Directorate of Intelligence

~~Secret~~

25X1

file copy
do not remove

International Economic & Energy Weekly

25X1

25 May 1984

~~Secret~~

DI IEEW 84-021
25 May 1984

Copy 683

Page Denied

Sanitized Copy Approved for Release 2011/03/28 : CIA-RDP97-00771R000707010001-7

Secret

25X1

International Economic & Energy Weekly

25X1

25 May 1984

25X1

25X1

25X1

Comments and queries regarding this publication are welcome. They may be directed to Directorate of Intelligence,

25X1

25X1

25X1

International Economic & Energy Weekly

25X1

Synopsis

25X1

25X1

25X1

International Economic & Energy Weekly [redacted]

25 May 1984

25X1

Perspective

International Oil Market: More Shock Waves From the Persian Gulf [redacted]

The escalation of attacks against tankers by Iraq and Iran has slowed Iranian oil exports and increased the risk that Tehran will step up retaliatory attacks against other oil exporters in the Persian Gulf. Tehran continues to threaten to block oil shipments from the Gulf if its own exports are reduced significantly. Such action could lead to reduced oil exports from Kuwait and Saudi Arabia by increasing the reluctance of shipowners to send tankers into the area or by damaging oil facilities. The market's ability to cope remains substantial only as long as Saudi oil is generally available. [redacted] 25X1

[redacted] Iran's main oil export facility at Khark Island over the past seven days shows only five tankers loading, compared with 10 to 15 over similar periods in April and early May. [redacted] some companies have postponed scheduled tanker loadings at Khark in response to the rising risk and cost—hull and cargo insurance rates for tankers calling at Khark have more than tripled since early May. Rates for tankers sent to Saudi Arabia and Kuwait, although much lower, have also risen steeply. [redacted] 25X1 25X1 25X1

The oil market reaction to events in the Gulf has generally been calm. Although reports of incidents briefly pushed up spot prices on 16 and 18 May, volumes traded were small, and prices subsided quickly. Traders fear being stuck with high-priced oil if conditions do not worsen, and buyers remain uncertain about the added cost of insurance and freight. [redacted] 25X1

We expect Iran to take immediate action to boost exports. In the past, Tehran has responded to depressed exports by offering discounts and by transshipping oil in its own tankers from Khark to the southern part of the Gulf. Some negotiations with major customers are already taking place. While these negotiations are likely to provide some shipments, we believe Iraq will continue its efforts to curtail Iranian exports. Moreover, Baghdad will be able to increase the frequency of its attacks later this summer after it begins to take delivery of at least 10 Exocet-armed Mirage F-1 aircraft. [redacted] 25X1

More Iranian airstrikes against Saudi and Kuwaiti shipping are likely if Iraq continues to attack tankers bound for Iran. The impact of further tanker attacks on the oil market will hinge largely on the willingness of shipowners and oil purchasers to continue to send vessels into the Gulf. While the number of tankers chartered for Persian Gulf voyages dropped noticeably following last week's attacks, some shipowners probably will continue to trade in the Gulf as long as insurance is available. [redacted]

25X1

More ominous to the oil trade, however, would be a successful Iranian attack against oil facilities in Kuwait or Saudi Arabia—a move Tehran might take, especially if exports drop well below 1 million b/d for an extended period. Editorials in the Iranian media already are calling for strikes against Saudi Arabia and Kuwait, possibly preparing Iranians for a widening of the war. If Iran were to seriously damage or close major Gulf oil export facilities, the impact on world oil supplies could be severe. The market's ability to adjust to a disruption without major price increases remains substantial only as long as Saudi oil is generally available. Surplus productive capacity in Saudi Arabia and outside the Persian Gulf is adequate to offset the loss of crude exports from all other Gulf producers. [redacted] 25X1

A disruption involving the Saudis, however, could not be readily offset with increased production from other producers. In such a case, oil stocks would have to play a major role in slowing price increases. Preliminary IEA data suggest that non-Communist commercial inventories fell only about 1.75 million b/d during the first quarter, leaving on-land stocks at about 3.9 billion barrels on 1 April. Although the first-quarter drawdown of commercial stocks was apparently less than normal this year, [redacted] commercial inventories presently would provide only marginal help in offsetting a supply shortfall. As a result, the disposition of government oil stocks in the United States, West Germany, and Japan—and the floating stocks maintained by Saudi Arabia—will play a key role in providing consuming countries with additional protection against a short disruption in oil supplies from the Gulf. 25X1

[redacted] 25X1

[redacted] 25X1

Briefs

25X1

Energy

[redacted]

[redacted]

Indonesian Exploration Commitments

[redacted]

Jakarta signed its first two production-sharing contracts this year in late April. Shell has agreed to spend at least $110 million on exploration in the next 10 years, and British Petroleum has agreed to a six-year, $60 million exploration program. The signings reflect the continuing willingness of foreign oil companies to make exploration commitments in Indonesia despite obstacles posed by Pertamina, the state oil company. According to the US Embassy, oil company managers have complained increasingly in the past few months that Pertamina is now scrutinizing all activities of the foreign oil companies, lengthening delays in gaining approvals for exploration programs, and even disallowing expenses formerly considered recoverable by the oil companies. Delays in the approval process have forced oil companies to operate drilling rigs for more than a year without official permission and to skirt the procurement rules to obtain spare parts. [redacted]

25X1

25X1

25X1

25X1

[redacted] 25X1

25X1

[redacted]

International Finance

Status of Philippine-IMF Negotiations

[redacted]

Manila's economic austerity policies probably will not produce results fast enough to satisfy the IMF, and further delays in negotiating the proposed $650 million loan from the Fund are likely. The austerity package includes proposals to reduce the budget deficit—higher taxes and a spending cut of 5 percent—and new measures to restrain growth in the money supply. Manila also has increased petroleum prices by 8 percent in a move designed to slash oil imports by $500 million a year. In addition, the Cabinet last week approved a proposal to float the exchange rate as soon as the IMF is satisfied that a sound fiscal and monetary program is in place. [redacted] 25X1 25X1

Preelection spending by the government, however, financed by expanding the money supply, has driven inflation up to an annual rate of 60 percent. As a result, the IMF is now insisting that the newly announced austerity measures show results before it agrees to a new loan. [redacted] 25X1 25X1

The government's proposed economic policies will not slow inflation and trim imports until late summer at the earliest, and the IMF is likely to wait until at least then before approving the new loan. Without an IMF program in place, the Paris Club will not reschedule the government's official foreign debt, new lending by the World Bank will be suspended, and no progress will be made on rescheduling foreign commercial debt. The danger for Manila is that, if negotiations with the Fund require the rest of this year, foreign commercial bankers will refuse to sustain foreign trade financing at current levels. This would mean an even weaker economy than the government now anticipates. World Bank officials already are projecting a 2-percent contraction in national output this year. [redacted] 25X1

IMF Loan Programs Stalled in Central America

The lack of functioning IMF-supported loan programs is adding to severe shortages of foreign exchange and eroding the basis for economic recovery in Costa Rica, Guatemala, and Honduras. Government reluctance to cut social programs further and to alienate key domestic interest groups is blocking accommodations with the Fund: 25X1

- Prolonged negotiations between Costa Rica and the IMF for a new loan agreement have caused at least two foreign exchange crises so far this year. One major obstacle is the Fund's request for a currency devaluation, which San Jose is strongly resisting. Costa Rican officials worry that Communist-led unions could exploit tougher economic measures to incite unrest similar to the demonstrations last summer.

- Guatemala has rejected IMF requests for further fiscal austerity measures, and this is blocking the Fund's disbursement of the remaining $60 million under the current loan agreement. Guatemalan leaders reportedly are concerned that tax increases would provoke a rightwing military coup.

- Honduras fell out of compliance with the Fund's budget limits late last year, and the absence of a new loan agreement has held up a World Bank loan and commercial debt rescheduling that together total about $300 million. The government lacks the $20 million needed to pay current and overdue foreign debts. With elections approaching in 1985, the Honduran Government opposes a devaluation and other austerity measures [redacted] 25X1

To delay coming to terms with the Fund, Costa Rica and Honduras will continue to urge the United States to disburse aid in advance of IMF-requested measures. Guatemala, whose prospects for securing foreign aid are less promising, may choose to do without the IMF funds. [redacted] 25X1

Kuwait Stops Aid

Kuwait plans to suspend its Baghdad Pact payments to the Arab Confrontation States—Syria and Jordan—as well as the PLO this year, according to press statements by the Foreign Minister. Kuwait already has delayed payments to these countries, probably because of depressed oil revenues, increased budget expenditures, and outstanding stock market debts. Kuwait's suspension of its Baghdad payments—$550 million annually—still awaits endorsement by the National Assembly, which is likely to approve the plan. Kuwait failed to meet its commitments to Syria last year, [redacted] Jordan's economy will be hurt; Amman has received about $200 million a year from Kuwait. [redacted] 25X1 25X1 25X1 25X1

Somalia's Economic Woes Ease

Somalia continues to avoid a major financial crisis as well as coming to terms with the IMF. The US Embassy in Mogadishu reports that Saudi Arabia apparently has granted Somalia enough crude oil to cover the country's needs for the next two to three months. The grant, replacing one that expired at the 25X1

25X1

start of this year, will release up to $13 million in foreign exchange that could be used to pay debt arrears. Moreover, inflation, largely fueled by food shortages, should ease as increased international food aid shipments arrive. These developments relieve immediate pressures on the government to reach accommodation with the IMF over an $83 million Extended Fund Facility. Nonetheless, we believe Mogadishu ultimately will have to reach agreement on a Fund program. So far, President Siad has rejected IMF-mandated measures to liberalize the state-run economy, largely because he fears they would limit his ability to dispense patronage, an important element of his power base. Mogadishu is likely to credit the oil grant to US intervention and may again ask Washington to urge the IMF to soften its conditions. 25X1

Summit Issues 25X1

EC Declaration on New Trade Round

The EC Foreign Ministers last week approved a declaration on the US- and Japanese-backed proposal for a new round of multilateral trade negotiations under GATT. The declaration notes the potential importance of such a round, but it asserts that commitments to reduce protectionist measures and complete the current GATT work program should take priority. It calls for extensive prior consultations among all GATT members and suggests a senior-level GATT meeting by the end of 1985 to consider possible courses of action. 25X1

25X1

The EC declaration avoids committing the EC to the timing and content of a new round of talks on multilateral trade. Except for West Germany, which has publicly endorsed a new GATT round, EC members almost certainly will not be more forthcoming on the issue at the London Economic Summit. The Community fears that the liberalization measures resulting from a new trade round would intensify the unemployment problem in Western Europe.

25X1

Global Negotiations

Mexico, the chairman of the Third World's UN caucus, probably will press the major industrial countries to place the so-called Global Negotiations on the agenda of the London Economic Summit, according to the US Mission to the UN. Global Negotiations is the LDC scheme to promote international economic change by allowing the UN General Assembly to issue recommendations to UN specialized agencies such as the IMF and the World Bank. Not much has happened on this topic since 1982 when Third World countries rejected the industrial countries' demand for guarantees that the General Assembly not encroach on the prerogatives of the specialized agencies. Earlier this month, Mexico circulated a new proposal for launching Global Negotiations, but even many developing countries have reservations. Mexico probably wants the London Summit to give impetus to its proposal or, at a minimum, to keep the idea of Global Negotiations alive by mentioning it in the conference communique.

25X1

25X1

25X1

Global and Regional Developments

25X1

Japanese Press Reacts to Statements on Auto Export Restraints

The Japanese press has harshly criticized Liberal Democratic Party Vice President Nikaido for his recent statement favoring an extension of voluntary restraints on auto exports to the United States after 31 March 1985. Most editorials stated the restraints are not justified and clearly are not voluntary. The press has given favorable coverage to recent statements by some US officials opposing an extension.

25X1

25X1

25X1

[redacted] 25X1

Indian Rice Purchases

[redacted]

Despite a bumper harvest, India is expected to buy a near-record 725,000 tons of rice by June, more than doubling rice imports this year. Rice stocks used to support India's vast public distribution system have declined sharply because of the drought last year and high domestic prices, which forced consumers to rely on subsidized rice supplies. India currently is trying to buy 200,000 tons of rice from Burma, according to the US Embassy in Rangoon. Indian purchases will tend to raise world prices and will squeeze African buyers, who [redacted] are coping with drought conditions. If India experiences a poor monsoon this summer, its import requirements could rise further, placing an additional strain on record-low world stocks of export rice. [redacted] 25X1 ILLEGIB 25X1

Austria's Expanding Relations With Iran

[redacted]

The visit of Austrian Foreign Minister Erwin Lanc to Tehran, proposed for the end of this month, underscores the improving relations between the two states, particularly their growing trade ties. [redacted] 25X1 25X1 25X1

Austrian exports to Iran more than doubled in 1983, from approximately $135 million in 1982 to over $280 million, and Austrian Airlines recently inaugurated a twice-weekly service to Tehran to handle the increase in passengers and cargo. Austria sells primarily machinery, iron and steel products, plastics, and timber to Iran, while buying mostly oil and carpets. [redacted] 25X1

Vietnamese Workers Sent to Iraq

[redacted]

Hanoi sent nearly 200 drivers, welders, and technicians to Iraq early this month apparently as the first phase of a labor agreement. Although more than 50,000 Vietnamese are currently working in the Soviet Union and Eastern Europe, this marks Vietnam's first export of labor to the Middle East. The agreement probably resembles arrangements with Moscow in which part of the workers' earnings is withheld as payment on Vietnam's overdue foreign debt. Hanoi is about $30 million behind in its payments to the Central Bank of Iraq on loans taken out in the late 1970s to finance oil imports. The remainder of the workers' salaries will probably be paid in oil. [redacted] 25X1 25X1

National Developments

Developed Countries

Israeli Cost-of-Living Agreement

[redacted]

The new cost-of-living adjustment formula agreed to last week will not help the government's efforts to reduce inflation. Workers will be compensated more frequently for price hikes. In addition, labor will still be able to bargain for additional wages at the industry and plant levels. The Histadrut, the large trade union organization, has been extremely successful in recent years in winning wage gains that more than compensate for the difference between the cost-of-living adjustment and inflation. [redacted] 25X1 25X1

Under the complicated new formula:

- Wages will be adjusted any time the consumer price index (CPI) rises 12 percent or more in a single month.
- Wages will also be adjusted whenever price increases since the last adjustment reach 12 percent.
- If the CPI rise that triggers the adjustment is less than 25 percent, wages will be increased by 80 percent of the price hike; otherwise, the linkage will be 90 percent. [redacted] 25X1

Histadrut officials hope that they will receive credit for protecting real wages, according to the US Embassy, thus helping their Labor Party allies in the 23 July national elections. They reacted angrily last week to Finance Ministry charges that government efforts to slow inflation would have succeeded if the Histadrut had entered a "social compact" on wages and prices. Finance Minister Cohen-Orgad announced that the new formula will apply to government workers, who comprise roughly one-fourth of the labor force. We believe he only reluctantly agreed to do so because of fear of losing their votes. [redacted] 25X1

Turkish Business Concerns

[redacted]

Turkish business leaders remain skeptical of Prime Minister Ozal's economic program, citing concerns over inflation, unemployment, and low levels of investment. [redacted] industrialists complain that Ozal's new trade policy, which liberalizes imports and provides export incentives, favors large holding companies over small and medium-sized firms. Furthermore, they doubt that Ozal will be able to sell off the state economic enterprises—which he has pledged to do—because the firms are overstaffed, poorly managed, and deep in debt. [redacted] 25X1 25X1 25X1

Despite the complaints, Ozal's program is showing results. Exports rose 37 percent in the first quarter of 1984 over the same period last year. Moreover, preliminary data for January and February show a substantial reduction in the current account deficit. Ozal is aware, however, that he will need the backing of the business community if he is to succeed in redirecting Turkey's economy along free market lines. In a bid to win the support of business leaders, he has promised to take additional measures to encourage investment, and he is likely to implement new reforms to make the state enterprises more attractive to private buyers. [redacted] 25X1

Surprise Increase in South African Taxes

[redacted]

South Africa has increased its general sales tax from 7 to 10 percent, exempting only some basic foodstuffs. The size and timing of the increase—less than four months after a sales tax hike from 6 to 7 percent—surprised most local observers. The need for additional tax measures to help limit budget deficits, however, was generally recognized. Record high interest rates have increased the cost of government borrowing, and South African officials are emphasizing tax increases and spending restraint in order to control the budget deficit. Pretoria also is concerned about a growing current account deficit and expects the increased sales tax will slow consumer spending and thus reduce imports. The exemption of some foodstuffs from sales taxes is a concession to blacks, who normally bear disproportionately more of the sales tax burden. Nonetheless, several black leaders have criticized the new measures, contending that the benefits of the food tax exemption will be outweighed by the tax's contractionary impact on the economy. [redacted]

25X1

25X1

Tokyo To Boost Support for Advanced Materials

[redacted]

MITI is drafting a bill for a "New Materials Development Promotion Law," according to press reporting. The bill, which MITI plans to submit to the Diet next year, would provide private industry with low-interest loans and tax incentives to support high-risk, long-term R&D on advanced materials. Proposed support is aimed at developing advanced structural materials: ceramics, polymers, metals, and composites. Additionally, MITI proposes to promote the distribution of information on advanced materials technology, develop requirements for advanced materials in the public sector, and establish standardized testing and evaluation systems. Tokyo is already supporting development of advanced materials, particularly through the 10-year "Next-Generation Industries Basic Technologies Research and Development Program," which will spend an estimated $275 million for materials development. [redacted]

25X1

25X1

Less Developed Countries

Nicaragua Exaggerates Damage Caused by Insurgency

[redacted]

In an effort to gain international sympathy—and economic support—the Nicaraguan Government has magnified the dollar value of the economic damage caused by the insurgents in 1983 by using a greatly overvalued exchange rate. In a recent speech, Junta Coordinator Ortega claimed $128 million in physical damage to the economy last year. Later in the speech, however, he referred to the damages in cordoba terms that implied Managua was using the official exchange rate of 10 cordobas to $1. The controlled commercial rate, however, is 28 to $1, and the black-market rate recently reached 140 to $1. We estimate that the fair market value of the cordoba ranged between 28 and 80 to $1 last year, and using a fair market rate would reduce Ortega's damage estimates to no more than $46 million. This is in the range of our own estimate of insurgent damages and is considerably smaller than the economic losses coming from economic mismanagement and lower commodity export prices. [redacted]

25X1

25X1

25X1

Islamic Banking in Sudan

President Nimeiri is pressuring the governor of Sudan's central bank to begin the Islamization of all Sudanese banks, according to the US Embassy. An Islamic banking law probably will be enacted soon and go into effect at the start of the Islamic new year in September. [redacted] the plan under consideration would provide for a transition period to Islamic banking principles by allowing existing contracts to continue through their expiration date. Under Islamic banking, interest payments will be replaced by profit-sharing and management fees; some banks in Sudan have been operating on an Islamic basis since 1978. The US Embassy reports that the foreign business community is concerned that Islamization of the economy will worsen an already poor investment outlook in Sudan. [redacted]

25X1

25X1

Nigeria's Currency Conversion

Last month's unexpected currency conversion has temporarily tightened liquidity, causing prices to drop. Black-market trafficking, however, resumed almost immediately with new naira selling both domestically and in markets across Nigeria's borders at close to the old rate. Although Lagos caught several minor black-market offenders as part of its anticorruption campaign, we believe that major operators had long since converted their naira into foreign currency. Nigeria's new currency has temporarily reduced the money supply, but we believe the government has not addressed trade distortions resulting from the overvalued naira and will have to take additional measures to secure an IMF standby loan. [redacted]

25X1

25X1

Power Shortage in Sierra Leone Heightens Discontent

Public dismay over the general deterioration of the economy has been increased by recent power shortages. According to the US Embassy, aging generators have broken down because of poor maintenance, while a shortage of foreign exchange has cut fuel imports. The energy shortages have adversely affected public transit, telephone communications, and food refrigeration, particularly in Freetown, the capital. Austerity measures under an IMF-supported loan program have proved especially unpopular in light of the government's inability to stem corruption and smuggling of exports that could otherwise earn hard currency. Sierra Leoneans—staggered by last year's 90-percent inflation, which was the worst in a decade—face higher food prices as shortages develop this summer and may take to the streets as they did in 1981. President Stevens could buy time by blaming these economic woes on unpopular ministers and by conducting a Cabinet reshuffle. [redacted]

25X1

25X1

Thai Trade Deficit Continues High

Thailand posted an $869 million trade deficit in the first quarter of this year, up 13 percent from the same period a year earlier. Despite credit restrictions and higher interest rates imposed late last year in response to a record $2.7 billion current account deficit, imports increased by 14 percent and offset higher export earnings. Although the central bank publicly contends that

25X1

second-quarter trade figures will show a marked improvement, we believe they are overoptimistic. Thailand's economic recovery, increased capital requirements for large industrial projects just getting started, and persistent devaluation rumors are likely to keep import demand high. Moreover, export growth will be constrained by an overvalued currency and protectionist measures in Thailand's export markets. Barring more stringent import restrictions, we expect the 1984 current account deficit will remain over $2 billion. 25X1

Summit Issues: Big Six Unemployment and the Recovery

25X1

The yearlong economic recovery under way in most of the Big Six countries has done little to reduce unemployment. In Western Europe and Canada, unemployment rates remain at or near double-digit levels; although Japan's unemployment rate never got above 3 percent, it also has been slow to come down. Despite predictions of a broader based, moderate recovery running into 1985, we expect unemployment to remain high throughout this period except in Japan. In most of the other countries, firms in traditional industries are reducing jobs faster than jobs are being created in the service and high-technology sectors, and the number of new entrants into the work force continues to grow.

Factors Influencing Unemployment Trends

The economic recovery that began in early 1983 in most of the Big Six countries has been too weak to stimulate employment. GNP advanced only 1 percent in the West European Big Four in 1983. Growth in Japan was far below normal in the first half of 1983 at 1.8 percent but rose to 5 percent the second half for an annual growth rate of 3 percent; unemployment still failed to come down. Even in the growth industries, employers in all Big Six countries are keeping their work forces lean. Given the considerable costs involved in hiring new workers, especially in Western Europe, firms have been slow to expand their work forces. Growth in Canada was fairly strong in both halves of last year, totaling 3 percent for the year, and Canada recorded the only decline in unemployment.

Structural factors rather than growth continue to have the major influence over Western Europe's unemployment rates. Demographic trends—the baby boom of the early 1960s and increasing female participation rates—continue to boost the supply of labor. Industrial restructuring in France caused an average decline of 20,000 jobs a month in the past year; the United Kingdom lost about 160,000 manufacturing jobs in 1983. 25X1

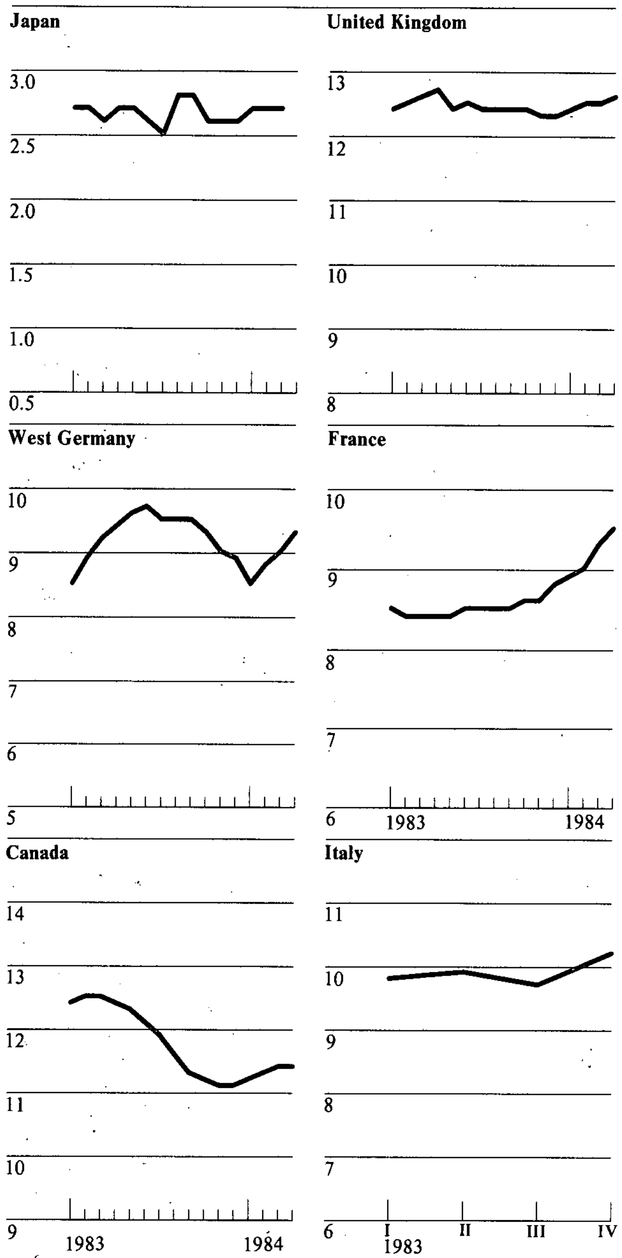
At least two factors that aggravated unemployment in the past—rising labor costs and slow job creation in the service sector—have turned around in the past year and should help reduce unemployment. Increases in manufacturing wages slowed dramatically in all Big Six countries in 1983, and the pace is expected to remain slow this year. In every country, wage costs are expected to rise about half as much in 1984 as they did on average during 1972-81. Job creation in the service sector resumed in 1983 as the recovery began and is expected to continue to grow. Service jobs expanded by 250,000 in the United Kingdom in the 12 months ending in March of this year; the bulk of the 340,000 new jobs in West Germany expected to be added by the end of 1986 will be in services and the public sector. 25X1

25X1

The Government and Labor Response

Most Big Six governments continue to shun quick-fix programs to put people back to work. They remain convinced that restrictive fiscal and monetary policies to limit budget deficits and inflation are keys to long-term job creation. In addition, most Big Six countries are stressing the importance of restructuring to restore international competitiveness and of promoting high-technology industries, even if jobs are lost in the short run. In Japan the government has intervened to make restructuring a relatively smooth evolutionary process; worker dislocations have been kept to a minimum. In France, the United Kingdom, and West Germany, however, governments have allowed recent massive 25X1

Big Six: Unemployment, 1983-84[a]



[a] Monthly data, except for Italy which is quarterly; seasonally adjusted.

302838 (A04668) 5-84

Big Six: Hourly Earnings in Manufacturing *Percent change*

	Average Annual 1972-81	1982	1983	1984 [a]
Japan	11.8	4.8	4.6	4.8
West Germany	7.2	5.0	3.7	3.8
France	14.8	15.3	11.1	6.8
United Kingdom	15.9	11.1	9.0	9.0
Italy	22.6	17.2	13.2	11.4
Canada	11.2	11.6	6.6	5.2

[a] OECD forecast.

25X1

layoffs in traditional industries, resulting in long-term and perhaps permanent unemployment for hundreds of thousands of workers. Only Italy has introduced a small jobs program to create 100,000 new jobs in the next two years in the public sector—primarily customs, tax collection, and the judicial system. Italy as well as the other major countries have introduced some measures to make restructuring less painful, make investment more attractive to the private sector, and create a more market-oriented environment. All these efforts will take time to implement, and more time will elapse before economies react and unemployment declines. 25X1

Organized labor in much of Western Europe and Canada accepts that the introduction of high technology in the workplace is inevitable but is not convinced that the overall impact on jobs will be positive. West German labor unions, in particular, have stressed the need for sharing available work by reducing worktime. The important West German metalworkers union went on strike in mid-May over union demands for a 35-hour workweek, and this has paralyzed the key West German auto industry. 25X1

25X1

Prospects

We believe unemployment levels will stay roughly unchanged in the Big Six countries at least through mid-1985. Economic growth, a slowdown in labor cost increases, and gains in service-sector employment should counter layoffs in traditional industries and labor force growth. This year we expect a reduction in the unemployment rate in Canada and West Germany of 1 percentage point or less. In France and Italy, where layoffs in traditional industries are proceeding quickly, the unemployment rate should continue to rise this year by perhaps 1 percentage point. The unemployment rate is expected to finally stabilize in the United Kingdom. 25X1

25X1

Sanitized Copy Approved for Release 2011/03/28 : CIA-RDP97-00771R000707010001-7

Summit Issues: The Soviet Economic Stake in Western Europe 25X1

Moscow runs a strong trade surplus with Western Europe, more than $7 billion in 1983.[1] These earnings help finance Soviet hard currency trade deficits with the United States, Japan, Canada, and Argentina. Trade with Western Europe accounts for 20 percent of Moscow's overall foreign commerce and 65 percent of its hard currency trade. We expect the USSR will continue to avoid becoming overly dependent on trade with the West. As a result, Soviet imports of West European machinery and equipment—which surged in 1982-83 with deliveries for the gas pipeline from Siberia to Western Europe—are likely to stagnate.

Overview

Moscow is maintaining its cautious approach to East-West trade and is pressuring its Communist trading partners to provide more of the goods the Soviet economy needs. This caution stems from the Soviets' longstanding conservative approach to foreign borrowing, reluctance to rely too heavily on non-Communist suppliers, and doubts about the capacity of the Soviet economy to assimilate large amounts of imported Western technology. Moreover, the Western trade sanctions imposed after the invasion of Afghanistan and the Polish crisis dampened the enthusiasm of Soviet planners for Western imports.

Despite factors limiting expansion, the Soviets nonetheless believe that maintaining trade ties with Western Europe carries both political and economic benefits. The Soviets see trade ties as a way of diverting West European interests away from the United States. Soviet trade with Western Europe is largely an exchange of fuels for steel and machinery:

- Energy products account for roughly 80 percent of Soviet exports to Western Europe.
- Soviet imports from Western Europe are dominated by machinery—especially heavy industrial machinery—and steel products, notably large-diameter pipe. Imports of machinery and equipment surged in 1982-83 with deliveries for the Siberia–to–Western Europe gas pipeline. 25X1

As a trading partner, Western Europe is a far more significant supplier to the USSR than the Soviets are to the West Europeans. Trade with Western Europe accounts for 20 percent of total Soviet trade. The export gas pipeline project, for example, required substantial imports. Imported Western equipment has also been critical to Soviet efforts to expand the chemical and automotive industries. Moscow depends on West European suppliers for certain specialty imports—notably plastics, pesticides, and manmade fibers. 25X1

On the other hand, exports to and imports from the USSR represent less than 5 percent of Western Europe's overall trade; the key exception is energy. In 1983, Soviet oil deliveries accounted for nearly 10 percent of West European oil consumption, and the share of gas was even higher. By the end of the decade, when the Siberian gas pipeline system is fully operational, the USSR could be providing as much as one-third of the gas requirements of West Germany, France, and Italy. 25X1

25X1

25X1

25X1

Sanitized Copy Approved for Release 2011/03/28 : CIA-RDP97-00771R000707010001-7

USSR: Trade With Western Europe *Million US $*

	1980			1981			1982			1983		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
Total	**22,578**	**16,405**	**6,173**	**22,393**	**16,839**	**5,554**	**24,598**	**16,186**	**8,412**	**24,798**	**17,616**	**7,182**
West Germany	4,767	4,603	164	5,053	3,757	1,296	5,610	4,020	1,590	5,490	4,536	954
France	3,453	2,326	1,127	3,509	2,314	1,195	3,162	1,749	1,413	3,270	2,332	938
Italy	3,235	1,438	1,797	3,453	1,393	2,060	3,952	1,687	2,265	4,048	1,939	2,109
United Kingdom	1,323	1,467	−144	897	1,193	−296	1,122	1,038	84	1,600	853	747
Finland [a]	3,116	2,872	244	3,186	3,788	−602	3,299	3,853	−554	3,347	3,626	−279
Other Western Europe	6,684	3,699	2,985	6,295	4,394	1,901	7,453	3,839	3,614	7,043	4,330	2,713

[a] Finland and the USSR trade on a soft currency basis.

[redacted] 25X1

USSR: Orders Placed for West European Machinery and Equipment *Million US $*

	1980	1981	1982	1983
Total	**2,066**	**5,380**	**3,184**	**1,310**
West Germany	892	1,797	1,162	808
France	806	1,948	746	123
Italy	55	843	326	140
United Kingdom	139	462	177	103
Other Western Europe	174	330	773	136

[redacted]

Recent Trends

In 1983 the value of the USSR's trade with Western Europe topped $40 billion, [redacted] Soviet exports to the area amounted to $25 billion, and imports totaled nearly $18 billion. This trade is heavily skewed toward the major industrial countries. West Germany, France, Italy, and the United Kingdom accounted for almost 60 percent of West European–Soviet trade last year. [redacted]

Maintaining large trade surpluses with Western Europe allows the USSR to cover the trade deficit it runs with hard currency suppliers elsewhere. In 1983, Soviet trade with Japan, Canada, Argentina, and the United States was in deficit by $7 billion. [redacted] 25X1

West Germany. West Germany is the Soviet Union's largest hard currency trade partner, accounting for nearly one-fourth of Soviet trade with Western Europe. Moscow values the quality of industrial technology provided by the West Germans, who supply equipment and expertise for a number of large-scale development projects in the USSR. Their firms have provided nearly half of the large-diameter pipe, many of the turbines, and much of the management and technical expertise for the Siberian gas export pipeline. Soviet orders for West German equipment, however, have fallen more than 50 percent since pipeline and other contracts were signed in 1981, and in 1983 they totaled only $800 million. [redacted]

25X1

25X1

25X1

25X1

25X1

[redacted]

25X1

Soviet–West European Trade Issues

25X1

[redacted]

buyer of Soviet energy, but French manufacturers appear to be at a disadvantage when competing against other Western firms. [redacted]

United Kingdom. Soviet trade relations with the United Kingdom have been strained for several years, with neither side inclined to launch a drive to expand ties. British business and industry representatives maintain contacts with Soviet counterparts, but their interest currently seems to be minimal. [redacted]

25X1

Italy. Close economic ties between the Soviet Union and Italy predate the growth in Soviet–West European trade that occurred in the 1970s. Trade relations, however, have been constrained by the limited Soviet demand for Italian exports and Rome's reliance on Soviet energy supplies. The $2 billion trade deficit the Italians ran with Moscow last year was the largest in Western Europe. Nevertheless, Italian firms continue to compete successfully for Soviet business– [redacted]

25X1

25X1

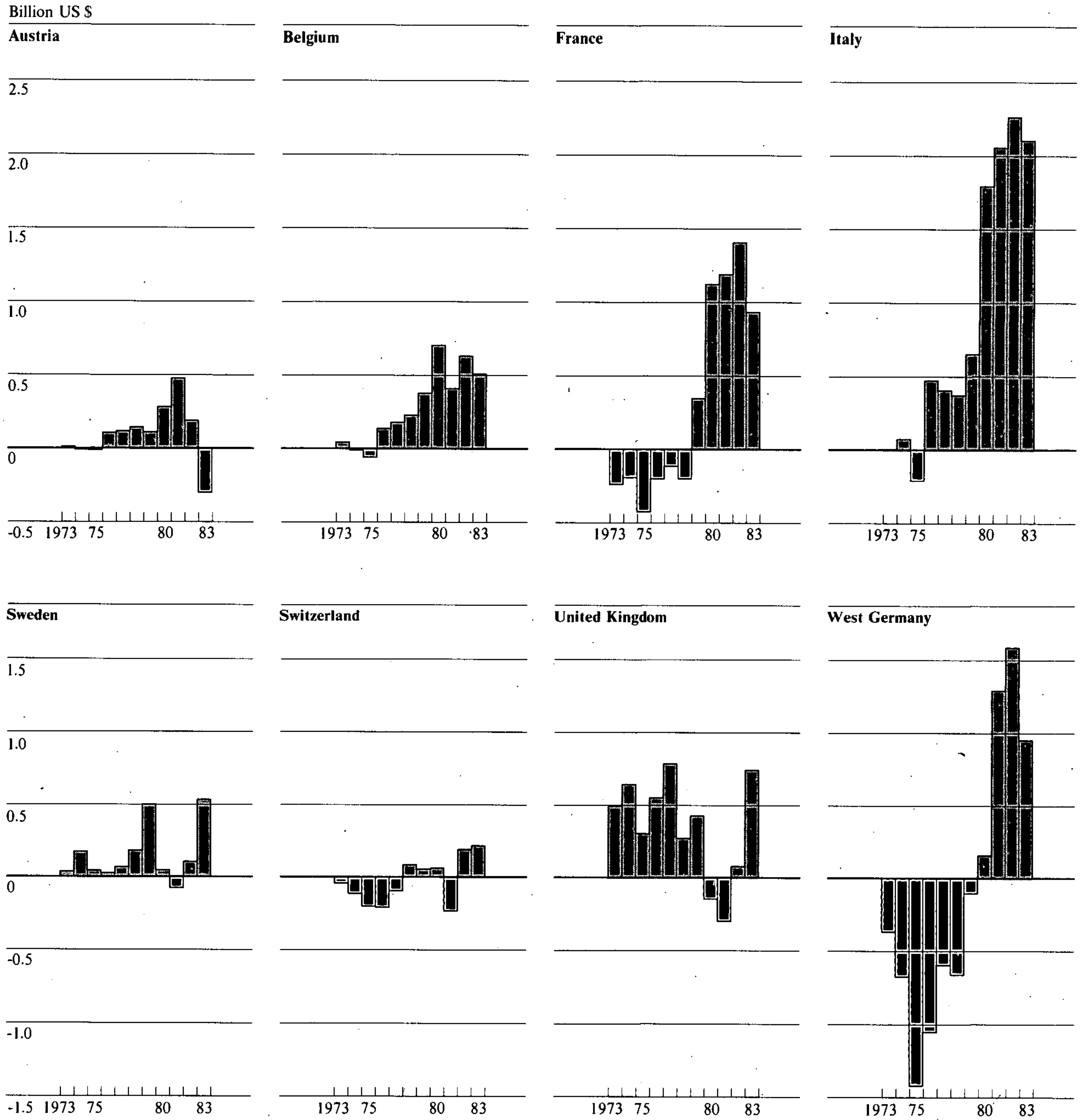
25X1

Prospects

The large trade surpluses with Western Europe are likely to continue through yearend, even if Soviet

25X1

USSR: Trade Balances With Major West European Trade Partners, 1973-83



25X1

302744 (A04653) 5-84

exports stagnate. Nonetheless, Moscow's ability to maintain its oil exports to the region could be hindered by domestic oil production difficulties and the soft oil market. Gas sales could suffer from the weak market as well. [redacted] 25X1

[redacted] 25X1

It appears that Moscow will try to hold down Soviet reliance on economic ties with the West. Soviet planners apparently hope to reduce imports from the West this year, in order to offset the expected sluggishness of exports. The plan for 1984 calls for a rise of 10 percent in trade with Communist countries and implies a decline of roughly 10 percent in trade with non-Communist countries. [redacted] 25X1

Although the USSR continues to look to Western nations for advanced technology to boost its lagging productivity and growth, the value of Soviet orders for machinery and equipment declined last year. After peaking in 1981 at more than $5 billion—mostly for pipeline equipment—orders amounted to just $1.3 billion in 1983. The value of Soviet orders placed with West European firms last year was the lowest since the early 1970s and 75 percent below that of 1981. [redacted] 25X1

Over the longer term, we expect Moscow will give priority to equipment imports necessary to develop energy resources. The Soviet Food Program, which gives priority to upgrading capital stock in all phases of food production, is also likely to receive special attention. Imports of machinery for other sectors of the Soviet economy probably will suffer. [redacted] 25X1

[redacted] 25X1

International Financial Situation: Political Update

25X1

Austerity measures taken to satisfy the IMF have been directly responsible for political turmoil in the Dominican Republic and Bolivia this past month. In the face of domestic resistance, Yugoslavia undertook tough economic measures in the hope of completing a new IMF agreement. In Argentina, President Alfonsin continues to be plagued by sporadic strikes, making it increasingly difficult for him to move forward on economic issues. Political unrest in Chile and the Philippines could lessen these governments' resolve to enforce austerity measures; any backsliding on economic reform could jeopardize IMF and new bank loans that are essential to meeting these countries' foreign payments obligations this year.

Government-ordered price increases on imports, including many basic foodstuffs, provoked three days of rioting and looting late last month in the **Dominican Republic**. The protests broke out after the recent agreement with the IMF that shifted most imports from the official to the more costly free market foreign exchange rate. Various opposition groups reportedly exploited the popular discontent. The government's use of force and the arrest of more than 100 members of opposition groups and two labor leaders during recent weeks has kept the lid on further demonstrations. In addition, government actions to subsidize food for the poor and to increase the minimum wage, dismissal of Central Bank Governor Vega, and agreement to meet regularly with union leaders have helped still the labor federations. Nevertheless, the inflationary impact of the devaluation continues to be a source of popular discontent, and the anniversary of the assassination of Trujillo on 30 May could be the occasion for new outbreaks. President Jorge Blanco remains determined to follow through on an IMF agreement, according to the US Embassy, even though several difficult issues remain unresolved, including the shifting of petroleum products to a more expensive exchange rate and the financing of the government deficit.

The **Bolivian** Government's decision last month to undertake a 75-percent devaluation and increase prices of basic foods and gasoline as preconditions for an IMF agreement has spurred widespread labor strikes. For example, the US Embassy reports that an ongoing strike at the Central Bank has nearly paralyzed the banking system. Responding to growing public alarm, President Siles has implemented a government takeover of the Central Bank. A communique issued by the armed forces' high command warns that the military will step in if the government cannot maintain order. Siles may accept the resignation of the Finance Minister to placate workers. Labor, however, is also demanding the revocation of austerity measures and the deferral of payments on the foreign debt.

25X1

25X1

The **Yugoslav** Government also implemented tough measures to meet IMF requirements this month, including the lifting of price controls imposed last December and legislation cutting wages in firms with persistent losses or failure to pay debts on time. The IMF, however, is not completely satisfied with the price measures, because the federal government can still intervene in cases where prices rise too rapidly. Conclusion of a Western financial package for 1984 hinges on resolution of the problem. The federal government—which changed its top economic advisers this month—will face increasing consumer frustration with inflation—now about 60 percent annually—and pressures from financially troubled industries. Regional resistance to the federal government's economic stabilization proposals remains strong.

25X1

Argentine labor unrest has increased over the past few weeks, but work stoppages remain sporadic and short lived. Stepped-up strike activity included a 24-hour railway stoppage—the first nationwide

25X1

union action since Alfonsin took office last December. Meanwhile, the President is moving to reach an accommodation with his Peronist rivals on pressing economic issues. Most recently, he has initiated a dialogue with the Peronists, led by former President Isabel Peron, that he hopes will result in more union flexibility. Even if an accord is reached on wage and trade union policies, however, rising interest rates are making the foreign debt issue increasingly political, and Alfonsin is under pressure to take stronger positions with the IMF and foreign lenders. In addition, a sharp cut in budget expenditures could provoke grumbling from the military. [redacted]

In **Chile** this month's reduced participation by the middle class and workers in nationwide protests over political liberalization and continued high unemployment will hurt efforts to call a national strike before August. Nonetheless, we believe the moderate Democratic Alliance and National Workers' Command will continue to call for protests against the regime. For its part, the Pinochet government has acted with restraint and avoided provoking demonstrations. Concern about Chile's political future has contributed to the reluctance of US regional banks to complete Chile's $780 million new money loan; it is 95 percent subscribed. Even when the package is completed, more expansionist policies that Finance Minister Escobar may deem politically necessary could jeopardize IMF and bank disbursements later this year. [redacted] 25X1

In the **Philippines**, demonstrations—some violent—protested government fraud in the 14 May National Assembly elections. Early returns from independent tallies and press reports showed impressive gains by the opposition and surprised President Marcos and his ruling party. Later announcements by the elections commission credited the ruling party with wins in areas where opposition candidates seemed assured of victory. [redacted] 25X1

[redacted] 25X1

25X1

Turkey's Military: The Impact of Economic Problems [redacted] 25X1

Turkey's transition to democracy following three years of military rule has gone smoothly. Newly elected Prime Minister Turgut Ozal and President Kenan Evren—who headed the military junta from 1980 to 1983—appear to have established a good working relationship. The new constitution grants substantial powers to the President, but Evren generally supports Ozal's economic stabilization program and is likely to continue giving the Prime Minister a relatively free hand in pursuing economic and political reforms. In return, despite tight fiscal and monetary policies, Ozal is unlikely to reduce resources devoted to the military. [redacted]

Ozal appears to share the military's belief that the terrorism, which brought the country to the brink of civil war in 1980, has only been contained, not eradicated. Ozal recognizes the threat from Turkey's northern neighbor, the Soviet Union, and has pledged his full support for the country's membership in NATO. Furthermore, he recognizes that increasingly important military challenges could develop on the borders with Syria, Iran, and Iraq. [redacted]

Turkey traditionally has devoted a large share of its GDP to defense—the third highest in NATO—but it is also by far the poorest NATO member, and successive economic and political crises during the past 30 years have left its military poorly trained and ill equipped. A massive modernization program was estimated by US officials in 1981 to cost at least $18 billion, well beyond Turkey's resources. Ankara's efforts to secure foreign military assistance, however, will continue to be hampered by budgetary constraints in donor countries and difficulties with various NATO Allies over human rights issues, the pace of democratic reforms, and the Cyprus issue. [redacted]

The Military's Role

The armed forces are perhaps the most highly respected group in Turkish society and traditionally have been viewed as the guardian of the state. The military's role in Turkey has been extensive since the days of Ataturk, the founder of the Turkish republic. The restoration of law and order following the military takeover in 1980 has probably increased its prestige, and Turks believe the military saved the country from anarchy. [redacted] 25X1

The military's primary mission is to defend the country from foreign attack and support NATO in the defense of its southeastern flank—primarily by protecting and controlling the vital Turkish Straits. Turkey maintains an armed force of about 790,000 men—the second largest in NATO. The Turks 25X1
believe their primary threat is from the Soviet Union, but they are increasingly concerned about Syria's intentions and the growing Soviet influence in Damascus. In addition, Turkey sees itself sur- 25X1
rounded by potentially hostile or unstable countries—Greece and Bulgaria to the west, and Iran and Iraq to the south and east. [redacted] 25X1

The Turkish Army is also assigned the task of assisting the national police and internal security forces (the Jandarma) and was responsible for successfully controlling terrorism following the military intervention in 1980. Martial law still exists in all but 13 of the 67 provinces, and the military's role in the political process continues to be extensive. [redacted]

25X1

25X1

25X1

The military traditionally has had little difficulty in securing adequate funding from the domestic budget but continues to face hard currency shortages. As President, Evren retains substantial powers under the 1982 Constitution, and he can be expected to represent military interests in the new civilian government. Defense spending as a share of the national budget has averaged about 20 percent since 1970 and nearly 5 percent of GDP. Under the new constitution, the Chief of the Turkish General Staff will continue to be a key player in determining security policy and the defense budget. Prime Minister Ozal also recognizes the need to address the military's interests and has accepted the "special programs" initiated by the previous military government, such as the F-16 coproduction project,

Despite budget problems, Turkish military officers are relatively well off. Officers are drawn from all regions of the country and mainly from low- and middle-income families. They are selected at an early age and receive extensive education between 14 and 22. While at school, the officer candidates are indoctrinated with the principles of Ataturk and military discipline. Their wages are generally similar to civilian pay, but, as officers rise in their careers, they receive generous perks, such as automobiles and shares in defense industries. The Foundation for the Promotion of the Turkish Air Force, for example, will have a 1.9-percent share in the F-16 coproduction venture. On the other hand, Turkish conscripts, who form over 90 percent of the Army, are not as well off. Their pay is extremely low, and they do not receive the perks the officers do. At best, the military keeps them employed and provides some training and education. 25X1

25X1

25X1

Economic and Political Backdrop

Turkey is emerging from a period of grave economic and political turmoil, which reached its nadir in 1979-80. At the end of 1979, inflation was in triple digits, the current account deficit was large, and the country's access to private foreign credit had been completely cut. Severe shortages of many imported products—especially oil—caused great hardships and severely disrupted production. In part, this crisis was the product of fundamental weaknesses in the economy, which was modeled along the nationalistic lines enunciated by Ataturk. Economic activity was largely directed by the state, foreign investment was discouraged, and export industries were ignored. The economic collapse also resulted from policy errors as successive weak coalition governments in the 1970s resorted to price controls, expansionary fiscal and monetary policies, and an overvalued exchange rate to avoid adjusting to the oil price shock of 1973/74.

The country's institutions were almost paralyzed. Terrorist acts were multiplying and at their peak claimed more than 20 lives a day. The number of "liberated areas"—effectively out of the control of government security forces—was proliferating throughout the country.

The turning point for the economy came with the January 1980 economic stabilization program. Largely drafted by Turgut Ozal—then chief economic adviser to the newly formed conservative coalition government of Prime Minister Demirel—the program was a serious attempt to reshape the economy along export-oriented, free market lines. It was supported by more than $4 billion in loans from the IMF, the OECD, and the World Bank and achieved dramatic results during the next two years as inflation eased, exports boomed, and GNP growth resumed. Domestic violence, however, continued.

The military intervened on 12 September 1980 to restore order. They suspended constitutional rights and imprisoned thousands of suspected terrorists. In an effort to depoliticize the bureaucracy, the military government rewrote the civil service laws to bar public employees from politics and barred leaders of established political parties from political activity for 10 years. The generals turned over the reins of power in November 1983 to a civilian government elected under a new constitution.

Following his election victory in November 1983, Prime Minister Ozal instituted a series of economic reforms to further his 1980 stabilization program and rejuvenate an economy that showed signs of slowing. Although GNP grew 3.2 percent in 1983, exports stagnated and the current account deficit grew to about $2 billion. In addition, the inflation rate rose to about 40 percent by yearend, up from 25 percent in early 1983.

Ozal's new measures included liberalizing import controls, improving export incentives, and abolishing most foreign exchange controls. Interest rates were raised above the inflation rate, and the prices of several subsidized goods were increased substantially. In addition, Ozal pushed through the Grand National Assembly a controversial bill permitting the state to sell shares in state enterprises to private investors—a dramatic departure from Ataturk's state capitalism. The measures have encouraged optimism among international bankers about Turkey's economic prospects, and the country is beginning to regain its access to the private credit market.

25X1

25X1

We expect Ozal's policies will improve Turkey's economic performance. Inflation should begin to fall by the end of this year but probably will remain around 35 percent for 1984 because of recent price hikes on several subsidized goods. GNP is expected to rise by as much as 5 percent in 1984, and exports will probably increase 15 to 20 percent, aided by the new export incentives and daily adjustments in the exchange rate. Preliminary results for the first quarter are encouraging; export receipts were up nearly 37 percent over the same period a year earlier.

25X1

25X1

25X1

In addition, Turkey's transition to democracy has gone smoothly since the parliamentary election in November, even though Ozal was not Evren's favored candidate. The recent municipal elections gave a further boost to Turkish democracy and another solid victory to Ozal's Motherland Party. A dark note is that terrorist acts are on the rise again. As a result, Ozal and Evren have been reluctant to push for an amnesty bill or lift martial law.

25X1

25X1

Economic Stringencies and the Military

Economic problems have significantly affected Turkish military capabilities. Inflation and a shortage of foreign exchange have had a significant impact on military spending, since nearly all of

25X1

25X1

Turkey's military equipment is purchased abroad. Defense spending, which rose sharply in the mid-1970s following the invasion of Cyprus, has slowed since 1978 and would have declined in real terms without assistance from Turkey's NATO Allies. In addition, the US arms embargo following the Cyprus invasion further reduced Turkey's defense capabilities.

Economic difficulties have forced several important programs to be delayed or scaled back, including the replacement of F-5 and F-100 squadrons, the purchase of ASW helicopters and short-range air defense missiles, and the building of sufficient war reserve ammunition stocks. There is insufficient live-fire training in all three services because of ammunition shortages. Both the Army and Air Force have had difficulties in retaining skilled and experienced personnel. Equipment procurement has been particularly hard hit, with only 10 percent of the military budget devoted to this purpose—the lowest share in NATO. Moreover, the Turks have

25X1

25X1

[redacted] 25X1

been forced to spend a high proportion of their budget on operations and maintenance because much of their equipment is obsolete. [redacted]

Turkey is almost totally dependent on foreign aid to fund military equipment purchases. Over the past several years, foreign military aid has accounted for roughly 15 to 20 percent of the total Turkish defense budget and nearly one-fourth of spending for operations and maintenance. [redacted] A large reduction in aid would force Turkey to abandon several important projects, such as the F-16 coproduction deal and ammunition procurement. [redacted]

Turkey recently has begun a major effort to develop a domestic arms industry to reduce the country's dependence on foreign suppliers. Much of this effort, however, is tied to foreign military assistance programs or offset arrangements. For example, the Turks plan to assemble some of the frigates purchased from West Germany and are now building submarines with West German assistance. The Turks will make some parts for the 160 F-16s they are buying from the United States and will assemble the aircraft at a new aerospace factory at Murted to be completed by 1989. A small technological base and lack of a highly skilled labor force will hamper Turkey's efforts to establish an indigenous arms industry over the next several years. Moreover, political differences between Turkey and its allies over human rights, the extent of democracy, and Cyprus have affected aid levels and continue to hurt modernization efforts. [redacted]

25X1

25X1

25X1

25X1

Implications for the United States

Economic difficulties probably will not seriously weaken the ability of the Army and Jandarma to deal effectively with internal security threats, but Turkey's external military capabilities and modernization efforts will fall short of their perceived requirements. Financial constraints will grow, as large rescheduled debt payments begin to come due later this year. Turkey's ability to match the military strength of its neighbors is likely to deteriorate unless military aid is increased sufficiently to permit a large modernization effort. [redacted]

25X1

25X1

25X1

Page Denied

Next 4 Page(s) In Document Denied