	1.06	1.48	1.21	0.81	11.6	−22.6
Mexico	3.46	3.88	3.33	3.74	2.15	1.81	2.9	−24.7
Venezuela	3.61	3.72	4.05	4.43	4.27	2.64	2.6	−15.1
Group average	2.30	2.26	2.36	2.79	2.12	1.48	3.0	−19.4
Asian NIC average	1.13	1.24	1.52	1.65	1.69	1.77	5.9	1.9
United States	12.13	12.66	13.18	12.38	12.41	12.59	0.3	0.7

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**Largest Latin Debtors:
Changes in Real Domestic
Manufacturing Labor Costs,[a]
1975-84**

Average annual percent

	1975-81	1982-84
Argentina	−3.4	3.9
Brazil	6.0	−3.2
Chile	11.7	−7.1
Mexico	2.0	−10.3
Venezuela	0.3	−4.3
Group average	4.1	−4.9
Asian NIC average	7.6	7.1
United States	0.2	0.7

[a] Measured in national currencies.

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future increases in labor cost competitiveness will derive primarily from real devaluations of Latin American debtor currencies.

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Somalia: Uncertain Prospects For Economic Reform

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Somalia made limited progress toward improving its ailing economy in 1985, but major problems remain including a growing external debt, continued high current account deficits, and slippages in implementing the 1985 IMF reform package. Although the economic stabilization effort continues, enthusiasm for economic reform in 1986 probably will be tempered by continuing opposition from many of President Siad's supporters in the government and military. Because Siad's overtures to Libya and the Soviet Union have netted him only limited assistance thus far, we believe he will come to terms with the IMF in 1986 to avoid jeopardizing essential Western and Arab aid.

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Economic Slide

The Somali economy has not recovered from the severe drought of 1974-75 and the Ogaden war with Ethiopia in 1977-78. The war resulted in a steady inflow of refugees and an end to Soviet financial and technical assistance. As foreign aid grants declined, Mogadishu substantially increased government expenditures in 1978 and 1979 leading to high budget deficits. Government domestic and foreign borrowing to finance these deficits pushed the inflation rate higher and widened the current account deficit.

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Mogadishu undertook some reforms in 1981-83 to accommodate IMF standby arrangements, but heavy short-term borrowing and high interest rates kept current account deficits high. Efforts to establish a medium-term economic program in late 1983 and early 1984 were abruptly postponed, and Siad rejected a new IMF agreement to appease supporters who stood to lose financially if effective reform measures were enacted. A Saudi ban on livestock imports from Somalia because of disease, and the 1983-84 drought, exacerbated Mogadishu's economic and financial situation. In 1984, the inflation rate topped 90 percent—nearly three times the average of 1981-83—the budget deficit increased from 3.3 percent of GDP in 1983 to 6.9 percent in 1984, and the foreign payments situation worsened drastically.

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The 1985 Reform Program

In response to mounting economic pressures, Siad introduced an ambitious reform package in January 1985, along with another IMF standby agreement. The new package aimed to increase economic growth from 2.3 percent in 1984 to 4 percent in 1985, to dampen inflation from 92 percent to 20 percent in 1985, and to reverse the financing gap from a $139 million deficit in 1984 to a surplus of $18 million.

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The linchpin of the program was a devaluation of the Somali shilling. The government allowed the shilling to float for most private transactions and devalued the official rate by about 50 percent between January and May 1985. The government also eliminated most controls on trade and payments, including licensing for most import and export transactions. The program also sought a substantial rise in revenues by liberalizing imports. The government undertook to reduce the civil service sector and to strengthen controls on expenditures.

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Limited Successes and Deep Problems

The economic reform efforts have had mixed results. Despite a shortfall in government revenue, Somalia probably came close to meeting the 1985 targets for the budget deficit and for banking system credit to the government, according to IMF data and Embassy reporting. Although inflation

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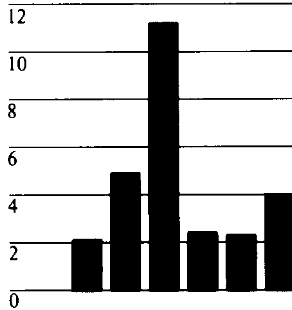
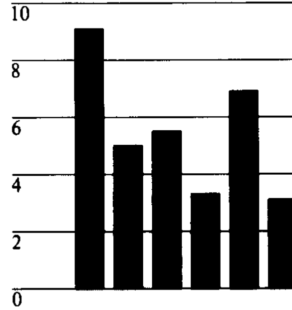
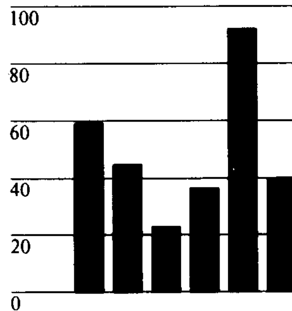
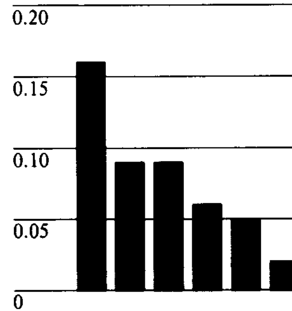
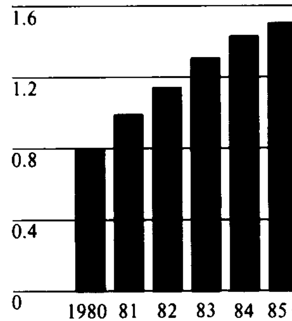
Somalia: Economic Indicators, 1980-85

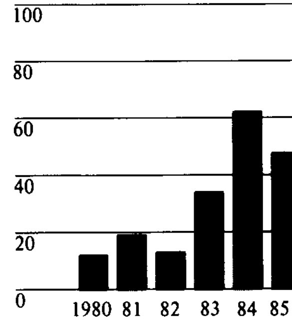












[a] Includes external grants.
[b] Average exchange rate for year except for 1985, which is the yearend exchange rate.
[c] Estimated.

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remained in excess of IMF targets, it is down by more than one-half to about 40 percent, according to IMF estimates. Exports were expected to increase by 60 percent because of favorable weather conditions, efforts to diversify export markets, and the lifting of the Saudi ban on noncattle livestock. Furthermore, real GDP probably grew by about 4 percent during 1985—close to government targets—according to IMF estimates.

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Despite these modest gains, difficulties remain. External debt mounted steadily—to an estimated $1.5 billion—and the IMF projects a $68 million foreign payments deficit for 1985, due in part to lower than expected aid donor receipts and high debt servicing requirements. According to the Embassy, external arrears totaled an estimated $61 million for 1985, up from a previous IMF estimate of $27 million. Mogadishu also has fallen behind in its repayments to the IMF and is seeking a short-term US bank loan to pay its arrears to the Fund.

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Exchange rate adjustment continued to be a major point of contention between the Fund and Mogadishu in 1985. The government ceased making monthly adjustments to the official rate in mid-May, leaving the official rate about double the free-market rate. The government continues to resist unification with the market rate because it fears the potential negative effects on the budget and inflation, but also because officials are unwilling to relinquish control over the allocation of foreign exchange and the benefits of the cheap official rate, according to the Embassy. The two sides have yet to reach an agreement on when or if unification will take place.

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Mogadishu also continues to avoid taking effective steps to reform the public sector. Under the 1985 program, the Somalis were to classify existing public enterprises into three categories: those to be phased out of operation, those to be privatized or converted into joint ventures, and those to remain in the public sector. According to the US Embassy, however, the Somalis dragged their feet—probably

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Somalia:
Current Account Trends, 1980-85

Million US $

	1980	1981	1982	1983	1984	1985 [a]
Current account balance	**−136**	**−83**	**−177**	**−150**	**−146**	**−172**
Merchandise trade balance	−268	−195	−300	−272	−425	−471
Exports	133	175	171	90	41	65
Imports	401	370	471	362	466	536
Net services	−68	−69	−54	−45	−78	−58
Private and official transfers	200	181	177	167	357	357

[a] Estimated.

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fearing losses of patronage and control—and are attempting to keep in the public sector all businesses that benefit top Somali officials and their friends and relatives.

Disappointed Expectations of Western Aid

Siad launched the 1985 program with the hope that the IMF, the United States, and other donors would quickly come to his aid. Senior government and party officials over the past year, however, have increasingly criticized his failure to acquire sufficient Western assistance to reverse the country's economic and military decline, in return for adopting reforms and providing the United States with military access Those officials who opposed the 1983-84 reform program and IMF agreement and profited from the corruption the previous system allowed are again pressing Siad to reimpose socialist economic policies.

To counter mounting criticism, Siad is seeking to improve relations with the Soviet Union and Libya in hopes of gaining additional aid and limiting military and political support for Somali dissidents. At the same time, he has become increasingly critical of Western donors, particularly the United States but also the IMF, blaming their "stinginess" for Somalia's woes. So far, Libya has provided some $20 million for a joint agricultural project, but the Soviets have replied to his overtures with political conditions that are unacceptable to Siad, according to US officials. Nonetheless, he probably believes renewed contacts with Moscow and Tripoli will give him some leverage in the difficult negotiations over Western aid and Somali economic reform in 1986.

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Outlook

We believe that, while Mogadishu's commitment to reforms is far from certain, Siad is well aware that the economic crisis will worsen if he does not take some action. The country's underlying structural deficiencies— high import dependence in combination with reliance on a few export products and markets, and low productivity of investment—will probably persist for many years, requiring continued foreign assistance to keep the economy afloat. Debt service for 1986, including arrears, will be $224 million—almost twice the projected level of exports, according to the Embassy.

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Siad probably will face increasing pressure to reject an IMF stabilization package in 1986, especially if donor assistance continues to fall below Somali expectations. More government leaders, however, are increasingly aware of the economic situation and the need for an IMF agreement, according to the Embassy. We believe Siad—with little viable alternative—will accept an IMF agreement to promote the flow of aid from Western and moderate Arab sources, but will test the tolerance of the IMF by delaying the unification of the exchange rates, the full payment of arrears, and other reforms. We concur with the Embassy assessment that the Somalis, fearing the potential economic consequences, are less likely to enter an agreement if the IMF insists upon a unified foreign exchange rate rather than a modified dual system.

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We believe Siad will persist in his criticism of the West to counter his domestic critics, and he will seek ways to mitigate the effects of economic adjustment on his favorite supporters. We do not believe Siad will risk a break with the West, however, given Somalia's strong need for economic and military aid and the low probability that the Soviet Union and Libya will respond sufficiently to his overtures.

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Briefs

Energy

Western Involvement in Libya's Oil Industry

Western Oil Companies in Libya

	Equity Share in Libyan Operations (*percent*)	Current Crude Liftings (*thousand b/d*)
United States		
OASIS		
Conoco	16	64
Marathon	16	64
Amerada Hess	8	32
W.R. Grace	12	14
Occidental	37	46
Total		**220**
Western Europe		
Elf [a], France	49	2
Wintershall, West Germany	49	2
VEBA [a], West Germany	35	21
OMV [a], Austria	12	15
AGIP [a], Italy	50	80
Total		**120**

[a] Includes total or substantial government ownership.

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Iranian Alternatives to Khark Island

Khark Island remains Iran's only export terminal for onshore oil production, despite Tehran's claim it has completed another export facility at Ganaveh. Satellite photography shows that work at Ganaveh is continuing but is not finished. Press reports from Bahrain indicate that, because of extensive damage, Khark may be abandoned when the new outlet is complete. The Ganaveh export terminal probably will not be finished before February and will add about 2 million b/d in export capacity. The reopening of Khark's sea island berths 11 and 12 and the recent simultaneous use of four T-jetty berths seen in photography suggest it is highly unlikely that Iran will abandon Khark for the new, smaller terminal.

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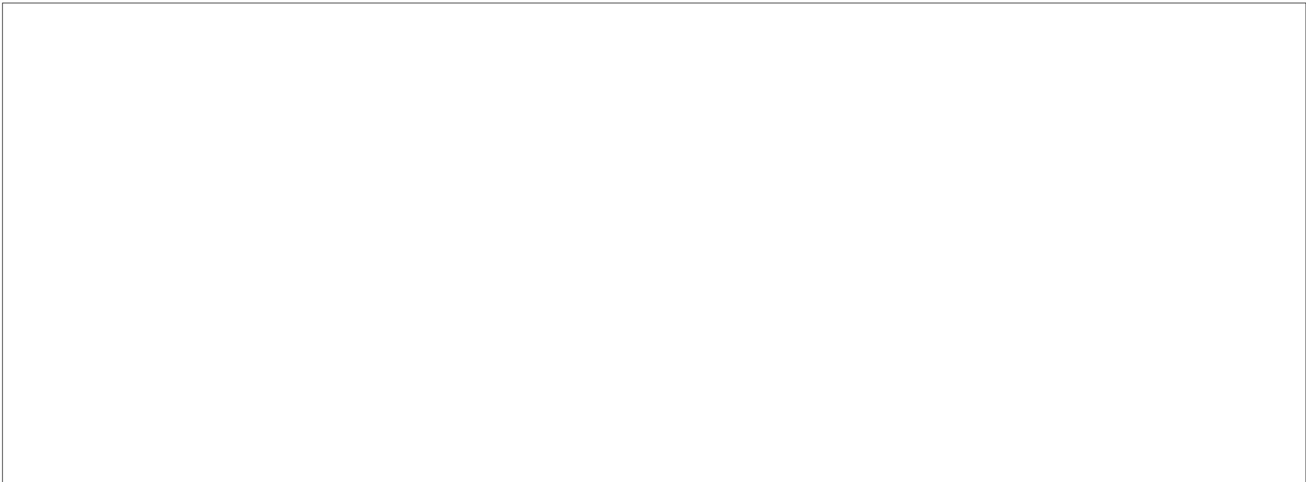

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Mauritanian Oil Hopes Waning

Mauritania is not likely to become an oil producer any time soon, despite some initial optimism by US oil companies exploring in country. According to US Embassy reporting, OXOCO's recently concluded onshore seismic studies in southwestern Mauritania proved favorable, but the company decided that the soft world oil market made exploitation of the fields uneconomic. The Secretary General of the Mauritanian Ministry of Mines and Industry believes Texaco has also decided to postpone drilling its offshore concession—despite promising seismic results—because of the company's legal battle with Pennzoil. AMOCO also appears to be dragging its feet on exploring potentially lucrative onshore and offshore fields. Although the Secretary General maintains AMOCO is interested in exploiting the concessions, a date for negotiating an agreement has not yet been set.

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International Finance

Japan Debates International Monetary Reform

Finance Ministry and Central Bank officials last week publicly opposed any attempt to modify the floating exchange rate system for "the foreseeable future," according to the Japanese press. Vice Finance Minister Oba noted that Finance officials would not support a target zone system in which major currencies would be allowed to fluctuate within a well-defined band, even if proposed by aides to Prime Minister Nakasone. We believe these statements are primarily intended to discredit any recommendation by Nakasone's special trade policy advisory group for reform of the international monetary system. Nakasone has said he will put forth some of the group's recommendations—due in March—at the Tokyo Economic summit in May.

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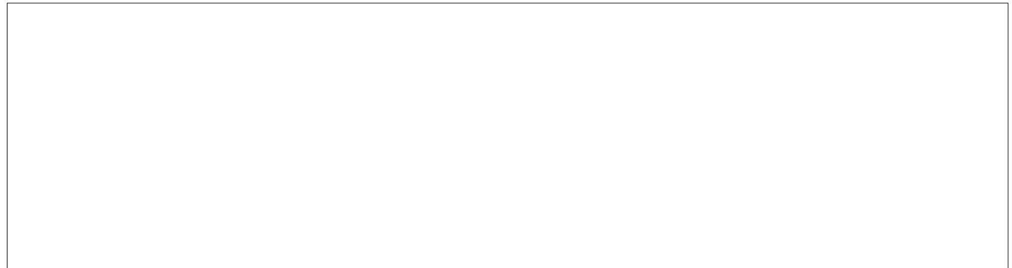

Costa Rican IMF Program Facing Problems

San Jose may need another waiver to stay in compliance with the IMF stabilization program it signed this July. Political realities during the presidential campaign have prevented full and timely implementation of promised tariff reforms. This is also holding up the second tranche of a World Bank loan. Moreover, a deterioration in Costa Rica's trade balance is further undercutting San Jose's ability to meet quarterly foreign reserve targets. Anticipating higher tariffs, Costa Rican manufacturers apparently have stepped up imports in recent months. Export earnings are down because coffee exporters are witholding sales, expecting higher prices in the wake of the continued Brazilian drought. According to Embassy sources, Costa Rican officials claim further import cuts are impossible before the 2 February elections. As a result, the new administration scheduled to take office in May is likely to be faced with clamping down on the economy or lobbying the World Bank and IMF for a relaxation in program targets. 25X1

Progress on Guinea's IMF Agreement

On 12 December Guinea signed a letter of intent with the IMF detailing a major reform program that Guinea hopes will be the basis for a standby agreement to be negotiated in coming weeks, according to the US Embassy. The most significant reforms include a major devaluation, an increase in rice and fuel prices, reform of the banking system, rationalization or abolition of state enterprises, reduction of the civil service, and various budgetary reforms. President Conte, who has moved cautiously to liberalize the Guinean economy, is likely to meet resistence to imposing austerity measures on what is already one of Africa's poorest economies. 25X1

Bangladesh Signs IMF Standby Agreement

Bangladesh and the IMF signed a standby agreement for about $200 million in December. Agreement in principle was reached last June, but final signing was delayed because of disagreements between Dhaka and the Fund over the scope and pace of economic reforms. According to the US Embassy, Dhaka has now agreed to increase public utility taxes, phase out fertilizer subsidies, and depreciate the taka. Dhaka also pledged to maintain ceilings on domestic credit and public external debt to reduce inflation and foreign exchange outlays. The IMF loan comes at a time when Bangladesh's financial reserves have declined to about $300 million, equal to about one month's imports. President Ershad, however, may backslide on some austerity measures to enhance his popularity as part of ongoing efforts to schedule national elections with the participation of opposition parties. 25X1

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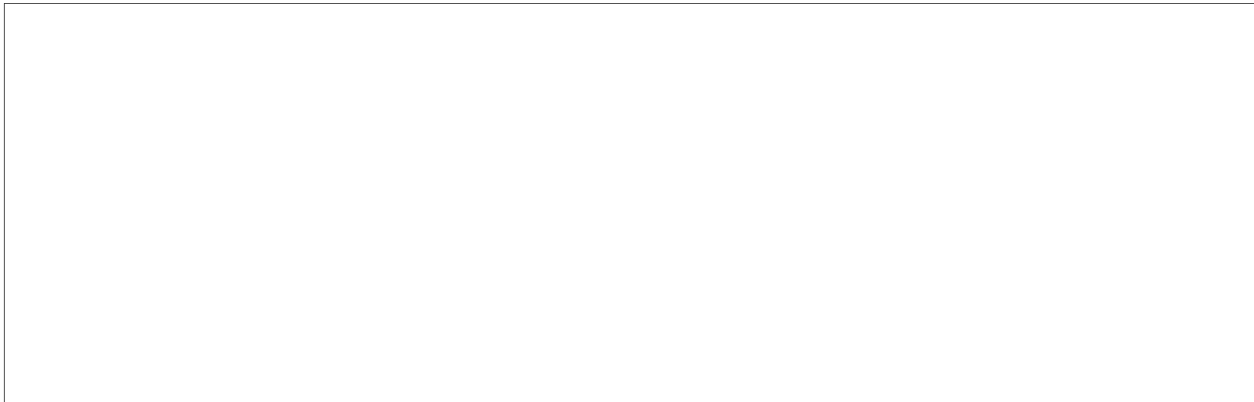
Global and Regional Developments



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EC Bans Livestock Hormones

EC agriculture ministers have approved a total ban on the nontherapeutic use of growth hormones in livestock effective 1 January 1988. The action is in response to consumer pressures and an attempt to curb overproduction of meat. Although not directed specifically against EC trading partners, the ban will apply to imports as well as domestic meat and thus threatens US exports of beef and beef products. The United Kingdom, a major user of hormones, opposed the ban, citing a lack of scientific evidence of harmful effects. The ban will likely be difficult to enforce, and, until the specific enforcement mechanisms are worked out by EC veterinary officials, the exact impact on US beef exports cannot be predicted.

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Canada To Impose Tariffs on EC Beef

Ottawa is expected to satisfy the domestic complaints of unfair competition by levying countervailing duties on EC beef imports. In 1984, Ottawa used its Meat Import Law to impose quotas on beef imports, but dropped the restrictions after the EC threatened retaliation against Canadian foodstuffs. Ottawa invoked the law again in 1985 but immediately suspended the restrictions, pending an investigation of EC beef imports by a government panel. The study will be completed by mid-January, and senior Canadian officials recently stated that the panel almost certainly would find the EC guilty of unfair trade practices. While the duty rate has yet to be determined, the influential Canadian Cattlemen's Association is arguing that a level of 43 to 57 cents per pound is needed to offset EC export subsidies. Ottawa, however, is likely to impose substantially lower rates because the EC subsidies are only about 25 cents per pound.

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Bonn and The Hague To Aid Semiconductor Project

The West German and Dutch Governments have decided to provide $185 million in subsidies to the joint Siemens/Philips project to develop by 1989 a next generation of memory chips. Bonn's share will be $125 million. The project's prospects were unclear last summer when Toshiba came out with samples of a 1-megabit chip and Siemens decided to purchase Toshiba's design. Siemens remains committed, however, and both firms optimistically

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contend that the microelectronics gap between West Germany and Japan will be closed if they can meet their target date. Siemens is also interested in using megabit chips to improve the competitiveness of the company's telecommunications and factory and office automation equipment. [ ] 25X1

Tin Council To Consider New Proposal

When the International Tin Council (ITC) reconvenes Tuesday after a three-week hiatus, the main topic of discussion will be the latest proposal put forward by ITC creditors. The plan calls for the establishment of a new company controlled by creditor banks and London Metal Exchange (LME) brokers to assume the debts as well as the assets of the ITC bufferstock. It also would allow for the orderly disposal of the ITC's tin inventory—about 85,000 metric tons, including outstanding contracts—over a three-year period to minimize price distortions. For ITC members, this proposal is preferable to earlier solutions because it limits ITC's liability to roughly $300 million instead of the potential $1.3 billion debt of the bankers' original proposal. The growing concessions in favor of the ITC reflect the relatively weak bargaining position of the creditor banks and LME brokers. Although more palatable to ITC members, the plan probably will not receive immediate approval because members remain divided on responsibility for the ITC debt. In the meantime, the LME—facing growing pressures—meets Monday to decide when to resume tin trading. [ ] 25X1

Vienna Agrees To Finance Hungarian Dam

Austria has agreed to provide substantial financial and technological support for construction of the controversial Nagymaros dam, part of a joint Czechoslovak-Hungarian hydroelectric complex on the Danube. The Austrian Government will guarantee bank loans covering nearly 90 percent of the estimated $440 million cost, and Austrian companies will perform 70 percent of the construction. To repay the loans, Hungary will deliver 1.2 billion kilowatt hours of electricity annually to Austria—two-thirds of its share of the complex's output—for a 20-year period, starting in 1996 when work is scheduled to be completed. After dragging its feet since 1977, Budapest agreed to proceed last year in response to pressure from Moscow and Prague. Austrian participation will alleviate some concerns about the project's costs and will free Budapest to channel resources to more productive energy investments. The meager potential return for Hungary—less than two percent of its current electricity requirements—could revive criticism from domestic environmental groups. [ ] 25X1

India and USSR Sign Trade Agreement

India and the USSR signed an agreement late last month that calls for an increase of up to 100 percent in bilateral trade over the next five years. It extends the longstanding arrangement under which India pays for its imports in nonconvertible rupees and provides more favorable credit terms for purchases of Soviet machinery and other equipment. The agreement does not indicate any major change in the composition of trade. India apparently used its threat to open its market even more to Western capital and technology to wring concessions from the Soviets. The target of doubling trade is not likely to

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be reached. Moscow probably will not increase its exports of crude oil and petroleum products, which make up more than 70 percent of Indian imports from the USSR. The Indians probably will be reluctant to accelerate purchases of Soviet capital goods significantly because of dissatisfaction with their quality.

25X1

South Korea Eyeing Caribbean Basin Investment

South Korean companies are considering investment opportunities in the Caribbean Basin in order to export apparel and other manufactured goods to the United States and Western Europe. Although the Caribbean Basin Initiative does not include textiles and apparel, there are only limited quota restrictions on textiles from this region. About two dozen apparel makers from South Korea, Hong Kong, Taiwan, and Singapore have opened factories in the past two years in the Caribbean Basin. Most recently, a South Korean firm is deciding whether to open a plant in Costa Rica to manufacture textile bags and luggage.

25X1

China and Japan To Renew Long-Term Trade Agreement

Beijing and Tokyo have resolved serious differences over future Chinese crude oil export commitments, enabling them to renew their long-term trade agreement for another five years. According to press reports, Japan will increase the minimum quantity of Chinese crude oil it imports by 10 percent to 176,000 b/d through 1990. Japan had resisted Chinese proposals for a significant increase in the oil import commitment level to help offset China's growing trade deficit with Japan, which was over $5 billion in 1985. This compromise is unlikely to reduce the bilateral deficit, however, because the Japanese already have been buying about 60,000 additional b/d of Chinese crude on the spot market for the past several years. Nonetheless, Beijing probably will use the agreement to placate students and other domestic critics who have recently protested Japan's trading practices.

25X1

South African Miners Fired After Wildcat Strike

Operations in the world's second largest platinum mine, located in nominally independent Bophuthatswana, shut down on 6 January after its South African owners, Impala Platinum Holding Ltd, fired 20,000 miners engaged in a wildcat strike over wages and better working conditions. Since the shutdown platinum futures prices for April delivery have soared. While the mine closure has also renewed concern that tensions in southern Africa might disrupt future metal supplies, it is unlikely the closure will be prolonged. In the absence of a labor settlement, replacement workers can readily be drawn from the vast pool of unemployed blacks in Bophuthatswana and South Africa. Meanwhile, mine officials claim that platinum stockpiles will prevent any break in consumer supplies.

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National Developments

Developed Countries

Japanese Economic Policy Dilemma

Prime Minister Nakasone this week called for a coordinated international effort to lower interest rates to spur economic growth in industrial nations. We believe the timing of Nakasone's plea reflects his growing concern over the impact of high domestic interest rates on the sluggish Japanese economy. Private Japanese forecasters project a further slowdown in 1986—an election year—because of reduced demand for Japanese exports. The Prime Minister may be out in front on this issue, however. The Bank of Japan so far is unwilling to cut interest rates unilaterally for fear that Japanese purchases of US securities would accelerate, thus weakening the yen. The near-zero growth budget approved by the Cabinet at yearend, moreover, gives Tokyo little room to boost the economy by fiscal measures over the next few months. Even if the Bank of Japan cuts interest rates—perhaps matching a cut in the US discount rate—we believe the impact would at most temper the economic slowdown because credit is readily available now for the larger firms. 25X1

Japanese Develop Ceramics Welding Technology

25X1 technicians at the Government Industrial Research Institute in Osaka have developed a capability for rapidly welding ceramics. The technology has been demonstrated for silicon nitride and silicon carbide, which are two of the three most promising ceramic materials (along with zirconia) for many high-temperature engine and tooling parts desired for commercial and military applications. We doubt that the welding technology will be commercialized soon principally because the critical long-term reliability of the welds has yet to be demonstrated. Whether or not this particular ceramics welding technology ultimately proves practical, it represents a conceptual breakthrough in joining ceramic parts. 25X1

Ottawa Announces Plan for Minimum Income Tax

Ottawa expects to raise $320 million in 1986 from its new minimum tax on personal income, but we believe the figure will be substantially less. Basically a flat rate tax with fewer deductions, the new levy greatly complicates Canada's income tax system because high income persons must now perform calculations under both the old and new systems and pay whichever is greatest. Tax experts have also criticized provisions that raise the effective tax rate on Canadian dividends by 50 percent at a time when equity investment is a major concern. In addition, the new tax strikes previously exempt capital gains, breaking the government's earlier promise of a $500,000 lifetime capital gains exemption. Finally, critics claim the tax will not raise the expected revenue because of its tax-averaging provision. 25X1

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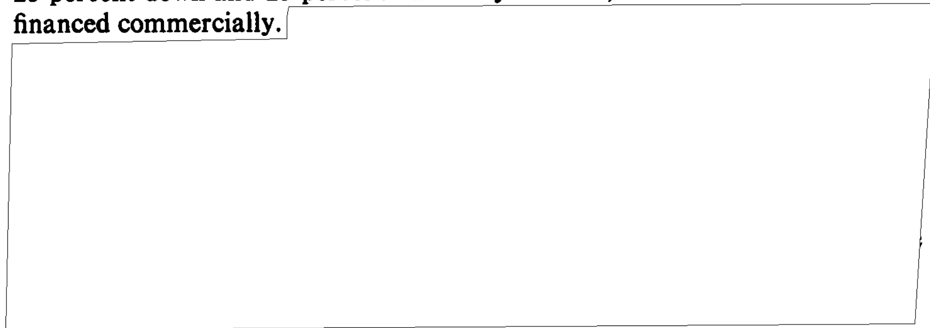
Less Developed Countries

New Life for Moroccan Efforts to Purchase French Aircraft

France has reopened negotiations with Morocco on a roughly $450 million deal involving 24 Mirage 2000 aircraft. Paris's latest offer calls for a 30-percent cash payment up front, another 30 percent payable one year later, and the remainder to be financed on a commercial basis. Rabat's counterproposal offers 25 percent down and 25 percent due one year later, with the remainder financed commercially.



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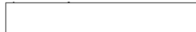
New Moroccan Tax Reforms

The Moroccan Government in December pushed through parliament the first phase of its IMF-supported tax reform program. The new value-added tax, scheduled to go into effect in April, is slated to replace two fraud-ridden turnover taxes on goods and services. Implementation could well be delayed, however, due to the parliament's concern over the technical complexity of the new tax and, in particular, its potential inflationary impact. The US Embassy believes the VAT, which has been in preparation since 1981, will be more or less revenue-neutral. Nevertheless, local retailers may well use the tax as an excuse to hike prices. Some government officials fear that any increase in inflation, coming on top of an already falling standard of living, could provoke unrest.

25X1

Peru Pursues Nationalist Foreign Investment Approach

President Garcia's decision to take over a US oil firm as an apparent first step in implementing his nationalistic foreign investment policies will further sour already shaky relations with Washington and is likely to discourage new foreign investment. On 27 December Garcia announced the takeover of an offshore US oil company that had failed to accept Lima's requirements for additional exploration, profit sharing, and new tax arrangements prior to the 26 December deadline. In a press conference on 29 December, Garcia said he intended to review the profit-sharing practices of a US copper firm and large local companies. The nationalization of the US oil company probably will complicate negotiations with the two remaining US oil companies over issues such as the amount of reinvestment and repayment of revoked tax credits. The copper concession—which produces 70 percent of Peru's copper annually and survived the 1974 nationalizations—is also vulnerable because its contract is subject to renegotiations soon. 

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Honduran Labor Troubles

A holiday truce has ended a strike against the Standard Fruit Company until at least mid-January. The government probably will then come under renewed pressure from labor and management alike to improve the competitiveness of banana exports—Honduras's largest foreign exchange earner. Some 4,000 banana workers, joined by thousands more in solidarity strikes, walked off the job in mid-December when Standard announced the layoff of 100 workers. The strike reportedly brought industrial activity to a near halt in three northern Honduran cities. Both sides are calling the government's reluctance to intervene irresponsible. Standard wants access to more advantageous exchange rates through establishment of an official parallel market and elimination of banana export taxes. While opposed to the layoff, union leaders fear that the government's failure to respond to the company's requests may force Standard to close its Honduran operations, according to the US Embassy. Although the government last year provided some relief on export taxes, it has consistently resisted pressures from international lenders and donors to liberalize exchange controls and effectively devalue the lempira. Recent Embassy reporting indicates that the new government, scheduled to take office on 27 January, also is committed to resisting devaluation. 25X1

Trinidadian Efforts To Revamp Oil-Based Economy

Port-of-Spain's recent devaluation of the local dollar and proposed new investment code will help to revitalize the country's economy over the long term, but the devaluation is causing problems for its Caribbean trading partners. Trinidad and Tobago has been attempting to diversify away from the still-dominant petroleum sector—25 percent of GDP. An overvalued exchange rate, high local wages, and restrictive government policies traditionally have limited foreign investment in Trinidad's manufacturing sector, which currently contributes only 7 percent of the country's GDP. The proposed investment code would permit full foreign ownership of assets, eliminating the previous joint venture requirements. Moreover, the 33-percent devaluation will help to stem the heavy losses of foreign exchange reserves, which dropped 65 percent to an estimated $500 million in 1985. Although the devaluation exempts essential foodstuffs and a few other imports, inflation in this import-dependent economy in 1986 probably will surpass the 7-percent rate in 1985. Moreover, labor unions will probably win wage increases that would partially offset improved international wage competitiveness caused by the devaluation. The devaluation already is putting pressure on other Caribbean Community (CARICOM) countries dependent on the Trinidadian export market. Difficulties are most pronounced in Barbados, Port-of-Spain's largest CARICOM trading partner, which is struggling to resist a similar devaluation. 25X1

Growing Pressure on Nigeria's President

Discontent within the military threatens to divert President Babangida's regime from following through on economic reforms required by the budget for this year. Babangida has announced an austerity budget for 1986 that includes periodic devaluation of the currency, divestiture of government-owned businesses, and an immediate 80-percent cut in petroleum subsidies. He also announced that debt payments would be limited to 30 percent of foreign exchange earnings. This amount will cover only about one-half of this year's

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obligations, according to the US Embassy. Babangida's crackdown on the armed forces last month may have preempted challenges to his rule, but it highlights the widespread disaffection in the military. The austerity measures and external factors probably will result in another year of economic stagnation. Western bankers are likely to cut trade credits in reaction to the debt-service limit, forcing Lagos to import on a cash basis. Declining oil revenues probably will offset projected savings on debt servicing, which will leave Nigeria without the means to finance economic growth or to ease the painful effects of cuts in the budget and in subsidies. 25X1

Indonesian Unemployment Worsening

Declining oil revenues—and falling export prices for commodities—are complicating Jakarta's efforts to deal with severe urban unemployment, unofficially estimated in excess of 20 percent. According to US Embassy estimates, Indonesia's economic downturn—along with technological changes taking place in industries such as semiconductors—led to 75,000 to 100,000 layoffs in 1985, with further retrenchments expected this year. The Manpower Ministry forecasts economic growth this year of 2 percent—far less than the estimated 5 percent needed to absorb the 2 million entering the work force. To complicate matters, President Soeharto announced sharp new budget cuts last week, a move that rules out fiscal policy as an economic stimulant. In lieu of a more labor-intensive development strategy, we believe Jakarta's near-term options for handling the growing unemployment problem are limited to continuing technical training programs, labor export, transmigration, and reliance on the informal sector to absorb excess capacity in the labor market. As a result, unemployment and underemployment very likely will continue to grow. 25X1

Thailand Worried About US Farm Bill

The rice export promotion provisions of the US farm bill will very likely heighten bilateral trade tensions, according to the US Embassy. Bangkok fears that the new policy will enable US rice exporters to regain the market share lost to Thailand in the early 1980s—and that cheaper US rice will drive down world rice prices. Thailand already is feeling the pinch of softening world demand for commodities. Its rice exports fell by over 11 percent in 1985 from 4.6 million metric tons in 1984, contributing to a 5-percent drop in total export earnings last year. Another export setback will add to Prime Minister Prem's political problems as exporters and farmers clamor for financial relief, and Prem's political rival, General Arthit, uses the country's economic difficulties as a pretext to continue maneuvering to replace Prem. 25X1

Sri Lankan Insurgents Threaten Tea Exports

Tamil insurgents claim to have contaminated an undetermined quantity of Sri Lankan tea exports with potassium cyanide, according to the US Embassy. The government has alerted factory owners, buyers, and shippers but has so far not taken any additional security measures. Damaging the tea-export and -production centers—located in Sinhalese-dominated areas—would represent the most serious economic attack by the Tamils so far. Even if the insurgents fail to take such action, their threat may deter tea buyers. Tea exports account for 25 percent of Sri Lanka's export earnings. 25X1

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Communist

Soviet Aid to Vietnam To Increase

A Soviet Foreign Ministry official says the USSR will double its aid to Vietnam in the next five years. In July the Vietnamese press reported such an overall increase. It had been left unspecified in the joint communique issued during party Chairman Le Duan's visit to Moscow in June. In November the Vietnamese reported that oil exploration assistance would be quadrupled. The Soviets probably calculate that this will bring some tangible economic returns as Vietnamese oil production comes on line. The aid promised in June was tied to Vietnamese undertakings to increase production and export of raw materials to the USSR, and a good part of it will apparently go to the oil sector. Soviet Foreign Ministry officials also say the increase is meant to indicate that improved Sino-Soviet ties will not affect military aid to Hanoi and that, while a negotiated settlement on Cambodia is desirable, Vietnam can well afford to continue the war if pushed too hard for concessions.

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Soviet Interest in Japanese Machine Tools

According to recent Tokyo press articles, the Soviets are interested in purchasing large amounts—at least $200-250 million—of Japanese equipment and technology for motor vehicle production. This includes pressing machines, metal and plastic molding machines, and three-dimensional computer aided design (CAD) equipment—the same as that recently purchased by General Motors. This equipment is intended for the Tolyatti and Moskvich car plants, two other unnamed car plants, and the Kama River Truck Plant. The equipment would be in addition to at least $725 million worth of Western design and production technology ordered since early 1980 for the Soviet industry. The high price offered for this technology indicates that the Soviets will continue to modernize their automotive industry with vast quantities of sophisticated Western equipment. The Japanese expect the Soviets to use the CAD equipment to upgrade styling on autos intended for export markets. We believe most of the equipment destined for car plants probably will be used to produce new front-wheel-drive cars aimed at export markets.

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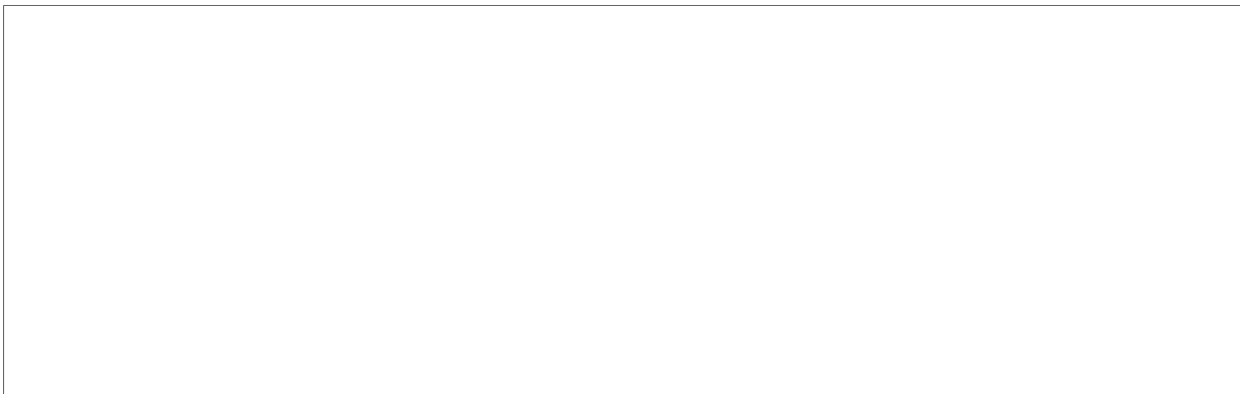

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