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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Synopsis

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24 February 1984

Perspective

The LDC Debt Service Burden 25X1

An increasing number of financial analysts over the past several months have expressed concern that LDC debt servicing burdens are unmanageable under current world economic conditions. Although most principal repayments now are being rescheduled or rolled over by creditors, attention has shifted to the terms on new and existing loans—particularly the interest costs—that borrowers must shoulder. According to our estimates, interest payments alone for several major debtors—including Argentina, Brazil, Chile, Mexico, Morocco, Peru, and the Philippines—account for at least 40 percent of projected 1984 export earnings. 25X1

Debtor countries have increasingly focused on the large debt service burden since the Latin American economic conference in Quito in early January. The conference issued a declaration calling for a new approach to handling the debt problem and for a sharing of responsibility between creditors and debtors for solving problems and assuming losses. Subsequently, Presidents Betancur of Colombia and Alfonsin of Argentina jointly emphasized the need for frank dialogue with creditors in order to work out "affordable" terms. Alfonsin also issued a joint statement with Venezuelan President Lusinchi calling for common financial policies among Latin American countries to strengthen their international financial position. 25X1

Although bankers have been narrowing interest spreads, lowering fees, and granting longer maturities and grace periods, the underlying problem of continued high LIBOR and other interest rates remains. Financial observers and academics have suggested several alternatives to reduce the total interest burden:

- One proposal involves the implementation of below-market interest rates on new and existing loans. The interest differential between the new and market rates would be converted to future principal repayments or subsidized by creditor governments or commercial banks.

- Another scheme would link debt service payments to LDC export earnings. For example, an individual country's debt service payments would be set at a maximum of 25 percent of export earnings. This plan would limit debt repayment to make available foreign exchange for imports in the hope of spurring economic growth.

- A third suggestion involves the conversion of outstanding debt of individual LDC enterprises to equity capital—or in other words, convert loans to shares in the firm—in order to reduce the overall debt burden. This would eliminate mandatory repayments until economic recovery is under way and the firms hopefully can pay dividends to the shareholders. 25X1

None of these alternative solutions has been formally endorsed by banks or governments. Banks—which must operate within various regulatory environments and seek to maintain the quality and profitability of their assets—are unlikely to agree to make loans below their cost of funds unless they are subsidized. Creditor country governments, however, are unlikely to agree to such subsidies with no strings attached. Banks are opposed to capping debt repayments by tying them to exports because this would cut into profits on the loans. Some banks might consider converting debt to equity as a means of avoiding nonperforming status on the loans. On the other hand, banks would have to forgo earnings under this proposal. In any event, we believe most debtors would be unwilling to allow greater foreign control of individual firms. 25X1

Debtor countries will continue to push for easier loan terms in upcoming meetings, such as the OAS special committee on Finance and Trade and the Inter-American Development Bank meetings next month. We believe the alternative proposals will remain in the talking stages unless a major debtor such as Mexico or Brazil were to offer its support. Even with such major debtor endorsement, countries probably would continue to negotiate with creditors on an individual basis with specific relief tied to the debtor's particular economic and political circumstances. 25X1

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Briefs

Energy

Heating Oil Consumption Rises Sharply

[redacted]

Cold weather contributed to a 12-percent rise in heating oil demand in five major developed countries in the fourth quarter of 1983 compared with the same period a year earlier. Heating degree days—a measure of the impact of weather on space heating requirements—were up 21 percent in the United States, 28 percent in Japan, and 8 percent in Western Europe, over year-earlier levels. As a result, heating oil consumption in the fourth quarter ranged from 8 percent in Japan to 20 percent in Italy. The rise in heating oil consumption—which accounts for about one-fifth of total oil consumption in the five countries—boosted fourth-quarter overall oil use 3 percent. Preliminary data indicate January 1984 heating oil demand in the United States was 35 percent above year-earlier levels. [redacted] 25X1

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Changes in Heating Oil Consumption *Percent change from a year earlier*

	1983				January 1984
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	
Total	**−7.7**	**−1.3**	**0.8**	**11.8**	
United States	−10.8	−3.7	−7.4	11.5	35.1
Japan	−1.6	−5.1	1.3	7.6	
West Germany	−5.9	16.8	−16.3	14.7	
France	−3.7	−6.2	−14.9	11.3	
Italy	−8.6	2.2	−0.7	20.5	

[redacted] 25X1

Kuwait Considers Japanese Petroleum Acquisitions

[redacted]

Kuwait Petroleum Corporation (KPC) is considering purchases of "downstream" petroleum assets in Japan, a move that is unsettling to the Japanese. According to a knowledgeable US Embassy source, Tokyo is unsure how to react to Kuwait's intentions, which apparently include acquisition of oil storage and marketing operations. In the past year, KPC has purchased the European assets of a major US oil company and now has three refineries and approximately 3,100 retail outlets on the continent. Kuwait views these acquisitions as necessary to secure future markets for its oil, particularly planned increases in exports of refined petroleum products. Now that it has established itself in Europe, KPC intends to make 1984 the "year of Japan." 25X1
According to the Embassy's source, Tokyo is unlikely to allow the type of investments Kuwait desires but has yet to formulate a policy to deal with the issue. [redacted] 25X1

Japanese-Soviet Oil Deal

[redacted] 25X1

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British-Norwegian Natural Gas Sales Agreement

The British Gas Corporation (BGC) and Statoil—the Norwegian Oil Company—have signed a contract for the sale of natural gas from Norway's Sleipner field to the United Kingdom. Although detailed information on the agreement is unavailable, press reports indicate that contract terms include a sales price of about $4.30 per million Btu and annual deliveries of 12 to 14 billion cubic meters. Under the agreement—which still must be approved by both London and Oslo—deliveries are expected to commence in 1990 via a new pipeline that will have sufficient spare capacity to allow for the transport of gas from small 25X1 British fields nearby. This spare capacity may lessen the expected opposition of some British officials to the purchase. We expect the Norwegian Government will quickly approve the Sleipner deal because successful conclusion of these negotiations will clear the way for Oslo to begin discussions with buyers on the sale of gas from the Troll field. [redacted] 25X1

Brazilian Oil Production Hits Record Levels

Brazilian oil output reached a new high last month of slightly over 440,000 b/d with the startup of a new production platform in the Campos Basin. [redacted] the national oil company Petrobras 25X1 is forecasting production to rise to 500,000 b/d by yearend and average about 460,000 b/d for all of 1984. This is approximately one-third more than last year's 338,000 b/d. If this year's goal is met, domestic oil production will cover about half of Brazil's petroleum consumption needs, double the proportion just two years ago. We remain skeptical, however, that Brazil will be able to 25X1 achieve its targets. Severe financial problems have forced Petrobras to cut its investment expenditures substantially and to reduce drilling activity. [redacted] 25X1

Indonesian Production-Sharing Agreements

Indonesia signed only three production-sharing contracts in 1983, down from 13 in 1982, reflecting its inability to promote exploration and development in the current weak oil market. Jakarta met resistance from the country's largest equity producers, particularly US firms that currently produce over 80 percent of Indonesia's output. Jakarta was unable to sign a new production-sharing accord with any US firm and, because the government demanded more than the standard 85:15 production split, was successful in converting Caltex's 25X1 contract of work to a production-sharing agreement only after protracted and difficult negotiations. Most other oil companies were reticent to enter agreements to explore for and produce oil they felt they would be unable to sell. Oil production this year is expected to outstrip additions to proved reserves for the fourth consecutive year, and the failure to sign more contracts in 1983 is likely to prolong this trend. [redacted] 25X1

International Finance

Argentine Debt Recalculated Upward

[redacted]

Economy Minister Grinspun's survey of foreign debt in preparation for rescheduling talks has turned up substantial additional obligations, which could necessitate greater borrowing this year. The latest estimate of Argentina's external debt is up by $5 billion to nearly $44 billion, including $3 billion in arrears. The new figure, announced by Central Bank President Garcia-Vasquez, grew as a result of $3 billion in recalculated military debt and $2 billion in civilian public-sector debt not previously reported. [redacted] 25X1 25X1

[redacted] Buenos Aires increased its estimates of new money needs this year from $3 billion to $5 billion. We expect new loans will be a particularly tough issue in bank negotiations because of Argentina's substantial payments arrears. Despite ongoing payments against trade arrears and a recent $78 million payment to the World Bank, total arrears continue to grow beyond the $2.5 billion level of December 1983. [redacted] 25X1 25X1

[redacted]

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New Syrian Foreign Exchange Measures

[redacted]

The Syrian Government recently announced a series of decrees spelling out new foreign currency regulations designed to ease serious foreign exchange shortages. The new laws primarily affect tourists, Syrians working abroad, and private-sector importers:

- Non-Arab tourists are required to exchange the equivalent of $100 at the tourist rate upon entering the country.

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- Syrian Government employees working abroad are required to remit at least 35 percent of their foreign currency salaries through official banking channels.

- Private-sector importers are authorized to open foreign exchange accounts with the Commercial Bank of Syria from funds currently held abroad. Once the funds have been on account for three months, the importer can draw on the money to pay for imports of raw materials and spare parts—up to an annual maximum of $300,000—or sell the foreign exchange to the Commercial Bank at the tourist rate.

The decrees also mandate that foreigners working in Syria exchange their foreign currency earnings through official channels and call for the establishment of a committee to issue letters of credit for imports. 25X1

The measures are unlikely to add substantially to Syria's pool of foreign currency. Only the provision dealing with private-sector importers has much potential. Syrian businessmen, however, probably will choose not to open the local accounts, because of concern that Damascus will confiscate or exact exorbitant taxes from the accounts. Moreover, it is unlikely that many of these businessmen would be able to comply with regulations that require proof that the foreign exchange was derived from activities outside of Syria rather than through illegal capital transactions or smuggling. 25X1

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Tanzania-IMF Talks Stalemated

Disagreement early this month between President Nyerere and the IMF over the removal of food subsidies and the amount and timing of a devaluation continue to block a standby agreement. Despite a general consensus among Nyerere's top advisers that Dar es Salaam must reach agreement with the IMF, Nyerere still believes the inflationary impact of a large devaluation could lead to unrest. According to the US Embassy, Nyerere has insisted that $800 million in prior aid commitments from the IMF, World Bank, and bilateral donors—a figure that unrealistically includes $200 million in bilateral assistance above existing levels—are necessary to cushion the effects of a devaluation. Failure to reach an IMF agreement soon will result in an accelerated deterioration of Tanzania's economy. 25X1 25X1

Madagascar Debt Rescheduling Postponed

IMF dissatisfaction with the progress of Madagascar's economic adjustment program has forced postponement of this month's Paris Club meeting to consider official debt rescheduling. The Fund has held up implementation of a standby agreement—necessary prior to a Paris Club rescheduling—because Madagascar's projected foreign financing gap for 1984 is still too large, and Antananarivo has not taken promised agricultural price reforms. Recent IMF projections show Madagascar will be nearly $220 million short in meeting this year's debt service payments, about $50 million above the original projection. 25X1 The Fund plans to canvas Western donors for pledges and, if sufficient commitments are obtained, will chair a donors' conference as early as April. According to the US Embassy, the Malagasy Government had planned to use an IMF agreement to pressure the Soviets—who have a significant military presence in Madagascar—to increase their economic aid. 25X1

Global and Regional Developments

MITI Calls for Restraint in Machine Tool Exports

MITI officials are urging Japan's machine tool industry to limit exports to the United States in an effort to avoid US trade restraints. In mid-January, the Director General of MITI's Bureau of Machinery and Information Industries cautioned machine tool builders to avoid excessive competition and price cutting and to generally observe orderly marketing practices. In late 1983, MITI officials extended the export price floor on numerically controlled (NC) lathes and machining centers through 1984 and expanded coverage to include an additional class of machining centers. Although exports of NC lathes and machining centers to North America were down 60 percent and 27 percent, respectively, in the first half of 1983, a strong resurgence in the second half has renewed fears in Tokyo of increased trade friction with the United States. 25X1
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Japanese Exports to China Up in 1983

Boosted by a sharp increase in steel exports, Japan's trade deficit with China dropped to $200 million last year after a record $1.8 billion in 1982:

- Japanese exports reached $4.9 billion, a 40-percent increase over 1982's depressed level. Steel exports—up from $1.3 billion in 1982 to $2.2 billion last year—made up 45 percent of Japan's total exports. The Chinese bought 7.4 million metric tons, 23 percent of Japan's worldwide steel exports, and surpassed the United States as Japan's number-one steel customer. 25X1

- Declining oil prices held Japanese imports from China to $5.1 billion, down 5 percent.

Record trade with China is forecast in 1984. The Japanese expect further Chinese purchases of machinery and equipment. Japan's economic recovery should boost its imports from China. 25X1

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National Developments

Developed Countries

Canada Introduces Election Budget

The Canadian Government's budget, announced on 15 February, proposes to reduce the federal deficit by US $1.5 billion from this year's estimated $25.5 billion. The budget provides for only a modest increase in social spending. With a federal election likely to occur this fall, the conservative cast of the budget is designed to boost the private sector's confidence in the Liberals' ability to manage Canada's recovery. The business community has expressed its approval of the budget's noninterventionist tone, emphasis on fiscal restraint, and new measures to simplify the small business tax system and provide tax credits for companies setting up owner-employee profit-sharing programs. Opposition party and labor leaders have strongly criticized the government for not doing enough to ease unemployment; Finance Minister Lalonde has responded by claiming that creating jobs is the responsibility of the private sector. 25X1 25X1

French Restructuring Measures

The most recent plan proposed by the French Government to deal with the structural problems of the economy calls for the establishment of "redevelopment zones" in the areas hardest hit by job losses. Within these zones:
- Workers from the coal, steel, and shipbuilding industries will receive 70 percent of their previous pay while they undergo retraining.
- Tax and credit incentives will be provided to attract new small- and medium-sized firms.
- The government will provide a larger share of total government public works spending to hard hit areas. 25X1

Both unions and employer groups have criticized the plan as inadequate and because it discriminates between locations and industries. The plan is expected to cost less than $1 billion over the next several years. It will not add significantly to projected deficits because it merely rearranges previous appropriations and uses off-budget financing—including unemployment insurance funds. 25X1

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Less Developed Countries

Mexico Revamps Public-Sector Contracting System

We believe recently enacted changes in the method of awarding public-sector contracts will drastically cut costs and represent a step toward institutionalizing President de la Madrid's anticorruption campaign. Contracts for all public-sector firms, including the national oil company, Pemex, will now be put up for bid, and all work must be performed by the contracting agent. In the past, a percent of contracts were automatically awarded to industry unions, which frequently sold them to third parties. Although this practice was not illegal, it increased costs and encouraged union profiteering. The oil workers' union, which previously received 40 percent of Pemex's onland contracts, 25X1 probably agreed to comply with the new regulations in exchange for an implicit administration promise to stay out of internal union affairs and not charge the union's leadership with corruption. Press reports speculate the government will save $1 billion this year as a result of the rule change. 25X1

Mexico Announces New Investment Guidelines

New foreign investment guidelines, issued last week, are an attempt to selectively attract new investment without altering the 1973 Foreign Investment Code. According to press reporting, the new guidelines specify 34 priority areas—including communications, computer, oilfield, and petrochemical equipment—where foreigners will be allowed to have majority control. Mexico's foreign investment law generally restricts foreign participation to 49 percent. Special attention will be given to labor-intensive industries that 25X1 produce exports or replace imports. Mexican officials indicated foreigners would be allowed to increase their participation in established Mexican firms if new capital investment is essential to the firm's survival. 25X1

Strong objection from the opposition left, labor, and some businessmen will preclude, in our judgment, any major shift in investment policy. Government approval of new investments is likely to remain subject to lengthy case-by-case negotiations. In a recent report on investment in Mexico, businessmen indicated that they fear Mexico City's flexible response now will be reversed in the future. According to US Embassy reporting, net new foreign investment fell 73 percent in 1983 and is likely to remain depressed until Mexico's economic recovery gets under way. 25X1

Argentine Labor Demands Threaten To Spur Inflation

[redacted]

Leaders of the confederation of major trade unions are pushing wage demands that could upset President Alfonsin's plans to cut Argentina's 400-percent inflation. The current labor demands follow real wage gains of nearly 22 percent for industrial workers last year and a further 12-percent nominal increase in January, which was later augmented to offset unexpectedly high inflation. We believe labor leaders probably calculate that attacking the government's wage policies will help them build opposition to Alfonsin's union reform legislation as well. The government is seeking new union elections, greater minority representation on union governing councils, and tighter controls over huge welfare funds to break the Peronists' longtime hold on labor. A Peronist-Conservative alliance in the Senate has stalled legislation on the reforms. [redacted] 25X1 25X1

To bolster labor support, Alfonsin has countered by decreeing several wage hikes and introducing other measures aimed at increasing working-class living standards. Moreover, Economy Minister Grinspun has stated his intention to raise real incomes by 6 to 8 percent this year. The danger in granting such wage concessions is that union leaders will continuously demand more wage hikes in an attempt to weaken Alfonsin's overall labor program, especially proposed reforms. Wage hikes unsupported by increased productivity will trigger another round of inflation. At the end of the last Peron government in 1975 and during the Bignone regime when inflation for September 1983 soared to an annual rate of 925 percent, high wage increases in response to heavy union pressures brought Argentina to the brink of economic collapse. [redacted]

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Communist

Cuba Seeks Increased Trade Credits From Argentina and Venezuela

[redacted]

Argentina and Venezuela are likely to expand credit lines to Havana this year, [redacted] The new Argentine Government signed an agreement with Cuba in December that increases Havana's line of credit for food products to \$104.5 million this year from \$67.5 million in 1983. Argentina and Cuba soon will begin negotiating a new one-year economic cooperation agreement that could include up to \$300 million in additional trade credits for capital goods and equipment [redacted] The existing agreement, which expires in June, provided Havana with \$114 million in such credits. [redacted] 25X1 25X1 25X1 25X1

The central banks of Venezuela and Cuba have tentatively agreed to establish a bilateral credit line of \$30 million in 1984 to promote trade, [redacted] Total trade turnover between the two countries in recent years has averaged only \$5 million and has been fairly balanced. The new agreement probaby will not include sugar and petroleum—Venezuela is self-sufficient in sugar, and Cuba receives all of its oil on Soviet account. Havana probably hopes to export rum and tobacco and may import fertilizer, iron and steel, and manufactured goods. [redacted] 25X1 25X1 25X1

Soviets Experiment With Consumer Services

[redacted]

The Soviet leadership announced in early February—a few days before Andropov died—that it would conduct an "experiment" to improve the provision of repair and personal care services for consumers. The initiative, limited to a few areas of the RSFSR with only 6 percent of the Soviet Union's population, is part of the long-term consumer goods and services program being developed for the 1986-90 Five-Year Plan. The experiment will include:

- A reduction in the number of targets that participating enterprises must meet.
- Greater freedom for these enterprises to use their profits.
- Broader use by larger service enterprises of labor brigades—small groups of workers paid according to their performance. 25X1
- Intensified recruitment of pensioners, housewives, and students for part-time work. [redacted] 25X1

The initiative is similar to the much-publicized experiment in five industrial ministries that began in January. Both experiments, although emphasizing greater enterprise autonomy, are cautious and involve no radical innovations. Furthermore, both are confined to a small portion of total activity in industry and services. They hold little promise for substantial improvements in consumer services any time soon. [redacted] 25X1

East Germany's Improved Financial Outlook

[redacted]

East Germany's financial prospects have been improved by East Berlin's success in running trade surpluses and by bankers' strengthened confidence that Bonn will serve as a lender of last resort. Last month the regime announced a "considerable" surplus in trade with nonsocialist countries in 1983, its third consecutive annual surplus after deficits throughout the 1970s. Figures of the Bank for International Settlements show that in the first nine months of 1983 East Germany's reserves rose nearly $1 billion, while its debt to Western banks fell by more than $600 million. Banker confidence also has been increased by Bonn's guarantee last year of a medium-term loan of DM 1 billion (about $400 million) and by the perception that it would provide help again if East Berlin needs money. Bankers remain wary about making long-term commitments, however, and they are providing only short-term loans. [redacted] 25X1 25X1

[redacted] 25X1

This year East Berlin should be able to cover estimated debt repayments of $3.6 billion, which is less than repayments in either of the last two years. The regime seems committed to reducing its debt further. It probably will be able to increase exports enough to accomplish this, while still increasing imports of key industrial products. East Berlin probably considers future economic deals with Bonn a good source of additional funds, despite its fears of becoming overly dependent on West Germany. [redacted] 25X1

China Offers Satellite Launch Services

China apparently intends to commercialize parts of its space program in the next several years [redacted] the Chinese have offered to sell launch services on their new CSL-X-3 space booster to the British. [redacted] the Chinese would be able to place between 1,000 and 1,200 kilograms into geostationary orbit at a cheaper cost than NASA could using the space shuttle or than the European Space Agency could using the Ariane. China has invested substantial sums in two new space launch facilities and in the CSL-X-3, which uses a liquid-hydrogen/liquid-oxygen third stage. The first launch of the CSL-X-3 late last month, however, failed to put its payload into the proper orbit. The CSL-X-3 closely resembles the Ariane booster, which had two failures in its first seven launches. [redacted] 25X1 25X1 25X1 25X1 25X1

The Chinese evidently believe that they will solve their problems with the CSL-X-3 and that they will be able to offer launch services at less than NASA's current price of $27 million for a satellite payload placed into geostationary orbit. A similar service using the Ariane would cost about $23 million. The Chinese, however, are likely to fulfill their own satellite launch requirements and establish a degree of reliability for the CSL-X-3 before they enter the launch services market. This process could take several years. [redacted] 25X1

International Financial Situation: Dropoff in Syndicated Lending 25X1

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

The volume of medium- and long-term syndicated loan commitments by commercial banks to LDCs totaled $44 billion in 1983, down about 25 percent from the previous year and the lowest level since 1980.[1] Banker concern about the world debt crisis was the major reason behind the cutback in new lending. The decline in bank lending, in turn, prompted large import cuts, devaluations, and accumulation of arrearages by debt-troubled countries.

The total interest cost on medium- and long-term syndicated loans was about 2.2 percentage points lower last year than in 1982. LIBOR fell from an average of 12.2 percent in 1982 to 9.6 percent in 1983. This decrease was offset, however, by a considerable widening of the average spread on these loans in 1983, rising by nearly 0.4 percentage point to 1.44 percentage points above LIBOR. Other lending terms for LDCs as a group remained about the same as the year before; the average maturity stayed at about six years, and banker fees ranged from 0.25 to 2.5 percent of the total amount of the loan.

Patterns in 1983

Several major patterns in syndicated lending were evident:

- About 40 percent of new medium- and long-term syndicated loans were tied to debt rescheduling packages. Nearly all of this "involuntary" lending went to Latin American debtors. Most other lending was provided to Asian and OPEC borrowers. 25X1

- Asian countries in general continued to attract the most favorable loan terms during 1983; India, Malaysia, and Thailand obtained spreads of less than 0.5 percentage point above LIBOR with eight- to nine-year maturities. Some large debtors in the region still considered fairly good credit risks—such as Indonesia and South Korea—were forced to accept higher spreads largely because of creditor nervousness about the Philippine and Latin American debt problems. 25X1

- LDCs drew down existing credits that had been committed in previous years to help make up for the shortfall in new loans. This trend began in late 1982 but probably has tailed off because the stock of undisbursed credits for many countries—particularly in Latin America—is not being replenished. 25X1

Borrowing by Key Countries

Latin American borrowers were the hardest hit in 1983. New syndicated lending by banks fell by about $6 billion overall, and nearly all countries had to pay loan spreads in excess of 2 percentage points. Argentina, Brazil, Chile, Mexico, and Peru had most of their new loans tied to IMF-mandated financial rescue packages during 1983. In addition, these five countries received the worst terms among all LDCs. Venezuela experienced the largest decline in loan volume last year; the $7.7 billion drop reflected banker reluctance to lend to Venezuela until debt renegotiations are completed and an economic stabilization program is in place. Colombia increased its borrowing last year but felt 25X1

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[1] These data cover only publicized loans and exclude repayments of existing credits. Moreover, not all new commitments are drawn down at the time they are signed. We estimate that medium- and long-term syndicated loans in recent years have accounted for 35 to 40 percent of total lending to all LDCs, although the share varies widely for individual countries.

LDC Loan Terms [a]

	Average Spreads (percentage points above LIBOR)		Average Maturities (years)	
	1982	1983	1982	1983
Total	**1.08**	**1.44**	**6**	**6**
Non-OPEC	1.15	1.64	7	6
Of which:				
Argentina	1.18	2.21	4	5
Brazil	1.89	2.12	9	6
Chile	1.28	2.25	7	7
Colombia	0.64	1.40	9	6
Hong Kong	1.46	1.13	4	7
India	0.45	0.47	9	8
Malaysia	0.39	0.49	10	9
Mexico	1.06	2.25	4	6
Peru	1.00	2.25	6	8
Philippines	0.85	1.05	10	8
South Korea	0.57	0.74	6	7
Thailand	0.50	0.38	10	8
OPEC	0.81	0.86	5	7
Of which:				
Algeria	0.56	0.59	7	8
Indonesia	0.46	0.75	10	9
Nigeria	0.99	0.82	9	8
Saudi Arabia	1.21	1.04	4	3
Venezuela	0.83	1.85	4	6

[a] Spreads are weighted by the amount and maturity of the loan. Maturities are weighted by the amount of the loan.

[redacted] 25X1

the impact of the region's problems as its average spread more than doubled. [redacted]

Most Asian debtors cut back the volume of new loans as they attempted to avoid the Latin American mistake of overborrowing. South Korea was the largest borrower in the region in 1983, but its total was $1.0 billion off that of 1982. Along with Malaysia and Thailand, South Korea was also able to increase its issues of foreign and international bonds at rates more favorable than on syndicated loans—an option no longer available to major Latin American borrowers. Indonesia was the only major Asian debtor to increase its syndicated borrowing, although it borrowed less than originally planned. The Philippines, which incurred major debt problems in mid-1983, received stiffer terms and few new loans in the second half. [redacted] 25X1

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Among other major LDC borrowers, Algeria sharply increased its syndicated loan total last year

LDC Syndicated Credits [a] *Billion US $*

	1982	1983
Total	**58.6**	**43.8**
Non-OPEC	42.3	35.9
Of which:		
Argentina	2.5	1.8
Brazil	6.9	9.2
Chile	1.3	1.4
Colombia	0.2	0.5
Hong Kong	1.7	1.2
India	1.1	0.9
Malaysia	2.3	1.6
Mexico	9.9	9.3
Peru	0.9	0.5
Philippines	1.4	0.9
South Korea	4.9	3.9
Thailand	0.4	0.4
OPEC	16.3	7.9
Of which:		
Algeria	0.5	1.9
Indonesia	1.7	2.1
Nigeria	1.5	0.8
Saudi Arabia	2.4	0.9
Venezuela	7.9	0.2

[a] Includes publicized medium- and long-term loans from commercial banks.

[redacted] 25X1

to $1.9 billion after intentionally limiting its borrowing since 1979. Nigeria's short-term debt problems reduced its access to medium- and long-term loans. [redacted] 25X1

Outlook for 1984

We expect the market for medium- and long-term syndicated loans to remain depressed this year. Much of the new lending—perhaps even more than last year—will continue to be linked with debt rescheduling packages and effectively will be involuntary. Because of their large loan exposures to commercial banks, we expect that the financing needs of the major debtors will be met. Smaller debtors whose external payments problems do not threaten the international financial system will have a harder time obtaining new syndicated loans. Average spreads may ease somewhat—as evidenced by the softer terms on the $3.8 billion loan for Mexico currently being syndicated—but probably not enough to be of great help to the debtors. [redacted] 25X1

[redacted] 25X1

International Financial Situation: Political Update

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

The political climate in the debt-troubled countries does not appear to have deteriorated over the past month, but neither has it improved. The situation remains particularly volatile in the Philippines—where President Marcos is resisting pressure to make political concessions to the opposition—and in Nigeria—where General Buhari is trying to avoid provoking a countercoup. In South America, political activity revolved around both economic policies and presidential elections.

President Marcos is presumably encouraged by the continuing splits among **Philippine** opposition groups on whether or not to boycott the May National Assembly elections, hoping that there will be sufficient opposition participation to make them look credible. **Nigeria's** General Buhari continues to purge corrupt military and police officials, in part to appease younger officers. The handling of the impending trials of former top civilian officials and the punishments given them entail considerable risk for Buhari, especially if junior officers conclude that the officials have been let off too lightly.

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Peronists and the Conservatives have thus far blocked **Argentine** President Alfonsin's proposals in Congress for labor union reforms such as new union elections and tighter controls over huge welfare funds. In addition, two rival factions of the Peronist-dominated union movement have agreed to work together, according to press reports, and are organizing opposition sentiment among workers. Several unions have called strikes, and on 11 and 12 February about 10,000 workers demonstrated in Buenos Aires. Alfonsin has countered by decreeing several wage increases and taking a tough stand against strikers, including threats to arrest union leaders. We believe Alfonsin will continue to negotiate with the Peronists, but new union elections are essential to his plans to curb the unions' opposition to future reforms. Workers will be returning from summer vacations later this month, and Peronists will no doubt increase their calls for protests if Alfonsin cannot further reduce inflation or grant additional wage hikes.

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In **Bolivia,** President Siles continues to lurch from crisis to crisis. The US Embassy reports that his recent capitulation to demands by labor for higher wages and price controls led to a shutdown by almost all private businesses on 6 and 7 February. On 15 February, according to press reports, civil servants went on a 48-hour strike, and miners blocked roads demanding additional wage increases. In addition, Siles's failure to change any of the important portfolios in a cabinet reorganization in January led the Congress—for the second time in two months—to censure him for his autocratic rule and his mismanagement of the economy. Siles recently relieved some pressure on his government by assigning armed forces

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Political unrest in **Brazil** has centered on demands for the next president to be elected by popular vote rather than a government-controlled electoral college. Last week after President Figueiredo reaffirmed his commitment to the indirect method in the election scheduled for January 1985, demonstrators marched through downtown Rio de Janeiro. According to press reports, more than 200,000 demonstrated in Sao Paulo in late January to demand the return of direct elections.

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In **Ecuador,** a May runoff in the race for president will pit a center-leftist against a Conservative with strong support from the military. Rodrigo Borja, the center-leftist, has advocated more government intervention and social spending, while Conservative Leon Febres Cordero, who finished a close second in the first vote, has supported a free market approach and austerity measures. [redacted] 25X1

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[redacted] We believe the clear-cut ideological choice between the two men will polarize the voters, making it more difficult to develop a nonpartisan approach to Ecuador's economic problems. One of the first items on the new president's agenda will be negotiations for an IMF accord. [redacted] 25X1

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[redacted] 25X1

Iraq: War-Induced Austerity Grips Economy [redacted] 25X1

Iraq is trapped in a costly war of attrition with Iran that is straining its economy. On the threshold of an oil-driven economic takeoff before the war, Baghdad has seen its oil earnings and foreign exchange reserves plummet. The regime has slashed imports, virtually abandoned its development program, and even terminated combat pay. It now depends on foreign aid and credits to stay financially afloat. Despite Iraq's desire to end the war because of economic problems and growing casualties, a relentless enemy is pressing President Saddam Husayn to escalate fighting. [redacted]

Iraq's economic situation may stabilize in 1984, but its financial problems are far from solved. We believe the Gulf states and Western creditors will provide help for Iraq to meet basic import needs in 1984. If, however, they are not as generous as in 1983, imports will have to be reduced further, thereby increasing consumer dissatisfaction. Iraq's prospects for increasing revenues by opening new oil outlets through Saudi Arabia or Jordan this year are remote. The only positive development will be an increase in the capacity of the Turkish pipeline expected in April. The populace seems resigned to the economic situation for now but the austerity program has the potential to create political problems for Saddam. [redacted]

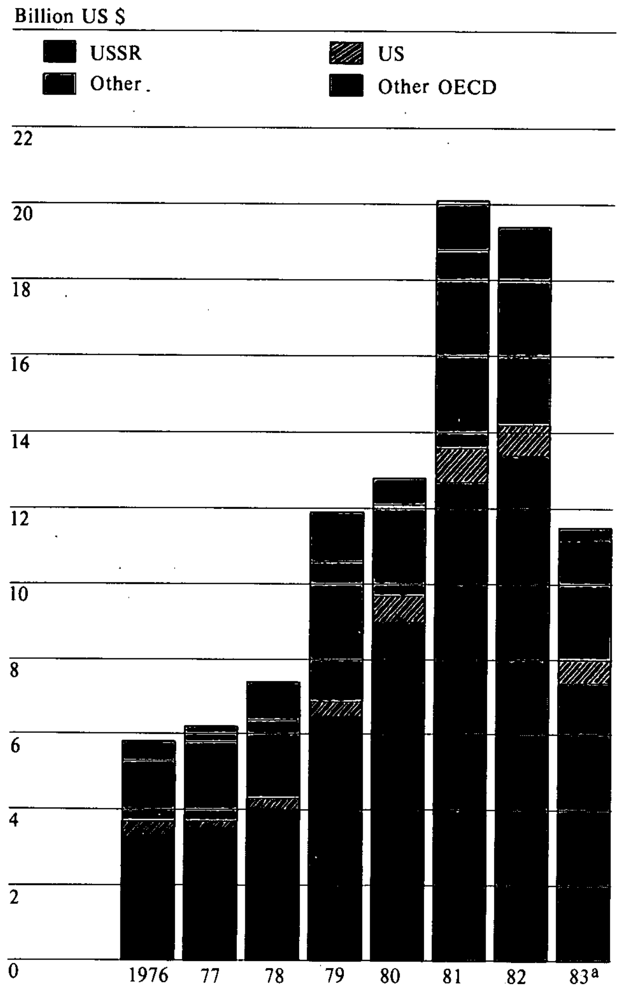
Harder Times at Home

The war is affecting all aspects of economic life. The government has all but abandoned its economic development program. This is a sharp reversal from the guns-*and*-butter approach maintained during the first year of the war. Baghdad has canceled nearly all new contracts not related to the military effort or the petroleum sector and postponed several nonessential projects already under way, according to the US Interests Section. As a result, many projects stand idle, including housing, hospitals, and irrigation work. Among the few projects where work is continuing are two $1 billion power plants at Al Yusufiyah and the $3.5 billion Baghdad–Umm Qasr railroad. In our view, the slowdown or cancellation of most infrastructure development will set back by several years Iraq's plans for rapid industrialization and import substitution. [redacted] 25X1

Although most basic needs are still met, the Iraqi consumer increasingly has been squeezed. As a result of Baghdad's sharp clampdown on imports— 25X1 some $11-12 billion last year compared with $19 billion in 1982—imported staples are more frequently scarce or exorbitantly priced. The list of scarce commodities in government shops often includes dairy products, eggs, sugar, cooking oil, and potatoes. Shortages also exist for automobile spare parts, cigarettes, and beer, as well as most luxury goods. Gasoline queues have cropped up because military fuel demands take priority; according to press reports, gas stations at times have been guarded by armed soldiers. [redacted] 25X1

The shortages have fostered a thriving black market and are fueling inflation that we estimate could be as high as 50 percent annually. Eggs, for example, now cost about $19 a dozen, and mutton, 25X1 an important meat in the Iraqi diet, brings about $7 per pound, according to the Interests Section. Many scarce items are available only to those with connections with the Army, the Ba'th Party, or the local shopkeeper. Hoarding has worsened immediate shortages as consumers respond to an uncertain future and growing rumors of government rationing. [redacted] private 25X1 retailers are holding back goods in anticipation of future shortages, higher prices, or to save them for favored customers. [redacted] 25X1

Iraq: Civilian Import Trends, f.o.b., 1976-83



aEstimated; based on partial third-quarter trade data.

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Pent-up frustrations with the war and its impact on the economy occasionally have surfaced. Sources of the Interests Section claim that members of the National Assembly, Saddam's rubberstamp parliament, have criticized exorbitant prices in the private sector. Late last year, buyers at a dairy outlet shouted antigovernment chants when the Army took the day's supply of dairy products, according to an unconfirmed report to the Interests Section. So far, however, the decline in the standard of living has not resulted in sufficient public resentment to threaten the regime. 25X1

Consumer Policies

To stem discontent, the regime is struggling to improve the economic situation. The regime so far has rejected comprehensive rationing. Administering a national rationing scheme efficiently and equitably would overextend a bureaucracy already strained by manpower requirements for the war. Baghdad, however, has had to restrict the sale of certain commodities. The government began issuing coupons for oil and gas products last October, according to the local press. The government reportedly is limiting electricity use in Baghdad. Moreover, the regime is introducing "specialized agencies" to distribute milk products produced by public-sector dairies. 25X1

The government is relying on local citizens' organizations to discourage hoarding and at the same time deflect criticism from the regime. Baghdad is using People's Councils—government-created citizens' groups in various urban areas—to monitor private shop deliveries and sales. Local observers report that People's Councils in Baghdad have given away to local neighborhoods goods confiscated from shopkeepers accused of hoarding. Some councils are using identity cards to restrict sales to customers living in their areas. 25X1
in some rural villages, the local manager of the government store distributes food based on his personal interpretation of the requirements of the local inhabitants. 25X1 25X1

The regime has adopted other measures that we believe are testing popular resolve. Baghdad apparently has increased income taxes for wage earners to help finance the war and has launched a campaign to collect "voluntary" gold contributions from a reluctant citizenry. According to the Interests Section, the government has resorted to using teams of Ba'th Party militia for unannounced nighttime gold collections. 25X1

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Other steps Baghdad has taken highlight the severity of its foreign exchange dilemma. Baghdad has restricted the amounts of foreign exchange that the large community of foreign workers can repatriate as well as jobs they may hold. These controls are hastening the flight of foreign labor and compounding a chronic shortage of skilled manpower. Women increasingly are used to fill the labor gap. The government has reduced salaries and benefits of its diplomats and closed several smaller embassies, with a commensurate decline in morale among Foreign Ministry employees. Perhaps even a more significant move was Saddam's decision last October to terminate combat pay for all military personnel, a particularly risky move considering Iranian attacks along the border. [redacted]

The Oil Question

[redacted]

Iraq is searching for alternative export routes, but has had only limited success. Heading the list is a program to expand the capacity of the Iraq-Turkey pipeline. According to Iraqi officials, the line now can carry 900,000 b/d of crude oil and will reach its planned maximum capacity of 1 million b/d by this summer. Although isolated incidents of sabotage since 1980 have caused only brief closures, the 980-km-long line is still extremely vulnerable to terrorists or commando-type attack. [redacted]

Other options—all longer term—include oil pipelines through Saudi Arabia, Jordan, and Turkey. Negotiations are under way with Riyadh to build a spur capable of moving up to 500,000 b/d of oil to Petroline, the Saudi pipeline to the Red Sea. The spur would take advantage of unused capacity in Petroline—currently above 1 million b/d—and could also be the first part of a project involving a separate Iraqi line with a volume of 1.5-2 million b/d parallel to Petroline. [redacted] 25X1

The Saudis, however, fear a separate pipeline will ultimately cause friction between themselves and Baghdad and become a target for Iranian military action. While senior Saudi officials have given public support to the project, [redacted] We believe the Saudis will delay the project. [redacted]

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The proposed pipeline across Jordan to the Red Sea port of Al Aqabah is only at the feasibility study stage. According to Embassy reporting, estimates of construction time run from 16 months to three years, with a cost of at least $1 billion and a capacity we believe would be up to 1.5 million b/d. As for a new Turkish line, Embassy reports indicate that Baghdad and Ankara signed a preliminary protocol late last year to study the construction of a liquefied petroleum gas pipeline that would parallel the existing crude oil line to the Mediterranean. [redacted] 25X1

The Outlook for 1984

Despite the prospect for only a marginal increase in oil sales, Baghdad will probably get enough foreign help to meet its basic import needs in 1984. These will include grain imports necessary to meet about half of domestic grain consumption. The Gulf states' oil sales are not likely to recover enough to prompt substantial increases in their direct financial aid to Iraq over last year's level of around $1.5 billion unless they perceive real danger to Iraqi political stability. The Gulf states, however, will continue to sell oil on Iraq's behalf. Commercial banks probably will refrain from giving major long-term loans to Iraq while the war continues. [redacted] 25X1

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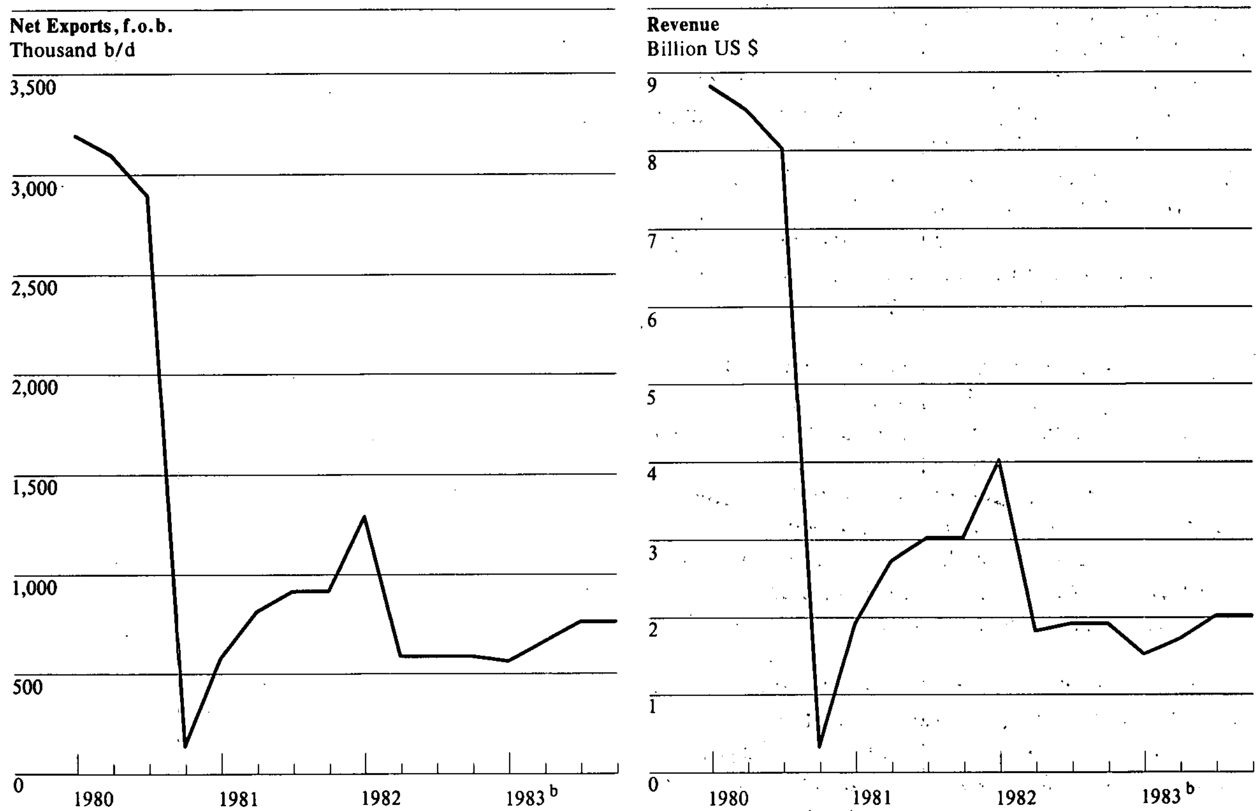
Iraq: Oil Exports and Revenues, 1980-83[a]



[a] Quarterly data.
[b] Fourth quarter estimated.

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Iraq probably will be able to obtain enough trade credits to match last year's level. Baghdad has lined up at least $500 million in credits from several countries including Austria, the United Kingdom, West Germany, and Australia, according to the US Interests Section and the press. Iraq will continue to negotiate with other countries, especially France and West Germany, for more deferred payments, but it is likely to encounter resistance. Moreover, should Baghdad renege on 1983 payments due in 1984, this will probably cause many creditors to shy away from new loans.

Iraq's economic problems probably will not be enough to loosen Saddam's tenacious hold on power. Instead, we believe growing war weariness among the populace and declining morale in the military will pose a more serious threat in the months ahead. If his ability to attract popular support significantly wanes, he will resort to repressive measures to maintain control. 25X1

Implications for the United States

Improving relations with the United States is an important part of Iraq's diplomatic strategy to alleviate its economic difficulties and end the war. Iraq believes US leadership is needed to elicit increased support for Baghdad, particularly additional financial assistance from the Gulf states and Western creditors. Baghdad probably will even seek economic help from Washington. 25X1

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Closer ties with Washington will not translate into a cooling off of the Iraqi-Soviet relationship. Baghdad and Moscow signed a comprehensive trade agreement last November that gives the Soviets an expanded role in Iraq's petroleum and development projects. Iraq's sizable arms deals also ensure Baghdad's dependence on the Soviets. Moscow probably will try to use closer military cooperation with Baghdad as an entree for expanding its political influence in Iraq—especially now that Soviet relations with Iran have soured. 25X1

Baghdad, for its part, will remain distrustful of Soviet intentions and will prevent any spread of Soviet interference in Iraqi internal politics—especially attempts to strengthen Communist Party influence in Iraq. Baghdad has warned the Soviets not to attempt to parlay its dependence on arms into a strategic alliance. Moreover, Baghdad has not forgotten Moscow's refusal to ship arms to Iraq during the first six months of the war. 25X1

If Iraq cannot somehow ease economic and military pressures, it may escalate the war in the Gulf, threatening oil exports vital to the West. Baghdad's attacks on oil tankers servicing Iran and the recent attack on a petrochemical plant at Bandar-e Khomeyni represent major attempts to break the economic stranglehold. The Iraqis, we believe, are prepared to make good on their threat to cut off Iranian oil exports in the hope that this will force Iran into negotiations to end the war. Baghdad's threats also may be used as leverage to obtain substantial increases in subsidies from the Saudis and other moderate Gulf states. More realistically, however, the Iraqis probably would count on major Western powers to intervene to stop an escalation of the war and enable Iraq to resume exporting oil from its Gulf ports. 25X1

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West Germany: Focus on Economic Policy 25X1

On the eve of Economic Minister Lambsdorff's visit to the United States, West German economic indicators are almost uniformly positive. The Kohl government is being criticized, however, for failure to bring about longer term structural changes needed to sustain economic growth. Business and union leaders complain of a rudderless economic policy, and respected economic research institutes accuse the government of lacking the political will to tackle the economy's fundamental problems. Even elements within Kohl's own center-right coalition question the government's ability to deal with the country's economic ills. 25X1

After 1.3-percent real GNP growth in 1983, forecasts for 1984 cluster in the 2.5- to 3.0-percent range—a much rosier outlook than expected even as recently as last fall. Inflation should remain near the 3-percent level of 1983, while last year's comfortable $3.3 billion current account surplus will benefit from a resurgence in exports, and we project the surplus will probably reach $5 billion in 1984. Even West Germany's most intractable economic problem—unemployment—could ease slightly. 25X1

From INF to GNP

With the initial INF basing debate in West Germany now over, attention in and out of government is focusing on the economy. The government of Chancellor Helmut Kohl had acted quickly after taking office in October 1982, enacting sizable tax increases and social benefit cuts that dramatically reduced budget deficits. Over the past year, each new economic forecast has been cheerier than the one before. Nevertheless, the government's much-proclaimed economic revival has not fully materialized. Kohl campaigned on a pledge to restore confidence and incentives to an economy burdened by too much government, an unaffordable social welfare system, and increasingly viewed as unable to adapt to economic and technological change. 25X1

Since Kohl's initial round of tax hikes and social benefit cuts, the government has taken few steps to boost the economy:

- A committee has been formed to look into reducing bureaucratic and regulatory burdens. Regulations governing the construction industry, occupational health and safety, and dismissal of employees are likely targets for eventual change.
- Another committee is to recommend badly needed improvements in West Germany's financial markets. Legislation reportedly will be introduced soon to promote venture capital, and some taxes on new stock issues have been eliminated.
- Legislation promoting retirement at age 59 instead of 60 helped take the wind out of labor's campaign for the 35-hour workweek.
- A small-scale denationalization program began last month with the reduction of the government stake in the oil firm Veba AG from 44 to 25 percent. More sales are promised but probably will not occur this year. 25X1

We believe West German business perceives a sense of drift in economic policy as the government fails to follow up on its initial round of tax hikes and spending cuts. Business unease has been fostered by:

- Kohl's acknowledged lack of economic expertise.
- His inability to project an image of strong leadership.
- Government vacillation over issues such as tax reform and overhaul of the ponderous social welfare system.

- Intracoalition bickering reminiscent of the last days of the Schmidt government.
- The uncertain fate of Economics Minister Lambsdorff.

Lambsdorff was indicted in November for allegedly granting tax breaks to the Flick concern, West Germany's largest private holding company, in exchange for campaign contributions to his Free Democratic Party (FDP). He almost certainly will resign once formal court proceedings begin in the next few months. The first Bonn Cabinet minister ever indicted, Lambsdorff is a longtime champion of free enterprise and has been a key architect of
25X6 economic policy under both the Kohl and Schmidt governments.

Other Setbacks

In addition to the Lambsdorff affair, Kohl has been buffeted by a succession of setbacks to his economic policy:

- A merger of West German steel giants Thyssen and Krupp collapsed in November when the government's final offer of $185 million in aid was rejected as insufficient. The rebuff was a sharp blow to Kohl and the slumping steel industry. Kohl had intervened personally to thrash out the plan, which was the crux of government efforts to restructure a sector hurt by weak demand and cheap imports.

- At the same time, a major corporate and banking crisis occured when IBH Holding, one of the world's largest construction companies, filed for bankruptcy. This sparked anxiety about the West German economy and contributed to the weakness of the deutsche mark. 25X1

- West German labor may be shifting away from the moderation in wage demands and strikes that has been a major factor in West German economic strength. Last October the Metalworkers Union, West Germany's largest union with 2.6 million members and a pacesetter for the rest of organized labor, announced that it was mobilizing to achieve the 35-hour workweek. In acrimonious debate with management since then, labor has demonstrated a new militancy in the face of firm employer resistance. Government and business leaders alike fear that serious industrial disputes this spring could threaten the nation's nascent economic recovery. A recent poll, however, shows a sharp drop in worker support for the shorter workweek, which may cause the union to change its strategy. 25X1 25X1

Criticism From Without and Within

West Germany's five major economic research institutes acknowledged in last fall's joint report that the economy has picked up more rapidly than they thought possible. Still, they expect the recovery to be short lived because of unresolved structural problems. Indeed, even the institutes' projections of 2.5-percent real GNP growth in 1984 show the expansion decelerating over the course of the year. The institutes believe business generally lacks confidence because Bonn has not made the changes it led business to expect. Subsidies to ailing industries, taxation, and bureaucracy actually have increased, according to the institutes, discouraging investment and initiative. 25X1

Private consumption led the recovery in first-half 1983. Consumers more than offset a decline in real

West Germany: Economic Outlook *Percent change, except where noted*

	1983	1984 Projections	
		Council of Economic Experts	CIA Model
Real GNP	1.3	2.5	3.0
Private consumption	0.8	1.5	1.9
Government consumption	−0.6	0.5	−0.1
Investment	2.9	6.5	5.8
Equipment	5.0	5.5	6.7
Construction	1.6	7.0	5.2
Exports of goods and services	1.0	4.0	5.6
Imports of goods and services	0.4	4.5	3.3
Consumer prices	3.0	3.0	2.7
Current account surplus *(billion US $)*	3.3	NA	5.0

disposable income by turning to savings and credit to fund autos and consumer-durable purchases postponed during the recession. The miniboom in consumption now has fizzled but has been replaced by strong investment, which averaged 2.9-percent real growth in 1983 and should grow about 6 percent this year. The crucial question in the near term for investment and the recovery, according to the institutes, is how much of the increase in investment results from one-time government stimuli—monetary expansion, an investment tax credit, and housing programs—and how much stems from more sustainable factors such as lower interest rates, higher profits, and expectations of increased sales.

A number of government coalition leaders and party rank-and-file elements lack confidence in Bonn's economic policy. They worry that, should the recovery founder and unemployment resume its climb, the government could be unseated by the Social Democrats (SPD) in 1987. Lambsdorff has said the election will hang on the economy's performance. Government support among workers is particularly vulnerable because they have been hit in the pocketbook by austere budget measures. Criticism from within Kohl's own party began last August when Lower Saxony's Minister President Ernst Albrecht, a highly respected CDU moderate, published a paper critical of government economic policy. Albrecht wrote that neither self-sustaining economic growth nor a reduction in unemployment would be achieved by the measures taken by the government. He cited overtaxation, bureaucracy and regulation, inadequate corporate profits, and excessive labor costs—particularly employers' social welfare contributions—among the problems that needed urgent attention. 25X1

On the Brighter Side

The most upbeat analysis of near-term economic prospects thus far came close on the heels of the joint institute report, when the Council of Economic Experts presented its annual submission to the government in late November. 25X1 Although the five-member Council—composed largely of prominent university economics professors and known as the Five Wise Men—officially projected growth of 2.5 percent, it asserted that 3-percent real growth is attainable this year with exports and investment playing leading roles. In general, the Council seems determined to counteract a prevailing pessimism in West Germany, which it believes has hurt investment. Even the Council, however, states that not enough has been done to dismantle obstacles to economic growth. 25X1

The most welcome and surprising aspect of the economic rebound for the Kohl government is the recent leveling off in unemployment. Although the seasonally adjusted level of joblessness—2.2 million 25X1 or 9 percent of the labor force—remains near a record, it has been inching downward since August, ending a 42-month unbroken climb. Government and labor union analysts have long believed that real growth on the order of 6 percent a year would be necessary to substantially reduce unemployment in the 1980s because of rapid labor force expansion. Now most forecasters—including the Five Wise Men—see unemployment holding or declining slightly this year. [redacted] 25X1

Outlook

Kohl is not now in trouble. His government has garnered the credit for reversing the trend toward ballooning federal deficits, and polls show that, if an election were held today, the Christian Democrats would do almost as well as in the election last March. Kohl, however, can no longer blame the former government for the country's economic ills and is vulnerable to criticism over the absence of a comprehensive and convincing economic game plan. [redacted] 25X1

The government is well aware of the need for structural change in the economy, and we believe Kohl realizes his political future in large part rides on his perceived handling of the economy. The strengthening recovery offers an opportunity to begin implementing a medium- and long-term economic strategy. Kohl would like to introduce such a strategy at the CDU congress this May, according to a press report. Decisive action on the economy will not come easily, however, given the sidelining of key player Lambsdorff, coalition strife over the timing of tax reform and other issues, and Kohl's reluctance to involve himself in disputes. [redacted] 25X1

[redacted] 25X1

North-South Issues: Prospects in 1984

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We believe the developing countries will continue to press their demands for a New International Economic Order (NIEO) this year despite their inability to make significant progress on it during the past decade. In our judgment, they will cling to the NIEO because it represents their vision of an egalitarian world order, unites them by consolidating their economic demands into one proposal, and places principal blame for their economic difficulties on external rather than internal factors. The developing countries particularly will focus on four North-South issues in 1984: ratification of the Common Fund, the convocation of an international monetary conference, the launching of Global Negotiations, and the enactment of 39 "immediate measures" for reform of the specialized agencies in the United Nations, particularly the IMF.

The Common Fund

The Common Fund obliges participating nations to make prorated financial contributions to a central body that would intervene in commodity markets in an effort to increase the revenue of developing countries. The Common Fund would embrace as many as 18 nonfuel commodities, five of which are already covered by price-stabilizing international commodity organizations. For the Common Fund to become operative, 90 ratifications and direct capital contributions of $313 million are needed. As of late 1983, 110 countries, including the United States, had signed the agreement, but only 64 nations accounting for $195 million in contributions had ratified it. The countries that have ratified probably will meet this spring to set a deadline by which the agreement must enter into force or be scrapped. It appears likely that enough new ratifications will be forthcoming this year to make the agreement's fate contingent on the United States, which is slated to make the largest capital contribution, $74 million

We expect the other major industrial countries will press the United States at the June 1984 London Economic Summit to ratify the Common Fund. In our judgment, the setting of a deadline in conjunction with the expected new ratifications will make the Common Fund a high-profile issue around the time of the summit. Four summit participants—Japan, Great Britain, France, and Canada—have ratified the agreement while two others, West Germany and Italy, have begun ratification procedures. We believe our summit partners will see the Common Fund as an opportunity to enhance their image with the Third World. It has great symbolic value because it would be the first part of the NIEO to become operative and entails only a small direct expense for the other summit countries ranging from $11 million in direct capital contributions for Canada to $34 million for Japan. We expect Japan to take the lead in lobbying for the Common Fund at the summit. It played a similar role at UNCTAD VI in June 1983. According to US Embassy reporting, Tokyo sees its stand on the Common Fund as an important element in its relationship with Malaysia, the Philippines, and Indonesia—all supporters of the agreement.

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An International Monetary Conference

At the March 1983 Nonaligned Summit in New Delhi, the developing countries called for an international monetary conference to negotiate the financial issues contained in the NIEO. The proposed conference would have universal participation and focus on "reforming" the IMF. The conference, however, would not be held under the auspices of the IMF where the industrial countries have effective control. At the May 1983 Williamsburg Economic Summit, the seven major industrial countries, prompted by France, said that

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The New International Economic Order

The NIEO presumes that sustained economic growth in the developing countries can occur only through a massive North to South transfer of wealth and dramatically increased Third World power in international economic institutions. It focuses on changes in five areas: money, trade, commodities, aid, and energy.

Money:
- *The IMF's system of tying a member's voting strength to its financial contribution should be altered so that the LDCs can have voting power commensurate with their numbers.*
- *The IMF should create large new quantities of Special Drawing Rights, mostly to be allocated to the developing countries.*
- *The IMF should relax the conditionality it attaches to its loans so as not to conflict with a member's national economic program.*
- *The IMF should use its loans to encourage expansion in domestic production rather than correcting foreign payments problems.*
- *Stable exchange rates should be created through the use of target zones and guidelines supervised by the IMF.*
- *The IMF should expand its resources by borrowing from capital markets and linking increases in its quotas to growth in world trade and payments.*

Trade:
- *Industrial countries should increase nonreciprocal trade preferences for the LDCs.*
- *The industrial countries should dismantle protectionist barriers to Third World exports.*
- *The industrial nations should phase out their aging industries so that LDCs can expand their market shares.*
- *GATT and UNCTAD should engage in more joint activities and eventually merge.* 25X1

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Commodities:
- *Enactment of the Common Fund.*
- *Industrial nations should assist the LDCs to increase their participation in the processing, marketing, and distribution of their commodities.*
- *Prices of commodities the LDCs export to the industrialized countries should be linked to the prices of manufactured goods the LDCs import from the industrialized countries.* 25X1

Energy:
- *The World Bank should establish an energy affiliate to finance Third World energy projects.*
- *The industrial nations should transfer energy-related technology to the LDCs.* 25X1

Aid:
- *Industrial nations should donate 0.7 percent of their GNP to the LDCs in foreign aid; the aid should be assured, continuous, and automatic.* 25X1

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they would invite finance ministers from unspecified countries and the head of the IMF to consider the possibility of a high-level monetary conference. Subsequently, India, the chairman of the Non-aligned Movement, publicly implored the industrial nations to enter into a dialogue with the developing countries on the organization of a monetary conference. The developing countries tried unsuccessfully at UNCTAD VI and the fall 1983 UN General Assembly session to gain the industrial nations' approval for resolutions that incorporated language on a monetary conference from both the New Delhi and Williamsburg communiques. 25X1

We believe the developing countries will make a major effort in 1984 to initiate preparations for a monetary conference. We expect they will try to formulate a UN resolution that would commit the industrial nations to the convocation of a conference. Press reports indicate that they have established a group of experts to work out the details of their proposal. The developing countries hope to keep alive the idea of a conference and to be prepared with their own proposals should the industrial countries decide to hold high-level discussions on monetary reform. [redacted]

We doubt that a Third World proposal for a monetary conference will win significant support from the EC and Japan. The major industrial nations have made clear that discussion of a monetary conference must start in the IMF's Group of 10, which they dominate. Most industrial nations have little interest in a conference addressing their own monetary problems much less one focusing on Third World concerns [redacted]

Global Negotiations

We believe the so-called Global Negotiations, which the developing countries first proposed in 1979, will be a secondary issue in 1984. Global Negotiations would involve recommendations by the Third World–dominated UN General Assembly on trade, aid, energy, commodities, and finance to the UN's specialized agencies, such as the IMF, the World Bank, and GATT. The industrial and developing countries have been unable to agree on a General Assembly resolution that would launch Global Negotiations. In an attempt to break the impasse, the developing countries proposed at the fall 1983 session of the General Assembly that Global Negotiations be separated into two stages. This approach would postpone discussion of the two thorniest issues, energy and finance, so that negotiation of the less controversial issues could begin. The developing countries, however, have not yet offered details on how the two-stage approach would work. [redacted]

Immediate Measures

[redacted] developing countries concluded at the March 1983 Nonaligned Summit that Global Negotiations were unlikely to bring progress on the NIEO in the near future. Consequently, they formulated 39 "immediate measures" that they want to pursue in the IMF, the World Bank, GATT, and other UN specialized agencies. The measures are virtually identical to the NIEO demands and call for the IMF and World Bank to transfer funds quickly to the developing countries. 25X1 The developing nations say that the immediate measures are meant to supplement, not replace, Global Negotiations. [redacted] 25X1

We doubt the EC and Japan will urge the United States to consider the immediate measures. These proposals require substantial short-term resource transfers, and we have no evidence that any major industrial country is prepared to make them. The developing countries pressed for the immediate 25X1 measures at UNCTAD VI and the September 1983 IMF/World Bank meetings, but the industrial nations refused to make substantive concessions. [redacted] 25X1

The Soviet Union and the North-South Dialogue

The Soviet Union has used North-South forums to try to win Third World sympathy for its positions on East-West issues. At UNCTAD VI, for example, the Soviets claimed that the United States was diverting aid into arms expenditures and that US sanctions on East-West trade were limiting Soviet access to hard currency and thus curtailing Moscow's ability to aid the developing countries. Despite such claims, the US delegation to the conference reported that the Soviet Union did not enhance its image with the developing countries by emphasizing East-West issues. [redacted] 25X1

The Soviet Union is committed to bilateralism in its relations with developing countries and stead- 25X1 fastly refuses to enter into the types of multilateral agreements called for in Third World demands. For example, Moscow has:

- Not signed the Common Fund.
- Not established a generalized system of trade 25X1 preferences for developing countries.
- Declined to join any of the multilateral aid institutions. [redacted] 25X1

The Soviet Union endorses the Third World's call for the NIEO but avoids participation in North-South negotiations that involve the transfer of wealth. Moscow uses forums such as UNCTAD and the UN Economic and Social Council to back the NIEO's assertion that Third World poverty is largely a result of colonialism and Western exploitation. It claims that as a noncolonial, socialist state, it bears no responsibility for the Third World's plight.

In our opinion, the developing countries have discounted the Soviet Union as a factor in the North-South dialogue. We believe they have done so partly because the Soviet Union is not a member of the three international economic institutions they want to change most—the IMF, the World Bank, and GATT. Furthermore, the Soviet refusal to engage in multilateral trade and aid negotiations is so firm that we believe the developing countries doubt they can ever change Soviet policy. In our judgment, the developing countries occasionally will criticize the Soviet Union for not helping them more, as they did at UNCTAD VI, but will continue to fix virtually all of their attention on the wealthy industrialized countries.

An International Financial Crisis: The Potential Wildcard

While we believe continued stalemate will mark North-South discussions this year, a dramatically different alternative scenario cannot be ruled out. The whole tenor of North-South relations could shift markedly in the event of a financial crisis induced either by the default of a major debtor or by a major shock to the world economy such as an oil price runup caused by interruption of Persian Gulf oil supplies. We believe that some LDCs might think the Third World as a group has sufficient bargaining power to coerce the industrialized countries into making real concessions on the NIEO.

Following the 1973/74 oil price hikes, the LDCs believed that they could use OPEC's leverage and the West's concern about oil supply and price stability to secure the economic and political concessions included in the NIEO. The tactic failed principally because OPEC was neither willing nor able to use what leverage it had to help poorer Third World countries at the North-South bargaining table. We believe that, in the event of international financial crisis precipitated by a debt default or world oil shortage, some LDCs could try again to link the NIEO with their cooperation in managing the crisis. 25X1

25X1

Should a global financial crisis occur, some LDCs would try to convince the industrial countries that they need the cooperation of Third World debtors to contain the serious economic and political dislocations an international financial crisis would cause. Nicaragua and Ecuador, which have already proposed unified action on debt, could again raise that possibility in an attempt to link Third World debt directly to economic and political concessions. Although the major Third World debtors have repeatedly blocked proposals to create a debtors' cartel, the more radical Third World states may believe that the industrial powers would be willing to grant concessions in a crisis rather than risk even more uncertainty. We believe, however, the major debtors such as Mexico, Brazil, and Argentina, with a greater stake in the financial system, are unlikely to risk their national financial interests by supporting confrontational Third World tactics in the midst of a crisis. 25X1

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Soviet Education To Accent Vocational Training 25X1

A Politburo commission studying the Soviet educational system last month issued comprehensive proposals that call for increased vocational training and recommends a restructuring of the general education system so that children start school one year earlier. Not only are the Soviets seeking to make a larger proportion of youth available for employment at an earlier age, but they hope to increase the number of skilled workers and improve the match between job openings and suitably trained personnel. The proposed changes are intended primarily to help offset the decrease in the number of young people who will enter the labor force during the 1980s and are in line with the traditional Soviet educational policy of giving priority to meeting short-term manpower needs. The price for the immediate gains, however, could be a long-run reduction in the supply of highly trained manpower.

Past and Present Emphasis on Vocational Education

The current proposals to expand vocational education are a continuation of an earlier policy that has had little success. In December 1977 the Council of Ministers, in anticipation of declining increments to the labor force, adopted a resolution calling for an increase in vocational training in secondary schools. Such training was to increase from two to four hours weekly, curricula and textbooks were to have a more practical orientation, and material deemed to be "of secondary importance" was to be eliminated. The resolution was designed to make secondary school graduates better suited to the economy's immediate needs without abandoning the government's commitment to universal secondary education. The draft proposals reiterate the provisions of this resolution, calling for further streamlining of the academic curriculum, "stepping up the polytechnical thrust of the content of education," and increasing the time spent on labor training. 25X1

The emphasis on vocational education since 1977 has not worked out as planned. Between 1975 and 1980 there was little increase in the proportion of eighth-grade graduates entering specialized secondary or vocational-technical schools. The regime wanted to reduce the number of youths choosing the academic track, not only to increase the number being trained in specific skills and for specific trades, but because, as Soviet surveys have indicated, 15-year-olds are more willing to take blue-collar jobs than 17- or 18-year-olds. 25X1

Since 1977, Soviet educators have staged a massive public relations campaign to raise the prestige of wageworker occupations and to steer students away 25X1 from a college-bound track, the traditional path of upward mobility in Soviet society. The State Committee for Labor and Social Problems has been tasked with directing an ambitious program of career counseling for students about to enter a secondary school program. 25X1

Reform Likely To Have Limited Impact

Many of the commission's proposals have been made before, but issuing a comprehensive reform program suggests a willingness heretofore lacking in allocating the resources required to reform the educational system. Among the commissions recommendations are:

- A one-year course in secondary vocational-technical schools or a two- to three-year course in

Distribution of Eighth-Grade Graduates *Percent*

Year	Entered Work Force	Admitted to Full-Time Study		
		Vocational-Technical	General Secondary	Specialized Secondary
1965	42.5	12.3	40.0	5.2
1975	2.3	31.6	60.9	5.2
1980	0.5	33.1	60.2	6.2

25X1

specialized secondary schools for secondary school graduates who want more advanced technical training.

- Gradually integrating six-year-olds into general education schools beginning in 1986 as teachers and programs become available. The purposes are to lighten the academic load for children in the primary grades, allow for an emphasis on basic skills, and permit some mothers to enter the labor force a year earlier than might otherwise be possible.

- Expanding vocational training in all school programs and attaching each school to an enterprise that would act as a sponsor or patron. Vocational training in general secondary schools will be upgraded, primarily through increased use of interschool production combines. These combines consist of facilities set up by local governments and industrial and agricultural enterprises. Students work at the combines one day a week during the school year and three weeks during the summer. Currently, there are about 2,500 interschool production combines, which train one-third of general secondary school students. Plans are being formulated to increase the number of such facilities to 3,200 to train over half of the students by 1985.

- Training more teachers by increasing admissions to teachers' colleges and upgrading their education by extending the present four-year course by one year. Measures designed to make teaching more attractive will include wage increases, preferential housing, and improved living and working conditions. 25X1

At least in the short run, even with massive investment, the program's objectives face formidable obstacles. For example, reducing enrollment in general secondary schools and correspondingly increasing it in vocational-technical schools may be frustrated by shortages of the latter schools, particularly in Central Asia, the Caucasus, and some sections of the RSFSR. 25X1

Though the current reform proposals are less extreme than similar reforms under Khrushchev, the Soviets face the same problems in revamping the schools now that they did 25 years ago—a shortage of vocational schools, training materials, and qualified production instructors, unwillingness by enterprises to provide training, and the negative perception of wageworker positions held by students and their families. In fact, the resistance may be stronger now because of the gains made in educational attainment since the 1960s. 25X1

The objectives of the current reform are open to question. Gearing the educational system to deemphasize the academic curriculum at an early stage in life and to promote more rapid placement of young people with finely tuned vocational skills into the labor force could help ease the short-term manpower squeeze. But Soviet education is already vocationally oriented—in the RSFSR, for instance, one-third of the hours in general secondary schools are devoted to labor training—and pushing it further in this direction could jeopardize long-term Soviet interests. Lowering the quality of general education and placing greater stress on training that leads to excessively narrow specialization could leave the USSR ill equipped to deal with the demands of an increasingly complex economy in an era of rapid technological change. [redacted] 25X1

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