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International Economic & Energy Weekly

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10 February 1984

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International Economic & Energy Weekly [redacted]

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10 February 1984

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

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International Economic & Energy Weekly [redacted] 25X1

Synopsis

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1 **Perspective—*Brazil's Economic Struggle To Continue*** [redacted] 25X1

We believe it will take several years before Brazil's IMF-backed stabilization program provides the foundation for renewed economic vigor. Brasilia still faces the politically difficult task of making public corporations more efficient and of revitalizing the private sector. [redacted] 25X1

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17 **Brazil: Social Pressures on Economic Policy** [redacted] 25X1

Another sharp drop in living standards this year probably will provoke sporadic violence and demands to reverse Brazil's economic slide. The transition to civilian rule probably will not be threatened. [redacted] 25X1

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21 **Brazil: Struggling With Economic Stabilization** [redacted] 25X1

Despite this month's signing of a second major international rescue package, we believe Brazil will be hard pressed to avoid another foreign exchange crisis this year. The measures taken to date have resulted in appreciable economic and social costs, and we judge that the government is highly reluctant, in an election year, to demand significantly greater sacrifice. [redacted] 25X1

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27 **Mexico: Pushing Nonoil Exports** [redacted] 25X1

Mexico's foreign payments success last year has not been mirrored in expanded nonoil exports. Even though President de la Madrid made the expansion of manufactured exports a key goal, efforts to spur foreign sales have been dampened by missteps, ongoing policy contradictions, and the lingering financial crisis. [redacted] 25X1

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33 **New Zealand: Muldoon Faces a Troubled Economy in an Election Year** [redacted] 25X1

Although economic troubles have eroded public confidence in Prime Minister Muldoon, recent public opinion polls show he remains the popular choice for prime minister by a fairly wide margin. [redacted] 25X1

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39 **International Financial Situation: Oil Price Impact on LDC Debtors** [redacted] 25X1

This article in our series on economic and political aspects of the international financial situation examines the impact of oil price changes on selected LDC debtors. [redacted] 25X1

International Economic & Energy Weekly [redacted] 25X1

10 February 1984

Perspective

Brazil's Economic Struggle To Continue [redacted] 25X1

We remain concerned about Brazil's longer run economic health. In our opinion, it will take several years before the IMF-backed stabilization program provides the foundation for renewed economic vigor. Moreover, Brasilia will need to supplement existing adjustment efforts with a strong attack on major institutional impediments. The large, complex network of public corporations has shown its resistance to spending controls, while a long-established, heavily indexed price structure similarly has proved hard to modify. Until further reforms are undertaken—and they will be politically difficult—Brazil will face continuing economic problems. [redacted] 25X1

Brasilia last year made impressive progress on several fronts but did not achieve two key objectives—dampening inflation and rebuilding foreign exchange reserves. Steadfast monetary restraint did not prevent the inflation rate from doubling to slightly more than 200 percent. As a result, business and the middle class shifted financial resources from new investment to speculative ventures. Brazil's striking $6.5 billion trade surplus was attained primarily by curtailing imports sharply, and there is little room for further cuts. The trade surplus did not alleviate Brazil's precarious foreign reserve condition, because of unexpected shortfalls in foreign credit and direct investment, thereby leaving the country still vulnerable to new external shocks. [redacted] 25X1

The government's austerity program has not lightened the excessive economic dominance of the public sector. As a result of the public sector's continued large borrowing needs and its preferential access to the domestic banking system, the government's restraints on domestic credit have caused a severe liquidity shortage for private business. Parts of the private sector have survived mainly through increased participation in the underground economy. Although public corporations have accepted sizable budget cuts, they have moved mainly to postpone investment—even in such vital areas as domestic energy and export mining—rather than to trim employee benefits. [redacted] 25X1

Under Brazil's movement to a democratic political environment, future governments will be less able to force dramatic adjustment policies on the public and the Congress. We believe a continuing recession would stir considerable popular opposition, including more vocal media criticism, intensified lobbying for economic concessions, demonstrations, and strikes. With unemployment high, the potential for social turmoil remains. [redacted] 25X1

Barring rapid economic adjustment, Brazil's foreign exchange needs in the mid-1980s will grow. Debt servicing burdens will be large as loan repayments contracted in the early 1980s are bunched in these years. The rescheduling arrangements worked out with foreign creditors as part of the 1982 and 1983 rescue packages will add to the debt load. Although creditors will press for economic reforms, Brazilians are likely to demand growth. We believe that 4-percent real annual growth—and a concomitant rise in imports—will be required over the next five years to bring down unemployment gradually and preserve democratic rule. [redacted] 25X1

To meet its large debt servicing and economic growth needs, Brazil must strengthen its ability to earn foreign exchange—mainly by spurring export growth—and reduce its dependence on foreign borrowings. To accomplish this the government will need to implement economic and financial reforms aimed at revitalizing the private sector, mobilizing greater private domestic saving, and keeping a lid on public deficits. Furthermore, it will need to make greater use of price rationalization and free collective labor bargaining to improve productive efficiency. [redacted] 25X1

Although we believe that a favorable world economic environment might enable Brazil to ease its debt plight over the next five years, another economic slump or round of tight money policies in the industrialized countries probably would frustrate Brasilia's efforts. Slow export growth and sustained high interest rates would require Brazil to sharply depress economic activity or step up foreign borrowing to honor its debt obligations. Because neither option would be acceptable either to Brasilia or to foreign banks, the two sides would have to work out a compromise arrangement to ease repayment terms. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

OECD Increase in Nuclear Power Output

Nuclear power generation in the OECD countries increased nearly 11 percent in 1983, compared with 1982, and now accounts for over 15 percent of OECD electricity generation, equivalent to 4.0 million b/doe of primary energy. Fourteen new reactors, with a capacity of 11,900 megawatts-electric (MWe), entered commercial operation last year, and one reactor (about 200 MWe) was retired. Nuclear power capacity in Western Europe alone increased by 7,200 MWe with France accounting for three-fourths of the increase. Prospects for additional growth in the coming year are excellent, as 12 plants—with a capacity of about 9,600 MWe—are already undergoing startup and low-power testing. An additional 24 reactors, with a capacity of nearly 23,600 MWe, are in the late stages of construction and are scheduled to begin commercial operation in 1984. More than one-third of this new capacity will come on line in the United States. 25X1

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OECD: Nuclear Electric Generating Capacity and Output

	Installed Capacity (*thousand MWe, net*)		Gross Electricity Generation (*terawatt-hours*)	
	1982	1983	1982	1983
OECD	**134.3**	**146.0**	**767.6**	**849.6**
United States	57.6	60.4	298.7	313.6
Japan	16.6	16.6	104.5	106.5
Canada	5.2	7.0	42.6	53.0
Western Europe	54.9	62.0	321.8	376.5
Belgium	2.6	3.5	15.6	24.1
Finland	2.2	2.2	16.5	17.4
France	20.1	25.4	108.9	144.2
Italy	1.3	1.3	6.8	5.8
Netherlands	0.5	0.5	3.9	3.6
Spain	2.0	2.0	8.8	10.7
Sweden	6.5	7.4	38.8	40.5
Switzerland	1.9	1.9	15.0	15.5
United Kingdom	8.0	8.0	44.1	50.0
West Germany	9.8	9.8	63.4	64.7

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Dutch Boost Gas Sales

Dutch natural gas sales rose by 4 percent in 1983 to 74 billion cubic meters (bcm), ending a four-year decline. Domestic sales rose by 6.5 percent, as gas remained the cheapest fuel for residential and small industrial users. Gas exports were up 2 percent to 35.6 bcm. Sales to France and West Germany rose by 30 and 2 percent, respectively, while sales to Belgium declined 18 percent because of increased deliveries from Algeria. An expected increase in competition from Algerian and Soviet gas deliveries this year and sluggish gas demand do not bode well for future sales. Moreover, these market conditions probably put The Hague in an unfavorable bargaining position in export contract renegotiations scheduled for completion before October 1984. [redacted] 25X1 25X1

Norwegian LNG Prospects

Shipment of liquefied natural gas (LNG) from northern Norway to US and West European markets could be an economically viable alternative to pipeline transportation, according to a joint study by Tenneco and Norsk-Hydro. The study indicates liquefaction of Troms gas and shipment by tanker could allow the gas to be sold at prices comparable with Algerian LNG delivered to Western Europe. This would make it economical to develop fields not large enough to justify a pipeline to the nearest market. Current Troms gas reserves, however, do not yet warrant building a liquefaction plant, and additional reserves must be proved before the project proceeds. The report points to the United States as a promising market for Norwegian LNG because of future US gas import requirements and spare capacity at existing LNG receiving terminals. Troms gas might be used eventually to limit West European dependence on Soviet gas supplies in the 1990s. [redacted] 25X1 25X1

[redacted] 25X1

Taiwan Looks to LNG

Officials of the state-owned Chinese Petroleum Corporation (CPC) recently requested a foreign construction company's preliminary tender for the design, engineering, and construction of a 2-billion-cubic-meter liquefied natural gas (LNG) receiving terminal on the southern coast of Taiwan, [redacted] A final construction award is expected in April or May 1984, [redacted] the LNG is expected to be supplied under a long-term supply agreement with Indonesia. A gas supply agreement, 25X1 25X1 25X1 25X1 however, probably will not be completed until the terminal's construction is under way, [redacted] Taiwan is looking to LNG because the country is heavily dependent upon imported Middle Eastern oil, and existing gas reserves will be depleted in the 1990s at current production levels. [redacted] 25X1 25X1

Increase in Soviet Reexport of OPEC Oil

Recently released Soviet trade data indicate that the USSR reexported about 250,000 barrels per day of oil from Libya, Iran, Iraq, and Saudi Arabia during the first nine months of last year. This is about 60 percent more than during the same period in 1982. The Saudi oil, which helps pay Iraqi debts to the USSR, is part of Riyadh's support for Baghdad in the war. This was the first known time that the Soviets received Saudi oil. The three other Middle Eastern exporters are paying off their debts to the USSR with oil that they would find difficult to sell on the soft international oil market. The reexports accounted for about 20 percent of total Soviet oil exports to hard currency countries and for most of the estimated 13-percent increase in Soviet oil sales to the West last year. [redacted] 25X1 25X1

Venezuela Oil Company Plans Cutbacks

The Venezuela Oil Company (PDVSA)—a quasi-independent government corporation responsible for 95 percent of Venezuela's exports and one-fourth of the federal government's budget—is curbing expansion plans. The newly released 1984-88 Development Plan projects a sharp reduction in new investment in response to depressed world crude prices and the failure of previous governments to raise domestic oil prices. [redacted] PDVSA will make severe cutbacks in new oil exploration, reduce new drilling activity, and dismiss a number of foreign technical advisers. PDVSA intends to maintain current capacity of 2.5 million barrels per day (b/d) by increasing the use of secondary recovery methods at old wells. This will enable Venezuela to continue oil exports at its OPEC quota of 1.7 million b/d. Barring higher oil prices, however, this will result in stagnant oil export and tax revenues, thereby limiting the new Lusinchi government's ability to fund new development programs. Although a gradual increase in domestic oil prices is a part of the new administration's economic plans, the additional revenues proposed would be insufficient to restore PDVSA's investment program. [redacted] 25X1 25X1 25X1 25X1 25X1

Problems at Libya's New Refinery

The startup of the Libyan National Oil Company's (LNOC) new refinery at Ra's al Unuf has again been delayed until at least July 1984, [redacted] The facility, initially scheduled to come on stream in 1981 and to double Libya's refining capacity, reportedly has problems that will require the installation of new pipes. [redacted] the LNOC has refused to offer discounts on products from the new refinery and has reduced the facility's initial processing rate to 110,000 b/d, 60 percent of its original design capacity. Delays in the startup of the refinery coupled with continued weak demand for products could result in further setbacks for Libya's ambitious downstream investment program. [redacted] 25X1 25X1 25X1 25X1 25X1

Sudanese Rebels Disrupt Oil Development

The rebel attack on Chevron's base camp on 2 February has temporarily halted the company's oil exploration in southern Sudan. The group responsible for the raid, in which three workers were killed, appears to be the same one that kidnaped two Chevron contractors in November. Personnel have been evacuated from the southern camps, and two of Chevron's four drilling rigs—both in the south—have been idled. Construction of the pipeline to the Red Sea has been suspended, and its scheduled completion date is likely to be pushed back from 1985. Chevron has invested over $800 million in Sudan and plans to resume operations in the south when its facilities become more secure. We expect the Sudanese Government will provide a strong armed presence at the work sites. [redacted] 25X1 25X1

New Zairian Oil Discovery

A new discovery in the offshore Lukami oilfield could yield as much as 25,000 barrels per day, [redacted] Attaining this level of production would double Zaire's oil output, the country's second-largest source of foreign exchange behind copper, and could bring annual oil export earnings to $500 million. Zaire currently is Africa's ninth-largest oil producer and has been exploiting offshore oilfields since 1975. Present plans call for the Lukami field to produce about 5,000 barrels per day this spring. If the field maintains adequate wellhead pressure and crude quality for several months, a major international oil company reportedly will commit itself to full development. The government desperately needs a major new source of earnings. [redacted] 25X1 25X1 25X1 25X1

Tanker Safely Avoids Mines at Nicaraguan Port

A tanker bringing crude oil—probably from Mexico—has passed through mines laid by insurgents at Puerto Sandino, Nicaragua's main oil port. [redacted], after failing to disarm the mines, the Sandinistas were able to mark the location of at least some of them by late last month. This is the first tanker to enter Puerto Sandino since the insurgents mined it in early January, and Managua expects to bring in additional tankers over the next two months. The Sandinistas probably risked running a tanker through the mines because of severe crude oil shortages and to demonstrate the insurgents' failure to disrupt oil deliveries. [redacted] 25X1 25X1 25X1 25X1

International Finance

New Latin American Talk of Coordinating Debt Policies

Latin American governments continue to discuss joint approaches to their creditors. Argentina and Venezuela issued a declaration on 4 February stating they would coordinate their debt renegotiation policies to better protect their respective interests, according to press reports. They called for joint studies with industrial nations to find solutions to Latin American debt problems. In another declaration issued this past week, Argentina and Colombia asked for a broad dialogue with creditor countries to alter the current approach to treating the region's debt. In addition, press reports indicate that Chilean President Pinochet and Colombian Foreign Minister Lloreda discussed the need to join efforts to cope with their foreign debts. [redacted] 25X1 25X1

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This is the first time major debtors have indicated publicly that they might coordinate their debt renegotiations with other debtor countries. These public statements are general in nature and do not lay out specific policy guidelines for managing current debt problems or negotiating with foreign creditors. Although we do not know if serious actions will result from these proposals, debtors this year are taking bolder stands on a number of debt issues. Joint action by major debtors could upset creditors and could disrupt ongoing debt-relief renegotiations in Latin America. [redacted] 25X1

Sharp Drop in Persian Gulf Aid to Iraq

[redacted]

[redacted] we estimate Persian Gulf aid disbursements to Iraq fell by one-half last year to about $3 billion. Although cash transfers were down 75 percent, during April-December Saudi Arabia and Kuwait sold about 200,000 b/d of crude oil on Iraq's behalf. Japanese oil companies and the Soviet Union were the principal buyers. [redacted] 25X1

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Iraq: Aid Disbursements From Persian Gulf States, 1980-83 *Million US $*

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	1980	1981	1982	1983		
				Total	Direct Disbursement	Crude Oil Sales [a]
Total	**7,100**	**8,000**	**5,970**	**2,948**	**1,420**	**1,528**
Saudi Arabia	3,000	4,000	2,400	1,809	620	1,189
Kuwait	2,000	2,000	2,000	739	400	339
United Arab Emirates	1,450	1,400	1,250	400	400	0
Qatar	650	600	320	NA	NA	0

[a] Valued at $29 per barrel.

[redacted] 25X1

Barring a sharp oil price rise or increased Iran-Iraq hostilities, we believe a substantial pickup in Gulf aid to Iraq this year is unlikely. Depressed oil revenues and domestic spending priorities are restricting Saudi and Kuwaiti aid worldwide. Moreover, increasing Saudi and Kuwaiti oil sales on Iraq's behalf could come under attack by other OPEC members, particularly Iran, for violating Iraq's OPEC production quota. Currently, Iraqi production is near its 1.2 b/d quota and is expected to increase at midyear when pipeline exports through Turkey can be expanded. Oil sales and cash that again approach $3 billion in 1984 will still require Baghdad to obtain other financing or draw down foreign reserves—which we estimate at about $5 billion—if Iraq wants to maintain imports at last year's austere level of $11 billion. Shortages of food and consumer goods already are starting to appear and if they worsen could cause unrest and further problems for Saddam Husayn's government. [redacted]

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Philippines Seeks Financial Help

[redacted]

Manila is soliciting financial assistance from other Asian countries to cover its needs, pending a new agreement with the IMF:

[redacted] 25X1

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- The **ASEAN** states in mid-January agreed to reactivate a currency swap agreement with the Central Bank that involves a dollar deposit of $80 million.

- **Japanese** Prime Minister Nakasone last month promised the release of $130 million worth of commodity assistance, $20 million in new project loans, and $10 million in grant aid within two months.

- **South Korea** has indicated to US officials that it is willing to provide assistance totaling $10 million.

- **Taiwan** reportedly plans to extend a $50 million loan.

- **Australia** is considering offering $90 million in emergency assistance, but it has not made a final decision. [redacted] 25X1

Most of the offers reflect regional concerns about political instability in the Philippines following the assassination of Benigno Aquino. [redacted] 25X1 25X1 Japan and South Korea, however, are primarily responding to US prodding. 25X1 The total, however, is only a small part of what Manila requires. Trade financing has been cut by about one-half since October, when the payments moratorium on its commercial debt was announced, and delays in reaching agreements with the IMF and with commercial creditors has precluded the restoration of normal levels of trade financing. So far, the impact of the foreign exchange shortage has been softened by drawing down inventories of raw materials and spare parts. Inventories are now at low levels, however, and Manila is bracing for large cutbacks in manufacturing activities and worker layoffs. [redacted] 25X1

Nigeria-IMF Talks To Resume

[redacted]

A Nigerian economic delegation will arrive in Washington next week to reopen stalled negotiations with the International Monetary Fund. Discussions with the IMF have been on hold since the coup on 30 December while the Buhari government reviewed the last round of negotiations undertaken by the Shagari administration. Next week's talks will center on conditions for Nigeria's request for a loan of up to $2.5 billion; devaluation of the Naira remains the 25X1
major stumblingblock. The Buhari government, like its predecessor, may hope

the United States will intercede to soften IMF terms. International bankers have linked the rescheduling of $2 billion in officially guaranteed, short-term debt and the extension of additional credits to an IMF agreement. [redacted] 25X1

Troubled Moroccan-IMF Relations

[redacted]

Rabat's failure to cut food subsidies in the aftermath of recent riots threatens the nation's financial stabilization program. Food subsidies of $250 million are now projected for 1984, twice that originally budgeted under the IMF standby loan agreement. Although the government is considering measures to reduce budget outlays, the IMF may withhold loan disbursements until new measures are in place. Problems with the IMF would jeopardize the completion of commercial debt rescheduling, and this in turn would further complicate relations with the IMF. [redacted] 25X1 25X1

India Threatens To Block World Bank Capital Increase

[redacted]

India appears ready to impede the World Bank's effort to agree to a selective increase in the Bank's lending capital. The adjustment now under consideration would cause India to lose voting shares and its ability to nominate its own Executive Director to the Bank's governing board. To preserve its current position, India has said it will petition the Bank for a portion of the unallocated shares held in reserve for new members. If the Bank refuses, Embassy reporting indicates that India will block the selective capital increase. If a compromise cannot be reached with other bank members, this would reduce the Bank's ability to lend by nearly $1 billion a year and could jeopardize the replenishment of the International Development Association, the Bank's soft loan affiliate. Such a drop would affect the lower income LDCs, who receive most of their international loans from these institutions. We believe the Bank's management will acquiesce to India's demand because it fears any curtailment of its lending capacity and wants to avoid a dispute with India. [redacted] 25X1 25X1

Global and Regional Developments

Another Japanese Automaker Expanding Capacity

[redacted]

According to a recent press report, Japan's Suzuki Motors, the world's largest minicar producer, plans to enter the subcompact market with production of as many as 300,000 vehicles per year in 1988. Since Japan's subcompact market is already crowded, we believe Suzuki will try to market a large proportion of the autos in North America. Suzuki and other Japanese automakers plan to increase production capacity by nearly 2 million units by 1989. [redacted] 25X1 25X6

[redacted] 25X6 25X1

[redacted] 25X6

[redacted] 25X6

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[redacted] 25X6

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Canadian Grain Export Capacity To Increase

Canada will be able to increase its grain export capacity by 10 percent, to 33 million metric tons, starting in 1985 with the completion of a new export grain elevator at Prince Rupert on the west coast near Alaska. According to the builder, grain is expected to begin moving through the new elevator in November 1984, with full-scale operations planned for February 1985. The Prince Rupert elevator will move Canada closer to its export goal of 36 million tons of grain by 1990. Even with a cutback in barley production this year, we expect Canada to maintain grain exports at about 28 million tons—15 percent of the world market. [redacted] 25X1

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EC Consensus Developing on Agricultural Import Restrictions

EC Commission proposals to limit imports of corn gluten and other US-produced animal feed substitutes—which reached $500 million last year—appear increasingly likely to be accepted by EC members. According to US Embassy officials in EC capitals, recent US demarches on the proposals have been rebuffed. West Germany and the United Kingdom earlier had opposed taking action, but they now appear willing to use their assent as bargaining chips in their drive to secure reforms of the EC's Common Agricultural Policy (CAP) and to settle the Community's budget imbroglio. As a result, the Commission request for a negotiating mandate may be approved as early as March. [redacted] 25X1

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The proposed restrictions are primarily intended to placate increasingly strident EC farmers who have been hard hit by CAP cost-conservation measures. Although the Commission claims that imported feed substitutes displace domestic EC grain and encourage dairy overproduction, most EC members privately concede that import limitations have become a necessary trade-off in EC budget wrangling. France and Italy—who in the past have frequently blocked Community agricultural reform—have insisted that action against imported grain substitutes is necessary to demonstrate to EC farmers that third countries also are being made to pay part of the cost of CAP reforms. 25X1

EC Presses Japan To Increase Imports

EC Trade Commissioner Haferkamp recently sent a "friendly letter" to Japan's MITI Minister Okonogi outlining measures the Community wants Japan to take to redress the growing imbalance in EC-Japan trade, according to reporting by the US Mission to the EC. The EC views Japanese efforts to date as cosmetic, and the letter is an attempt to seize the initiative for the 13-15 February EC-Japan high-level consultations in Tokyo. Japan's 1983 trade surplus with the EC was $10.4 billion. In the letter, Haferkamp suggests Japan: 25X1

- Implement its remaining Tokyo-round MTN tariff cuts by April 1984.
- Target promotion efforts at imports of manufactured products in hopes of prompting increased consumption of EC goods.
- Suspend, either totally or partially, duties on manufactured imports for a limited period as was done by West Germany in the early 1960s when confronted by similar trade surplus problems. 25X1

EC Negotiating New Aid Package With LDCs

Representatives of the EC and 66 African, Caribbean, and Pacific (ACP) nations probably will make little progress this week in their first ministerial-level negotiations on the Lome III aid agreement. Under the Lome II agreement, due to expire in February 1985, the ACP countries have received more than $5.5 billion in aid. Preliminary discussions on the Lome III aid package held last November revealed a wide gap between the two sides. The EC insists it cannot afford to meet developing country demands to increase aid substantially. Instead, the Community has stressed the need to continue past instruments—such as the EC export stabilization mechanism, which compensates LDCs for falling commodity prices—and improve the quality of aid rather than increase its quantity. In addition, the EC reportedly is considering tying the Lome III aid package to human rights standards. The ACP countries argue that their share of total EC imports is falling, that they require immediately expanded aid, and that linking aid to human rights interferes in their domestic affairs. 25X1 25X1

National Developments

Developed Countries

Possible Wage-Price Freeze in Israel

Israeli officials say the government intends to try to negotiate a wage-price freeze with the Histadrut, the large trade union organization, in order to reduce the inflation rate of nearly 200 percent. The officials add that, if an agreement cannot be reached, the government may legislate a freeze. Union officials, however, are certain to resist the plan because they believe it would put a disproportionate burden on wage earners. Moreover, in view of the Histadrut's ties to the Labor Party, there is little political incentive for it to 25X1 reach an accommodation with the government. A freeze would do nothing to remedy the underlying causes of inflation and would lead Israelis to find ways—such as bartering and black marketeering—to get around the freeze. Prices would again soar after a freeze was lifted. 25X1

Turkish Prime Minister Outlines Wage Policy

Prime Minister Turgut Ozal last week outlined to the press his wage policy for this year. Rather than set a wage ceiling, he proposed a wage floor based on his government's 1984 inflation-rate target—25 percent. Ozal's announcement was timed to have the maximum impact on the collective bargaining process, which is expected to resume next month after a military-enforced hiatus of more than three years. Ozal wants to prevent large wage settlements from 25X1 hindering his efforts to control inflation—his top priority. Initial reactions to Ozal's announcement from the Confederation of Turkish Trade Unions, whose members have suffered declines in real wages over the past four years, were generally favorable. The Confederation probably will support Ozal's policy only as long as wages keep up with inflation 25X1

Austrian Policies Face First Electoral Test

Unpopular tax and price increases in January receive their first test at the polls in the 25 March provincial election in Salzburg. This is the first in a series of regional electoral tests this year for the social-liberal government, and it is being watched closely because Salzburg is the one province in which the parties share power. In a recent poll, nearly 90 percent of those interviewed objected to the January revenue measures. The 2-percentage-point increase in the value-added tax boosts consumer prices 1.5 percent. In addition, the new measures include higher taxes on income from savings accounts and price 25X1 hikes for postal and rail services. A substantial gain in the Salzburg election by the opposition conservative Peoples' Party—which now holds a slim majority in the provincial assembly—could well cause Vienna to reassess economic policy; it is likely to shift away from a reliance on tax increases toward more significant budget cutting. 25X1

Less Developed Countries

Cyclone Devastates Mozambican Agriculture

Mozambique—already suffering from two years of intense drought—was hit by an unusually large cyclone in late January that caused the rivers in the southern part of the country to overflow for the first time in recorded history. According to US Embassy reporting, the floods destroyed all crops along the major river valleys, drowned 5,000 cattle in one area, and caused at least 150 deaths. Before the storm, approximately 300,000 people in southern Mozambique were already dependent on foreign-provided disaster relief. The US Embassy in Maputo reports that, even with the rapid replanting of the now 25X1
devastated 1984 crop, at least $20-25 million in additional US food assistance could be required to tide the country over until the April 1985 harvest. [redacted] 25X1

India Rocked by Farm Protests

Violent protests by farmers demanding higher procurement and land compensation prices have rocked western and southern India. In Maharashtra and Karnataka, farmer demonstrations have stopped road and rail traffic and led to six deaths and over 40,000 arrests. Politicians have fanned farmer dissatisfaction in the hopes of cashing in during elections that must be held by 25X1
January 1985. We expect protests to continue as farmers push agricultural issues onto the national agenda. [redacted] 25X1

Chilean Measures To Decrease Unemployment

Finance Minister Caceres has announced that lower unemployment is Chile's primary economic goal in 1984, indicating that the government will continue to ease austerity in response to political discontent. According to US Embassy reports, Chile is asking the IMF to support its goal by easing the public-sector deficit targets and relaxing the ceiling on external borrowing. Santiago publicly estimates that it will be able to spur 5-percent real economic expansion and reduce unemployment from 16 percent to 12 percent by yearend. We are skeptical. Tax measures taken late last year will be slow in generating new investment. Moreover, US Embassy reports indicate that the overvalued peso probably will reduce nontraditional export growth. As a result, 25X1
Santiago may pursue more stimulative economic policies in response to domestic political pressure to curb unemployment. [redacted] 25X1

Libyan Water Project on Track

Tripoli has released a $160 million advance payment to the South Korean contractor in charge of the Great Manmade River Project—Qadhafi's showcase program—despite the nation's tight financial situation. This initial payment on the $3.3 billion contract will facilitate equipment purchases and the construction of two factories to produce prestressed concrete pipes. [redacted] 25X1

[redacted] 25X1 25X1

Communist

Chinese Grain Surplus Adds to Transportation Problems

Chinese agriculture in 1983 had another banner year, producing a grain harvest of 370 million metric tons, a 5-percent increase over the old record set in 1982. These bumper harvests are creating storage and transport problems—especially in northeastern China. In Jilin Province, grain storage facilities are overflowing, and peasant households are being asked to provide temporary storage for state grain. Moreover, the State Council has decided to move 2.2 million tons of this excess grain to southern China before the end of September 1984. According to the Chinese press, this grain will be moved by rail to Dalian port and then transferred to ships destined for Shanghai. 25X1

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These grain shipments will add problems to the already overburdened transport system. Rail cars to move the grain probably are being diverted from coal-carrying lines. Port congestion will increase because two of the three ports with dockside grain elevators used for foreign grain shipments will be used for domestic grain transfers. Ships loaded with foreign grain already wait weeks to unload. Delays and the record harvest undoubtedly are behind the decision to postpone purchases of foreign grain. About 2 million tons of US grain purchased in 1983 as required under the US-PRC grain agreement remain to be delivered, and the Chinese are committed to purchase 6-8 million tons more in 1984 under the agreement. 25X1

Romania Cracks Down on Private Farming

Romania recently announced measures to force private farmers to increase sales of agricultural produce to the state. Consumers are likely to suffer. The new measures will reduce food supplies in private markets, and increased government supplies are likely to be exported. Farmers are obligated for the first time to sell specified amounts of goods to the state at fixed prices and can sell in the private market only after meeting their obligations to the state. The measures include threats to expropriate the land of farmers who fail to meet their quotas. These policies amount to an admission of failure of past efforts to encourage private farmers to sell to the government. Last March the government imposed strict producer price controls and restricted the sale and transport of privately produced food; these measures only worsened shortages. 25X1

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East Germany Reports Higher Economic Growth

East Germany has reported a pickup in economic growth last year, but has not regained pre-1982 rates. The regime's accounting shows that national income rose 4.4 percent, compared with 2.6 percent in 1982. Our preliminary estimates indicate that real GNP increased only about 1 percent last year, slightly better than the 0.5-percent gain in 1982. The economy is still suffering from the effects of tight import controls, which produced shortages of raw materials and other goods. Grain production of 10 million metric tons approached the 1982 record, but many nongrain crops, such as potatoes, were 25X1 hurt by bad weather. Reported retail sales rose only about 1 percent, suggesting that, in light of numerous reports of price increases, real personal consumption probably declined again last year. East Berlin failed to report the size of what it called its "considerable" trade surplus with nonsocialist countries, suggesting that it ran a smaller surplus than the estimated $1.5 billion in 1982. [redacted] 25X1

Brazil: Social Pressures on Economic Policy

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Since 1980, economic stagnation and high inflation have reversed the rise in Brazilian living standards. Last year, triple-digit inflation and growing unemployment in the wake of IMF-mandated austerity sharply squeezed most Brazilians, generating public discontent and social unrest. The formerly prosperous middle class responded by intensifying political resistance to the tough economic policies; the poor reacted with rising crime and violence, heightening the government's fear of a social explosion. Although Brasilia sustained austerity reasonably well, it had difficulty in complying with all the IMF targets.

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We foresee another sharp drop in living standards this year caused both by the recession—now in its fourth year—and IMF-mandated adjustments. These losses are likely to provoke sporadic violence and demands to reverse the economic slide. Such popular discontent will bring pressure on Brasilia to moderate its austerity but probably will not threaten the transition to civilian rule.

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Inflation and Its Effects on Income Classes in the City of Rio de Janeiro *Percent*

	Low Income	Middle Income	Wealthy	Annual Increase in Consumer Price Index Components (November 1982–November 1983)
Share of Expenditures				
Foodstuffs	60	40	10	232
Housing	29	30	41	112
Clothing	3	6	7	130
Health care	3	6	7	167
Personal services	3	6	6	156
Public services	NEGL	2	4	126
Other	2	10	25	144
Weighted annual inflation rate	**188**	**170**	**140**	

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The Squeeze Intensifies in 1983

Brazilians were accustomed to a steady growth in income through the 1970s but since 1980 have seen their fortunes decline sharply. Prolonged recession has caused real per capita income to decline roughly 15 percent in the last three years, according to US Embassy reports, and unemployment has impoverished growing numbers of Brazilians. A Brazilian survey indicates that the proportion of the labor force earning less than the poverty level—approximately $120 a month—climbed from 67 percent in 1981 to 72 percent in 1982. For the middle class, Brazil's economic stagnation has blocked upward mobility and fostered discontent.

Last year, unemployment shot up because of the plunge in economic activity resulting from IMF-mandated retrenchments and the global recession. The US Embassy estimates that 25 percent of the roughly 50 million labor force is now unemployed or engaged in marginal occupations; other estimates are as high as 40 percent. Moreover, already high inflation doubled to 210 percent for 1983, and tougher wage restraints accelerated the decline in real wages.

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Middle Class Frustrations Grow. The worsening recession forced many in the middle class to face unemployment for the first time or to accept less

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Brazil's Middle Class

Rapid economic growth since the late 1960s has created a large and increasingly influential middle class, which until recently provided much of the political base for the military-dominated regime. We estimate this group—defined here to include families earning between three and 20 times the minimum wage—to be some 25-30 million strong, or about 20 percent of the population. Mostly employed in services and industry, the country's most dynamic economic sectors, the middle class receives more than one-third of the country's personal income and comprises nearly all of the domestic market for personally owned automobiles and other big-ticket consumer items.

Economic discontent probably played a significant role in congressional, state, and local elections in 1982, when many middle-income voters shifted to the opposition. These votes, combined with those of less privileged groups, enabled opposition parties to gain control of Brazil's wealthiest and most populous states.

Brazil's Poor Majority

The impoverished majority of Brazilians has been growing but has not received greater political power. We estimate the poor—defined to include families earning less than twice the minimum wage—to be some 80-90 million strong, or about 65 percent of the population. Mostly employed in unskilled manual jobs, the poor receive about one-fourth of the country's personal income and have little purchasing power beyond necessities. 25X1

Although low-income voters contributed to opposition gains in the 1982 elections, as a group the poor have little direct political influence. Most prolabor politicians come from the middle or upper classes and distribute favors paternalistically to their lower class constituents in return for electoral support. 25X1

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prestigious jobs. Some unemployed professionals, especially recent university graduates, had to drive taxis at subsistence pay, and others resorted to street peddling. Some workers who attained lower middle class status in recent years were laid off and slipped toward poverty. One Brazilian analysis indicates that 37 percent of the middle class had fallen into lower income groups since 1980.

To cope with the decline in income, most middle class households pared spending on items considered necessities, such as education and housing, as well as on such luxuries as automobiles and travel. In the state of Sao Paulo, for example, some 800,000 students have transferred from private schools—widely regarded as essential for university admission—to public schools.

The Poor Get Poorer. Layoffs have swelled the ranks of the unemployed. Over the last year, according to an industrialists' group, Sao Paulo lost some 200,000 manufacturing jobs, reducing even skilled and semiskilled workers to poverty. The recession and the many business failures have reduced opportunities in the service sector, which traditionally absorbs unskilled labor. 25X1 25X1

Drought and floods in 1983 boosted food costs—which represent some 60 percent of budgetary expenses for low-income households—by 300 percent nationwide. Recent studies in two cities indicate that, as a result, the minimum wage no longer is enough to buy food for one adult. The decline in purchasing power has forced cutbacks in the consumption of foodstuffs. According to the press, two-thirds of Brazil's population now suffer from dietary deficiencies, and many workers and their families survive on one meal a day. Consumption of low-grade meat—traditionally a main source of protein for the poor—dropped by as much as 40 percent in Rio last year, according to the US Consulate. The press reports that in big cities, including industrial Sao Paulo, increasing numbers of the indigent are combing garbage dumps for scraps. 25X1 25X1 25X1

Many Brazilians forfeited hard-won progress toward middle class status last year. To cope with economic adversity, workers cut expenses by living with relatives while attempting to bolster family income by sending wives and children out to look for work. Some urbanites moved back into slums; according to the mayor of Sao Paulo, 55 percent of the city's 9 million residents now live in slums, squatter settlements, or other substandard housing.

The Consequences

Widespread frustration with deteriorating living standards generated sporadic violence, scattered strikes, and other signs of unrest last year. Public discontent was reflected in political resistance to Brasilia's austerity program.

Social Unrest Erupts. Economic reversals provoked periodic outbreaks of violence by the lower classes. Demonstrations in April sparked destructive riots, and in September and October hundreds of food markets and other stores were looted in cities as well as in drought-stricken rural areas. In Sao Paulo, where low-income groups have the longest journeys to work, commuters—angered by train delays—on several occasions have attacked and heavily damaged railway equipment. Bus passengers in at least two cities have rioted over fare increases.

Common crimes, motivated at least partly by the economic crunch, are provoking mounting public concern. Assaults, robberies, and thefts are up sharply, and polls in Sao Paulo and Rio de Janeiro cities show that four of 10 residents have been victimized.

Protests Rise. Frustrations in the middle class intensified as austerity bit deeper. In May 1983, over one-half the respondents in a poll of urban voters said they expected their economic circumstances to worsen in coming months, and approximately two-thirds of upper middle class individuals took this negative view of the future. A survey in November confirmed the deepening pessimism among city dwellers. 25X1

Political discontent with the government's austerity policies blossomed:

- Industrial workers staged large demonstrations to protest austerity.
- Businessmen lobbied for a return to more expansionist policies.
- Intellectuals criticized the IMF for imposing 25X1 tough conditions on its loans to Brazil.
- The media assailed incompetence and corruption among top officials, including the economic team.
- The lower house of Congress passed a resolution calling for a moratorium on foreign debt payments. 25X1

Economic protests by the middle class became more frequent. In mid-1983, many homeowners 25X1 threatened not to pay rising mortgage installments, and more than 100,000 civil servants struck for higher pay and job security. Thousands of state-enterprise employees—mostly middle class, well paid, and well organized—demonstrated against cuts in budgets and salaries. In October, middle class groups joined labor unions in lobbying Brasilia to ease up on wage restraints. 25X1

Economic Impact. The government, wary of pushing the populace too far, granted economic concessions to alleviate political discontent. Last year, for example, authorities scaled back a hike in mort- 25X1 gage payments in deference to middle class protests. Moreover, the government was slow to begin phasing out wheat subsidies, fearing the political consequences. Few state-enterprise employees were laid off, and, until last August, Brazil's public enterprise operating budgets were spared. These economic concessions prevented Brasilia from com- 25X1 plying with its initial IMF agreement. 25X1

The Figueiredo government gradually introduced tougher austerity policies to appease its foreign creditors, but political resistance hindered implementation of the program. In October, members of the government party joined with the opposition in repealing the administration's wage-restraint law, as well as other economic-adjustment measures. These were the first defeats of government-sponsored legislation during 20 years of military rule. Brasilia was forced to compromise—pegging wage hikes at 87, rather than 80, percent of the consumer price index.

What Lies Ahead

With the economy likely to contract further this year, Brazilians can expect no improvement in living standards any time soon. The government, strapped by IMF requirements to reduce public deficits, will be unable to commit significant additional resources to create new jobs. We foresee further middle class agitation and sporadic outbursts of violence by the poor.

Despite the renewed IMF agreement and the current lull in opposition activity, we believe that over the next year—as the transition to civilian government approaches—politicians' concern over social discontent will influence economic policy making even more. With presidential elections scheduled early in 1985, the lameduck administration will be less able to resist opposition to austerity. Moreover, serious public disorders would resurrect fear of a social explosion and probably stiffen resolve in Congress to resist additional austerity measures. As a result, the government is likely to be forced to soften tough economic policies.

Lacking the political consciousness, organization, and leadership of other economically discontented groups—such as the middle class—the poor are unlikely to mobilize politically or engage in large-scale revolt. Many of these Brazilians have lowered their expectations for the future and now seem more intent on survival than on fighting for a bigger share of the pie.

Implications for the United States

The Figueiredo government's willingness to enforce austerity will be impaired by its need to take account of public discontent in formulating economic policy. We believe Brasilia will again have difficulty in complying with its IMF accord and 25X1
will experience continuing foreign financial problems this year. Economic nationalism is a strong current in Brazilian politics, and, if the economic decline is not reversed, politicians will be tempted to make scapegoats of the IMF and the United States. 25X1

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Brazil: Struggling With Economic Stabilization [redacted] 25X1

Despite this month's signing of a second major international rescue package, we believe Brazil will be hard pressed to avoid another foreign exchange crisis this year. IMF-imposed goals for cutting the public deficit and the foreign payments gap are extremely ambitious and probably will not be met. The measures taken to date have resulted in appreciable economic and social costs, and we judge that the government is highly reluctant, in an election year, to demand greater sacrifice. Brasilia probably believes that, if it can demonstrate reasonable progress in sustaining economic adjustments, the IMF will react flexibly. If harsher measures are demanded, the government is likely to suspend talks with the Fund and resort to a temporary unilateral debt moratorium. [redacted]

Reinforcing Austerity

After failing to meet IMF conditions last May and subsequently losing foreign bank support, Brasilia began last summer to stiffen its economic adjustment policies. To slash the public deficit, petroleum subsidies were eliminated by a 45-percent increase in oil product prices, while subsidies for wheat were cut by doubling its official price. Officials also pared interest-rate subsidies for agriculture and exports and introduced two new decree laws to cut 1983 state enterprise investment 25 percent below that of 1982 and to trim current spending. [redacted]

After considerable resistance from congress, the administration managed to enact in November the last important reform sought by the IMF. The compromise law permitted wage hikes averaging 87 percent of inflation—rather than the 80 percent sought by the IMF. To offset the fiscal impact of higher indexation, the government increased personal and corporate income taxes and cut state enterprise fringe benefits further. [redacted]

1983 Adjustments in Perspective

In retrospect, Brazil's austerity program has produced uneven results. According to government data,[1] Brazil posted a $6.5 billion trade surplus, which surpassed the IMF's 1983 target and enabled Brazil to halve its current account deficit. Suppressed imports were primarily responsible, but increased export earnings also contributed after midyear as a result of aggressive exchange rate policies. Centralized foreign exchange controls and the disbursement of suspended loans in December increased Brazil's reserves and reduced foreign payments arrears. [redacted] 25X1

Fiscal and monetary policies were also tightened. 25X1
Brasilia estimates it saved some $4 billion in 1983 by cutting subsidies and curtailing state enterprise investment. These actions, coupled with increases in taxes, permitted the government to reduce the operational public-sector deficit from 6.8 percent of GDP in 1982 to the 2.7-percent IMF target for 1983.[2] The government also maintained a firm monetary policy stance relative to inflation. Expansion of the monetary aggregates was held to less than 100 percent, close to the IMF's targets. [redacted] 25X1

The austerity policies did not push down the 1983 rate of inflation as intended. Inflation soared to 210 percent, more than double the rate for 1982. Partially responsible were the rapid cruzeiro devaluations and the withdrawal of oil and wheat subsidies. 25X1

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[1] Brazilian data may somewhat overstate trade improvements. [redacted] underinvoicing and overinvoicing, selling into warehouse stocks, delaying import clearances, and making contraband imports. We have no reliable data, however, to estimate the magnitudes. [redacted] 25X1 25X1

[2] The operational deficit, a key IMF performance target, differs from the actual public-sector deficit in that it does not include increases in inflation-adjusted values of the stock of outstanding public debt. [redacted] 25X1

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Brazil: Balance of Payments

	1982	1983	1984 Projections		
			Case I [a]	Case II [b]	Case III [c]
Current account balance	−16.3	−7.7	−6.0	−7.0	−8.0
Trade balance	0.8	6.5	9.0	8.0	7.5
Exports	20.2	22.0	25.0	24.5	24.0
Imports	19.4	15.5	16.0	16.5	16.5
Service balance, net	−17.1	−14.2	−15.0	−15.0	−15.5
Interest payments	12.6	10.5	11.4	11.4	11.9
Debt repayments	21.2	17.2	17.9	17.9	17.9
Medium- and long-term maturities	8.2	7.2	7.9	7.9	7.9
Short-term maturities	13.0	10.0	10.0	10.0	10.0
Gross foreign exchange requirements	**37.5**	**24.8**	**23.9**	**24.9**	**25.9**
Financed by:					
Direct investment, net	0.8	0.4	0.5	0.5	0.5
Official and supplier credits	3.2	3.0	4.0	3.5	3.0
Loans	28.1	22.5	23.5	23.5	23.5
Bridge operations	3.6	−3.6	0	0	0
Short-term rollovers	12.0	10.0	10.0	10.0	10.0
Short-term credits	0.5	0.3	0	0	0
Long-term credits	12.0	15.8	13.5	13.5	13.5
Other [d]	5.4	−1.1	−4.1	−2.6	−1.1

[a] Case I assumes Brasilia complies with IMF performance targets.
[b] Case II assumes Brasilia eases austerity slightly.
[c] Case III assumes foreign market and interest rate conditions worsen.
[d] Primarily changes in reserves.

[redacted] 25X1

Another important factor was the effect on food prices of major crop losses from adverse weather. Despite the setbacks, inflation dropped sharply in the last two months of 1983, prompting the administration to claim that anti-inflationary policies were finally yielding results. [redacted] 25X1

Austerity, combined with sluggish demand abroad, had a severe impact on production. We estimate GDP shrank 5 percent in 1983; deteriorating economic conditions in the last three years have cut output to 92 percent of the 1980 level. Industrial production last year probably declined about 8 percent, according to the authoritative Sao Paulo Industrial Federation. Sales of capital and construction goods, electronic products, chemicals, and textiles plunged. According to the Brazilian financial press, private business failures accelerated. Brazil's middle and lower classes were hard hit by higher unemployment, and real wage declines cut into living standards. [redacted] 25X1

Revised IMF Accord

The late November approval of the revised IMF stabilization program allowed loan disbursements to resume. We believe Brazil's creditors were dismayed at the minimal progress on inflation and wages but generally felt that the government promised as much as possible in the existing economic and political climate. Despite these qualms, the IMF and commercial banks released more than $3 billion in frozen loans. Nearly all the money was quickly used to repay short-term bridge loans and to clear up interest arrears approaching 90 days overdue, the point at which loans from US banks are declared nonperforming. International lenders also began assembling another large package to meet Brazil's financing needs through 1984. As the centerpiece, banks pledged $6.5 billion in new loans as well as $5.3 billion of 1984 principal reschedulings. Foreign governments, under the auspices of the Paris Club, agreed to sizable financial support as well. [redacted]

To maintain the support of the IMF and other foreign creditors this year, Brazil must persevere with unpopular adjustment measures. With the help of IMF-prescribed policies, Brasilia hopes to reduce inflation to 100 percent and the current account deficit to $6 billion. The ambitious policy targets include:

- A reduction in the expansion of the money supply and of the monetary base to only 50 percent in 1984.
- A cut in the public-sector borrowing requirement to 9 percent in 1984 by eliminating the operational public-sector deficit.
- Devaluations of the cruzeiro against the US dollar to adjust for Brazilian inflation.

In addition, the Brazilian Government has imposed on itself a $9 billion trade surplus target for 1984. [redacted]

Brazil's Phase II Financial Rescue Package

The IMF

By gaining from the IMF a waiver of noncompliance and reaching agreement on new and revised performance criteria extending through the end of this year, Brazil has become eligible to draw $1.6 billion in 1984 from its three-year Extended Fund Facility arranged in February 1983. [redacted] 25X1

The Private Banks

Support from the IMF was contingent upon assistance from private banks. On 27 January, some 670 commercial banks signed an agreement to provide Brazil a four-part syndicated loan package, including:

- *A $6.5 billion medium-term loan, on terms more generous than last year.*
- *A rescheduling of $5.3 billion in commercial loan payments that were due to mature in 1984.*
- *Continued access to $10.3 billion in short-term trade financing.* 25X1
- *Maintenance of $6.0 billion in interbank credit lines with Brazilian banks abroad.* [redacted] 25X1

Foreign Governments

The Western industrialized countries of the Paris Club agreed to:

- *Provide $2.5 billion in loan guarantees from official export credit agencies. Although the United States has made a firm pledge to cover one-half the total, others—including the United Kingdom, France, West Germany, and Japan—still have not made specific commitments.*

- *Reschedule $3.8 billion in payments due by the end of the year on government-to-government and officially guaranteed credits. This total considerably exceeds the amount of rollover Brazil initially requested from Western creditor countries.* 25X1
[redacted] 25X1

Outlook for 1984

Challenges and Uncertainties. More favorable foreign and domestic economic factors will help Brazil achieve its goals. Export earnings are likely to increase because of:

- Higher prices for key commodities such as soybeans and orange juice.
- A rebound in the production of other agricultural exports.
- Rising sales of manufactured products in response to economic recovery in foreign markets.

Nonetheless, we remain concerned that growing foreign protectionism could frustrate Brazil's export drive.

Meeting trade targets will again depend on restraining imports. Brazil hopes that rapidly rising domestic oil output and steady world crude prices will enable it to trim $1-1.5 billion from its foreign oil purchases and hold total imports to $16 billion. Savings will be used to replenish low stocks of essential raw materials and intermediate goods, according to the economic policy team. Boosting oil production one-third above last year's 340,000-barrel-per-day average could prove difficult, however, after last year's cutbacks in the state oil monopoly's operating and investment budget.

The IMF's domestic performance goals are perhaps even more vulnerable than the foreign payments goals, especially because of the temptation to backslide on austerity during an election year. Inflation probably will slow, but not as much as planned. The government's optimistic expectations for agricultural performance could be dashed by short supplies of seeds and fertilizers. Moreover, many Brazilians doubt the monetary authorities will restrain money growth to 50 percent, because of fears this would strangle the private sector.

Staying With the IMF—But Barely. We believe the Figueiredo administration will continue to push key economic reforms, but not to the point of jeopardizing its major political objective—an orderly transfer of power to a civilian government in early 1985. Brasilia is not likely to take the tough steps needed to meet all IMF goals and targets. If it did, it probably would lead to a second straight year of at least 5-percent decline, which we believe is politically unacceptable in an election year. 25X1

To placate influential Brazilian interest groups, the government is most likely to try to mitigate further economic decline by loosening the squeeze on credit, wages, and imports. Although government policies will take much of the steam out of price pressures, we believe inflation will not fall below 125 percent. Higher-than-projected inflation, in turn, will further hinder prospects for achieving the public-sector borrowing requirement target. We believe, moreover, less strenuous efforts to boost agricultural exports and to curb imports in the face of industrial material shortages could swell the country's current account deficit to $7 billion.

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If Brazil demonstrates that it is making reasonable progress toward adjustment despite missing some performance targets, we believe—and the Brazilians are likely to calculate as well—that the IMF would react flexibly. Although some tightening of performance targets undoubtedly would be requested and there might be some brief interruptions in the flow of foreign funds, Brazil would probably proceed with its stabilization program without losing its foreign creditor backing. Moreover, we believe Brazil may seek more money—perhaps $2 billion—and, as long as it remains in the good graces of the IMF, the major banks would ante up.

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Break With the IMF. Although we consider the prospect of a break with the IMF unlikely, a convergence of adverse economic trends, domestic political pressures, and economic policy setbacks could lead to such a confrontation. If the IMF decides that government efforts are inadequate and insists on harsher austerity, there is a chance the Figueiredo administration could suspend further talks and resort to a unilateral moratorium on all debt payments. In this situation, we believe the government probably would set the debt moratorium for a limited duration, perhaps 90 days, and attempt to persuade creditor banks to ease austerity conditions. Should the banks resist—and probably

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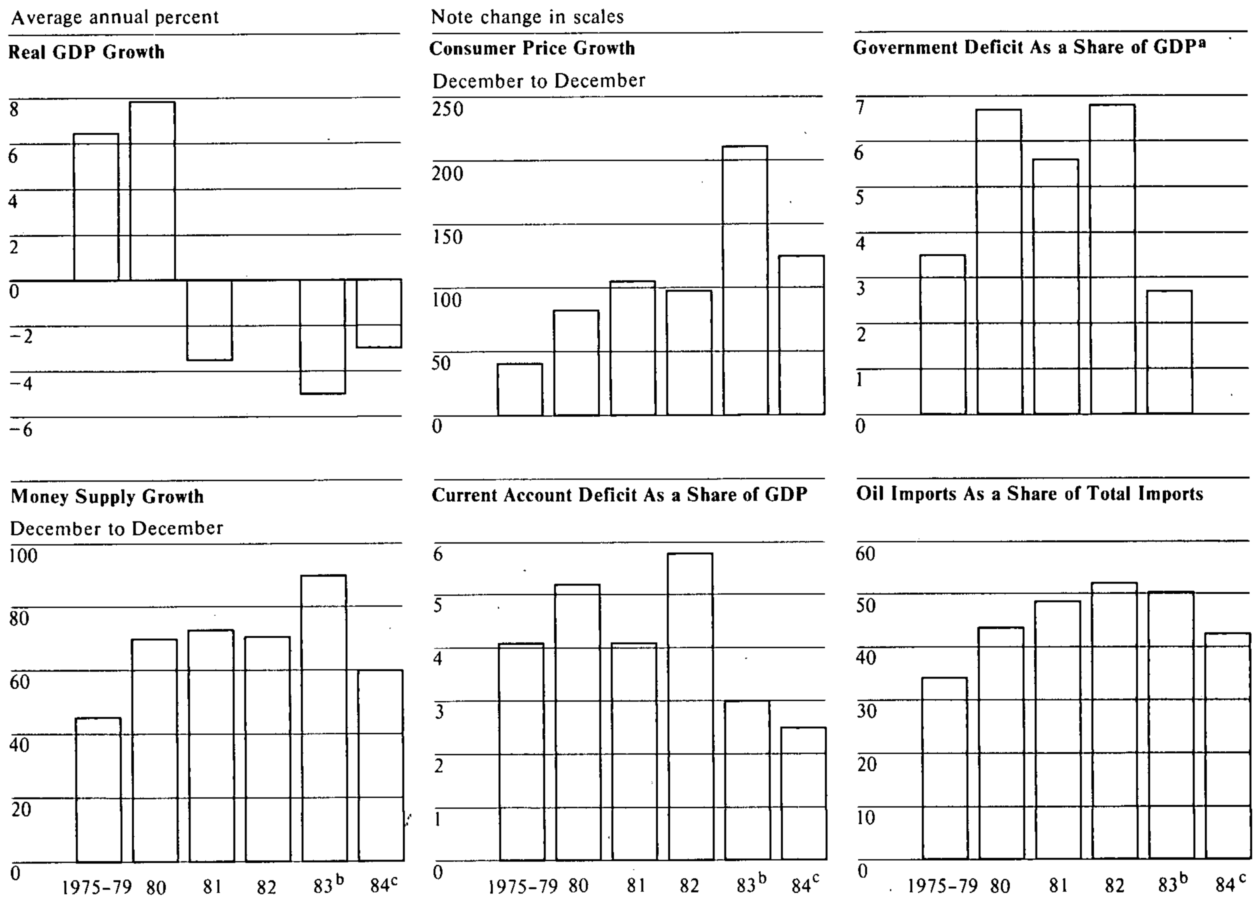
Brazil: Economic Indicators, 1975-84



[a] Excludes inflation adjustments to value of outstanding public debt.
[b] Estimated.
[c] Projected.

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some major banks would—the negotiating positions of both sides could harden, threatening an estrangement between Brasilia and its bankers

Signs To Watch

Brazil's economic performance in the early months of this year will be critical to the government's willingness and ability to stay its present austerity course. Single-digit price increases in the first few months of this year would support claims that the hyperinflationary cycle has been broken. A growing number of Brazilians might then concede that economic retrenchment was beginning to work and grudgingly acquiesce to these policies. A strong export recovery would not only help exporters and importers, but would also strengthen the country's general creditworthiness. On balance, we agree with the US Embassy that a continuation of these trends would open the way for a gradual reappearance of Brazilians' traditional optimism

Alternatively, if Brasilia does not show significant progress in controlling inflation or bolstering its foreign exchange position early in the year, it is likely to face rising pressure from the middle class, business, and labor for policy changes, especially after Congress reconvenes in March. Under these conditions, a nationalistic backlash could quickly develop, precipitate another confrontation with the IMF, and cause a new foreign exchange crisis by midyear.

Implications for the United States

US commercial interests have been hard hit by Brazil's debt servicing crisis and recession. US banks—holding nearly one-fourth of Brazil's foreign debt—are suffering profit declines because of the need to set aside reserves for potential loan losses and delays in debt servicing payments. The continuing recession in Brazil, accompanied by an array of import and currency controls, is denying the United States an important export growth market. US exports, which usually have captured the largest slice of Brazil's nonoil market, fell about 25 percent in the first nine months of 1983 compared with a year earlier. A further drop in exports is likely this year if Brazil sticks with its IMF program. US direct investors, holding about $7 billion of registered capital in Brazil, are taking losses and finding the investment climate increasingly unattractive. Moreover, US industries—steel, shoes, and textiles—are facing stiff competition from the influx of Brazilian exports.

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Mexico: Pushing Nonoil Exports [redacted] 25X1

Mexico's foreign payments success last year has not been mirrored in expanded nonoil exports. Even though President de la Madrid made the expansion of manufactured exports a key goal as part of renewing economic growth, efforts to spur foreign sales have been dampened by missteps, ongoing policy contradictions, and the lingering financial crisis. Moreover, de la Madrid has not initiated the major legal changes that will be necessary to stimulate export-led growth. We believe that de la Madrid considers the political costs of such far-reaching reforms would be too great. As a result, the goal of quadrupling nonoil exports from 1982 to 1988 will remain elusive. Moreover, even under the most optimistic case, increases in nonoil export earnings would only slightly ease foreign financing requirements. Debt service will remain heavy throughout de la Madrid's term and will absorb most of Mexico's export earnings. [redacted]

The Legacy of Import Substitution

Import substitution provided a major impetus for the Mexican economic expansion that averaged nearly 7 percent annually during 1961-81. Successive administrations used direct and indirect means to encourage manufacturing for the domestic market. At the same time, overvaluation of the peso made Mexico's goods unattractive abroad. Agricultural policy fostered self-sufficiency, and laws prohibited exports of specific items. [redacted]

Inward-looking regulations intensified in 1981-82 as the Lopez Portillo administration sought to cope with the deteriorating economy. Import and export license requirements were tightened in late 1981 as the current account raced toward a $13 billion deficit. Even with the devaluation in early 1982, nonoil exports fell 10 percent that year as Mexican policies discouraging exports were reinforced by continuing worldwide recession, falling commodity prices, the Mexican drought, and a lack of export financing. [redacted] 25X1

Turning to Exports

The de la Madrid administration, seeking a resumption of rapid economic growth, has promised a thorough restructuring of the economy. De la Madrid's program promoting nonoil exports includes: eliminating regulatory barriers, maintaining a competitive exchange rate, and improving relations with the alienated private sector. The President also promised emergency measures to help distressed businesses gain access to peso and foreign financing. [redacted] 25X1

Early in his administration, de la Madrid moved to eliminate some of the more onerous regulations imposed by his predecessor. Permit requirements were discontinued for about 90 percent of exports, and most export tariffs were reduced or ended. In January the Secretary of Commerce announced liberal regulations covering earnings from foreign sales—for example, exporters can use 100 percent of their foreign earnings to pay supplier debt. In other areas, most export regulations and incentive programs are now being administered by the beefed-up Foreign Trade Institute (IMCE), rather than by several agencies. For example, IMCE has established a one-stop "single window" program, where the exporter fills out one form and IMCE processes all the paperwork. [redacted] 25X1

To counteract mounting arrearages on private debt, the de la Madrid administration set up FICORCA, a scheme that allows access to foreign exchange at subsidized rates to firms that successfully reschedule their debts. According to press reporting, by

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December 1983 at least $11.6 billion of $16 billion in private debt had been tentatively rescheduled.

Mexico City has scrambled to gain funds from multilateral lenders and expand its export-financing programs to try to offset lost short-term private and official trade financing. The Mexican foreign trade bank, Bancomext, was authorized to distribute $2.5 billion in trade credits in 1983-84. Government export guarantees issued by FOMEX, a government trust fund to support exports, were raised from $2 million in 1982 to $78 million last year. Mexico City negotiated a credit program with the World Bank to channel $625 million in new and reprogramed funds to Mexican exporters at preferred rates. Recently, international banks extended new credits for use by Mexican businesses, but they are administered through the government because creditors remain wary of direct loans to private firms.

In addition to the export credit programs, the administration has taken a number of other measures to help industry, including peso credits, tax incentives, and technical assistance to firms with short-term financial problems. In return, the firms promise to maintain employment. On 31 January, Mexican financial officials announced that $5.7 billion would be made available in 1984 to help Mexican companies improve their international competitiveness. The private sector also has initiated some self-help measures to promote trade. Groups representing large industry have held training seminars, and exporters in western Mexico have held trade shows and sought ties with Hispanic chambers of commerce in the United States.

Impediments to Export Expansion

Despite efforts to date, existing policy contradictions and institutional impediments are obstructing the export drive. In many cases, the private sector and government bureaucrats are confused by the new regulations, and implementation of many of the new programs is incomplete. For example, an IMCE official told a US Embassy officer that the "single window" program is currently slower than the old system of filing individual requests with each separate government office. According to press reports, the private sector has resorted to 25X1
underinvoicing and "smuggling" exports by bribing border officials to avoid cumbersome foreign exchange regulations, despite stiff laws against such violations. 25X1

Much of Mexico's private sector is not structured for export, lacks the marketing skills to sell abroad, and does not have ready access to foreign distribution systems. In Mexico's highly protected domestic market, exports were long considered a residual by producers, who often had profit margins as much as three times higher on products sold internally. As a result, the government has made few converts to its export-led growth strategy because businessmen are not convinced the risks are worth the costs. Moreover, the austerity program required to deal with foreign exchange shortages has created a difficult operating environment. The government 25X1
has cut subsidies on fuel and freight transportation, eliminated tax rebate schemes and increased taxes and user fees. Principally as a result of the peso devaluation, the cost of needed imports has soared. 25X1

The private sector remains wary of government intentions despite de la Madrid's efforts to cultivate business. He included business in the tripartite pact with government and labor to restrain wages in exchange for job security and holding the lid on price increases. 25X1
the President meets with businessmen monthly to exchange views. Last July, the President held a highly publicized meeting with the new director of the Businessmen's Coordinating Council to end a 25X1
feud with the organization over the bank nationalization. Nevertheless, until de la Madrid defines what he means by state "rectorship" of the economy, the private sector will continue to hedge its support of the administration. 25X1

Conflicts Over Foreign Investment

Early signals by the de la Madrid administration that foreign investors would be welcome to enlist in the export campaign have faded. Soon-to-be-issued

Mexico: Balance of Payments *Million US $*

	1981	1982	1983 [a]	1984 [b]	1985 [b]
Trade balance	−3,003	7,802	13,080	12,000	11,500
Merchandise exports (f.o.b.)	20,927	22,224	22,080	23,000	24,500
Oil and gas	14,573	16,477	16,000	16,300	16,900
Manufactures	3,665	3,627	4,014	4,400	5,000
Agriculture	1,481	1,233	1,216	1,400	1,500
Coffee	347	371	NA	NA	NA
Shrimp	348	453	NA	NA	NA
Minerals	1,208	887	850	900	1,100
Silver	520	386	NA	NA	NA
Copper	310	231	NA	NA	NA
Imports (f.o.b.)	23,930	14,422	9,000	11,000	13,000
Net services and transfers	−9,541	−10,487	−8,700	−10,500	−9,700
Of which:					
Tourist receipts (including border sales)	6,530	5,555	5,700	6,200	6,500
Interest	−8,383	−10,879	−10,700	−11,600	−12,000
Current account balance	**−12,544**	**−2,685**	**4,380**	**1,500**	**1,800**

[a] Estimated.
[b] Projected.

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foreign investment guidelines that are designed to clarify exemptions to the rule requiring majority Mexican ownership are unlikely to be encouraging. The recent automobile decree and a pending pharmaceutical decree both reserve a portion of these industries for majority Mexican ownership, establish heavy local content requirements, set stringent requirements for balancing exchange earnings, and establish mandatory performance requirements. We believe, however, that most established foreign firms will use their bargaining power as large employers to create a tolerable operating climate rather than abandon a market that holds future promise. Such firms will cut deals, such as the recent agreement between a US automaker and the government, that bend implementing regulations and satisfy the home office and the Mexican administration. New investors, however, are likely to remain on the sidelines.

Performance in 1983

De la Madrid's trade promotion program fell far short of the target last year. Because the austerity program had caused a major slump—economic activity fell some 7 percent—the government drew back from basic structural reform to avoid more serious economic deterioration. Moreover, most of the $2 billion in official trade credits promised by foreign governments failed to materialize in 1983, as bilateral debt rescheduling negotiations dragged on. One facet of the program remained active, as de la Madrid kept the peso slightly undervalued. 25X1

We estimate the value of nonoil exports grew 6 percent in 1983, largely in response to the peso devaluation and economic recovery in the United

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States—Mexico's largest trade partner. Manufactured exports rose the fastest, posting an increase of 11 percent. On the downside, agricultural exports stagnated last year while mineral exports fell by 4 percent in value as world commodity prices remained depressed. 25X1

Outlook for 1984-85

Prospects for developing new markets are limited in the next two years. Most LDCs, including those in Latin America—which one Mexican official described as their natural long-term market—are undergoing similar financial crises and foreign exchange shortages that are causing imports to contract sharply. 25X1

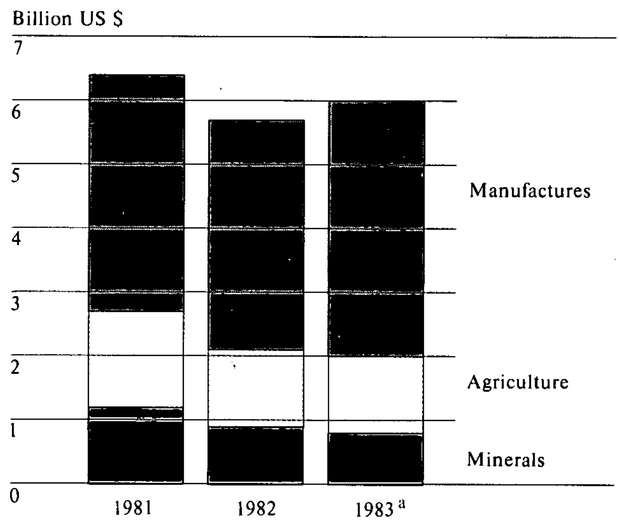
Oil gave Mexico a positive trade balance with 10 of the OECD countries in 1982, and these states generally are unwilling to allow greater Mexican penetration. Pegging the peso to the dollar has reduced the peso's depreciation against other currencies, and many of the items Mexico can quickly bring into the international market—car parts, steel, textiles, and shoes—face stiff competition from depressed OECD and other Third World industries as well as substantial tariff and other trade barriers. Prospects for increasing sales to other oil-exporting nations and centrally planned economies appear poor. 25X1

Annual growth forecasts for nonoil exports in 1984-85 range from the US Embassy's 10 percent to the Mexican Government's 26 percent. To reach their optimistic forecast, Mexico City would have to:

- More actively promote the private sector.
- Revamp fiscal policy to support export-oriented firms and markedly step up trade promotion.
- Strictly comply with the IMF program to assure adequate foreign lending.
- Open its doors to greater foreign investment.
- Aggressively undervalue the peso.

Even these measures, however, probably would be insufficient unless accompanied by strong growth in the US market and rising world commodity prices. 25X1

Mexico: Nonoil Commodity Exports, f.o.b., 1981-83



[a] Estimated.

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We believe nonoil export growth is likely to be nearer the 10-percent mark in 1984 and perhaps a little higher in 1985. We expect manufactured goods—including output from in-bond assembly plants—to lead export growth by increasing about 12 percent annually. Earnings from mineral exports will probably show little growth, reflecting continued weak international demand. Agricultural exports, particularly of winter vegetables and citrus fruit, should increase in 1984 because of heavy damage to US crops. 25X1

De la Madrid is likely to remain in reasonably close compliance with the IMF program and obtain access to essential credit. The administration plans to devalue the peso about 30 percent this year, in line with the policy of keeping the real value of the peso constant. Relations with the private sector may improve slightly. The attitude toward foreign investors is likely to remain negative, however, 25X1 although the government may aggressively pursue investment in certain areas such as computers and other high-tech goods. [redacted] 25X1

Although we expect nonoil exports to rise steadily, there remain downside risks, particularly if Mexico City responds to fears of burgeoning political unrest or yields to pressure from the left wing of the ruling party for rapid reflation. A dramatic shift to nationalist economic policies is most likely to be accompanied by further nationalizations, substantial tightening of government controls, and a loss of essential foreign financing. [redacted] 25X1

The US-Mexico Trade Relationship

Trade issues are likely to play a large role in bilateral relations in the next two years. Mexican officials believe that "assured" access to the US market is essential to economic recovery, and President de la Madrid has publicly chided the United States for growing protectionism. Until Mexico's recovery is well under way, we believe Mexico City will remain uninterested in joining GATT and will continue to oppose calls for reciprocity in trade matters. Mexican officials are likely to continue pushing for a bilateral trade treaty. They will also lobby for renewal in 1985 of the US Generalized System of Preferences (GSP)—a program that allows duty-free entry of nearly 3,000 LDC products. In our judgment, structural changes in the Mexican economy and maintaining the peso's competitiveness would contribute more to assuring healthy sales to the United States. The GSP program and a bilateral trade treaty, however, would help psychologically to encourage Mexican exporters. [redacted] 25X1

[redacted] 25X1

New Zealand: Muldoon Faces a Troubled Economy in an Election Year

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Prime Minister Muldoon's visit to Washington on 24 February comes against the background of a lackluster domestic economic performance. We believe economic issues—especially record unemployment—will dominate the election campaign later this year when Muldoon will be running for his fourth consecutive term. Although economic troubles have eroded public confidence in Muldoon, recent public opinion polls show he remains the popular choice for prime minister by a fairly wide margin. To keep inflation in check, we believe Muldoon will opt for a tight monetary policy and perhaps other controls when his 21-month wage/price freeze ends on 29 February.

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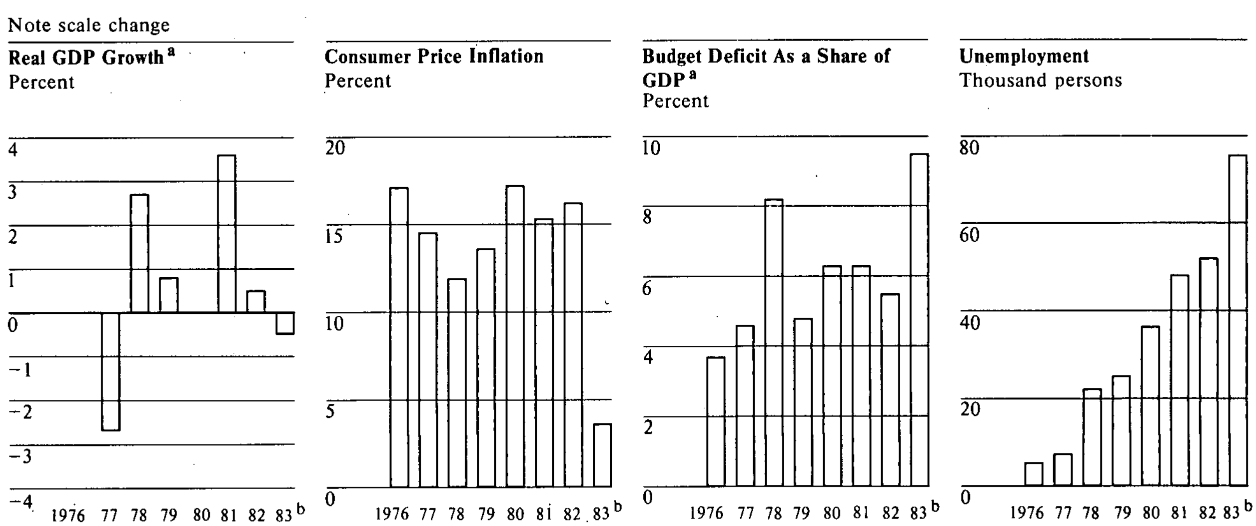
The Elusive Recovery

Economic activity in New Zealand remains weak. The OECD estimates that real gross domestic product will decline slightly in fiscal year 1983 (April 1983–March 1984)—the worst performance since 1977. Manufacturing has been particularly

New Zealand: Selected Economic Indicators, 1976-83



[a] Fiscal years.
[b] Estimated.

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hard hit with industrial production in 1983 nearly 10 percent below the level of a year earlier. As a result of the sluggish economy, unemployment has risen rapidly and has emerged as a key election issue. The number of registered unemployed has increased from less than 10,000 in 1977 to 77,000 in September 1983, a record 6 percent of the labor force.

Slack private investment spending is constraining economic growth. Poor corporate earnings and widespread lack of confidence by the business community have resulted in stagnant growth in real private investment this fiscal year. Moreover, low earnings have forced firms to borrow in domestic financial markets and compete with large government borrowing. Wellington's budget deficit is expected to reach $2.1 [1] billion this fiscal year, a record 9.5 percent of GDP.

The one bright spot Muldoon can point to is success against inflation. The wage/price freeze imposed in June 1982 for one year was extended in mid-1983 and is now scheduled to be lifted at the end of this month. The freeze successfully achieved Muldoon's goal of ending nine consecutive years of double-digit inflation. Consumer prices rose less than 4 percent in 1983, compared with 16 percent in 1982. The failure of nominal interest rates to fall much, however, suggests that the domestic financial market probably is unconvinced about the underlying success of Muldoon's anti-inflation policy. In particular, there could be a scramble for wage increases when the freeze expires at the end of the month. Muldoon appears to recognize this danger and, according to the New Zealand Insititute of Economic Research, plans to try jawboning to limit wage increases to 2.5 percent in 1984.

Another Political Business Cycle?

Substantial disagreement exists among domestic and foreign observers of the New Zealand economy about the pace of economic recovery in 1984. The key question is what policies Muldoon will pursue as he prepares to take his one-seat parliamentary majority to the polls later this year. The OECD and the New Zealand Reserve Bank foresee little if any growth. The US Embassy and several private economists, however, predict growth between 2 and 4 percent. These forecasts vary because of differing policy assumptions, particularly monetary policy. 25X1

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New Zealand governments—including Muldoon's—have traditionally primed the economy in an election year. Since Muldoon took office in late 1975, the average rate of growth in the money supply during nonelection years has been only 3.6 percent. During the election years of 1978 and 1981, however, the money supply expanded at an average of 20 percent. A similar trend for government fiscal policy is evident since the mid-1970s. 25X1

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Muldoon has received considerable criticism from foreign observers for election-oriented economic policies. The OECD's Economic and Development Review Committee last year scolded Wellington for the policy zigzags of recent years, arguing that little attention has been paid to inflation or foreign payments considerations and that this has upset domestic financial markets. So far, however, the opposition Labor Party has yet to make this an election issue. They probably fear that Muldoon will charge them with following the same practice in 1975. 25X1

Economic Issues at the Heart of the Election

Muldoon is trying to focus voter attention away from unemployment and toward his record on inflation. We believe he remains committed to limiting inflation and is unlikely to turn on the monetary spigot. As a result, we estimate that real GDP growth in fiscal year 1984 will be negligible. Thus, Muldoon is likely to face the electorate in late 1984 with a much weaker economy than in his two previous reelection bids. 25X1

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[1] All values in this article are expressed in US dollars.

New Zealand: Balance of Payments [a]

Million US $

	1980	1981	1982	1983 [b]
Current account	**−847**	**−1,433**	**−1,486**	**−1,044**
Trade balance	487	−24	−102	311
Exports	5,490	5,521	5,256	5,554
Imports	5,003	5,545	5,358	5,243
Net services and transfers	−1,334	−1,409	−1,384	−1,355
Net investment income	−569	−632	−735	−850
Capital account	**961**	**1,559**	**1,898**	**918**
Government borrowing for balance-of-payments purposes [c]	1,607	1,837	2,139	1,068
Other long-term capital	−667	−630	−1,182	−1,100
Of which:				
Direct investment	73	229	NA	NA
Repayments of official borrowings	−929	−1,175	−1,165	−1,330
Other short-term capital [d]	21	352	941	950
Foreign exchange reserves [e]	343	388	1,073	662

[a] Fiscal year (1 April–31 March).
[b] Estimated.
[c] Includes Reserve Bank borrowings.
[d] Including errors and omissions.
[e] End of period.

[redacted] 25X1

Despite Muldoon's efforts, we expect unemployment to loom larger than inflation as the dominant issue among voters. New Zealanders are traditionally accustomed to very low levels of unemployment, and recent public opinion polls indicate that most voters consider it the country's most serious problem. The Reserve Bank of New Zealand forecasts that fiscal year 1984 will be the fourth consecutive year in which total employment will be static. Muldoon's Minister of Labor has publicly conceded that employment prospects are not likely to improve appreciably over the next year or so. [redacted]

New Zealand's unemployment is higher than the official 6 percent rate. Wellington only counts as unemployed those workers who register with the Department of Labor. The government maintains that this accurately reflects the unemployment situation. The Labor Party and many domestic economists, however, argue—correctly, in our view—that the number of registered unemployed seriously understates the actual degree of joblessness. They claim that certain categories of workers (such as married women), who are not eligible for unemployment benefits, are systematically underrepresented because they have little incentive to register. The respected New Zealand Institute of Economic Research estimates that if these groups were counted the true unemployment rate would be at least 8 percent. [redacted] 25X1

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New Zealand's rapidly growing foreign debt may become a campaign issue as well. The Labor Party probably will charge that Muldoon has mortgaged New Zealand's future because total foreign debt reached $9.3 billion in 1983—some 45 percent of GDP. By this measure, New Zealand is on par with LDCs such as the Philippines, Mexico, and Brazil. With the bulk of the recent borrowing in the form of short- and medium-term loans, the average

New Zealand: Major Projects

Project	Construction Period	Approximate Cost *(million US $)*
Total		**3,780**
Energy projects		2,410
Marsden Point oil refinery expansion	1980-84	780
Petralgas chemical-methanol plant	Completed	455
Motunui synthetic gasoline plant	1982-85	620
Kapuni ammonia urea plant	Completed	60
Liquigas LPG distribution	1981-88	65
Petrocorp gas treatment facility	1983-85	80
Petrocorp LPG to fuels plant	1983-85	220
Ethane-processing plant	Late 1980s	NA
CNG auto conversion (150,000 vehicles over 5 years)	1979-84	130
Other projects		1,370

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maturity has shortened considerably, and nearly 62 percent of the government's foreign debt is due in the next five years. Debt servicing payments already exceed the cost of oil imports, and the New Zealand Planning Council, an economic advisory group for the government, estimates that the ratio of official debt servicing payments to exports of goods and services is nearly 25 percent.

The increase in foreign debt results from:

- Loans for New Zealand's major projects—sometimes referred to as the "think-big" projects by Muldoon—which consist primarily of energy projects designed to reduce New Zealand's dependence on imported oil.
- Borrowing to finance persistent current account deficits.

The debt for project financing poses few long-term problems because the projects are expected to generate the income necessary to service their debts. Borrowing to finance current account deficits is more troublesome, however, because austerity could be required in the future. New Zealand Government officials recently conceded in talks with the IMF that continued heavy government borrowing to finance foreign payments deficits increases the likelihood of slow growth over the next few years. 25X1

As a result of the heavy foreign borrowing, a US financial rating service lowered New Zealand's credit rating in mid-1983. Although the move will make borrowing somewhat more expensive, Wellington does not anticipate any difficulty in meeting its borrowing needs. New Zealand remains an attractive area for new loans, partly because many US regional banks, which are cutting back on loans to troubled LDC debtors, have sufficient funds available. Nevertheless, the lower credit rating has hurt Muldoon politically. In 1982 Muldoon said that New Zealand's credit rating should be the key criterion for judging the economic performance of his government, and Labor has made much of this. 25X1 25X1 25X1 25X1

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Muldoon's Political Prospects

According to the US Embassy, the Labor Party senses that the government is vulnerable on economic issues—particularly unemployment. Labor is almost certain to charge that New Zealand's economy has not fared well under Muldoon; real per capita income is now lower than it was in 1976—Muldoon's first full year as Prime Minister. Members of Muldoon's National Party—and Muldoon himself—are becoming increasingly concerned about the high level of joblessness. Despite the Labor Party's recent gains in public opinion polls, however, deep internal divisions are keeping Labor from devising credible alternatives to Muldoon's economic policies. 25X1

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International Financial Situation: Oil Price Impact on LDC Debtors [1]

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This article is part of our series focusing on the economic and political aspects of the international financial situation.

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The slide in oil prices since early 1981 has lowered the earnings of major LDC debtors that export oil by an amount greater than it has reduced oil import bills for oil-importing LDC debtors. The drop in oil prices and weak demand directly reduced annual export earnings of eight oil-producing LDC debtors by $17 billion in 1983 compared with 1981. During the same period, we estimate that the oil import bill for 15 key oil-importing LDC debtors fell only $6 billion.[2]

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Key Oil-Exporting LDC Debtors: Impact of an Oil Price Change

Billion US $

	Oil Export Revenues 1981	1982	1983 [a]	1984 [b]	Impact of $5/Barrel Price Change
Total	**72.5**	**64.2**	**55.5**	**56.6**	**10.2**
Ecuador	1.5	1.3	1.5	1.2	0.2
Egypt	2.8	2.9	2.4	2.4	0.4
Indonesia	14.7	10.9	9.2	9.4	1.7
Malaysia	2.1	2.7	1.3	1.3	0.2
Mexico	14.4	16.6	16.0	16.0	2.8
Nigeria	17.1	14.0	10.9	12.3	2.2
Peru	0.5	0.5	0.3	0.5	0.1
Venezuela	19.4	15.3	13.9	13.5	2.6

[a] Estimated.
[b] Projected using January 1984 prices.

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Impact of Past Price Changes

Past oil price increases contributed significantly to the current financial difficulties of most oil-importing LDCs. Higher oil prices after the 1973 oil embargo led many of these LDCs to borrow to maintain consumption and investment. The 1979-81 oil price runup put these borrowers in the position of having to take new loans both to meet the new oil price hike and to service loans coming due from the first increase. We calculate that, since 1973, higher oil prices have cost the 15 oil-importing debtors roughly $125 billion—nearly one-half of these countries' total debt at the end of 1983.

In the last two years the oil market situation has changed dramatically. The average official OPEC selling price has fallen from a peak of $34.84 in early 1981 to $28.60 late last year. We estimate that declining oil prices and reduced consumption shaved 20 percent off the cumulative oil bills of the oil-importing debtors between 1981 and 1983. At the same time, the export revenues of the eight oil-producing debtors fell nearly one-fourth.

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Price Sensitivity

We believe these LDC debtors remain highly vulnerable to an oil price shock. Last year, oil still accounted for nearly 30 percent of the 15 oil-importing debtors' foreign purchases. If oil prices were to drop by $5 per barrel, we estimate the annual oil import bill of these 15 importers would be cut $3.7 billion, while export revenues for the eight oil producers would plummet $10.2 billion. A large price increase could force the oil importers to

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[1] This article considers only the direct impact of petroleum price changes on oil imports and exports. The indirect effects of an oil price change—including altered industrial-country growth, trade with OPEC countries, and worker remittances—are not examined.

[2] The 15 oil-importing debtors we examined are Argentina, Brazil, Chile, Costa Rica, Ivory Coast, Kenya, Morocco, Pakistan, Panama, Paraguay, Philippines, South Korea, Sudan, Thailand, and Uruguay. The eight oil producers are Ecuador, Egypt, Indonesia, Malaysia, Mexico, Nigeria, Peru, and Venezuela.

Key Oil-Importing LDC Debtors: Impact of an Oil Price Change

Billion US $

	Oil Import Costs				Impact of $5/Barrel Price Change
	1981	1982	1983 [a]	1984 [b]	
Total	**28.4**	**26.7**	**22.5**	**21.5**	3.7
Argentina	0.4	0.3	0.1	0.1	NEGL
Brazil	11.0	10.1	7.8	6.8	1.2
Chile	0.7	0.7	0.6	0.6	0.1
Costa Rica	0.2	0.2	0.1	0.1	NEGL
Ivory Coast	0.4	0.4	0.2	0.2	NEGL
Kenya	0.3	0.4	0.3	0.3	0.1
Morocco	1.1	1.1	0.9	0.9	0.2
Pakistan	1.1	1.0	1.0	1.0	0.2
Panama	0.3	0.4	0.3	0.3	0.1
Paraguay	0.1	0.1	0.1	0.1	NEGL
Philippines	2.1	1.8	1.9	1.8	0.3
South Korea	6.9	6.8	6.0	6.0	0.9
Sudan	0.4	0.5	0.5	0.5	0.1
Thailand	3.0	2.5	2.5	2.6	0.5
Uruguay	0.4	0.4	0.2	0.2	NEGL

[a] Estimated.
[b] Projected using January 1984 prices.

[redacted] 25X1

face politically sensitive choices, including additional loans, debt rescheduling, or even more drastic import cuts. [redacted] 25X1

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