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The results of the Cartagena Conference last month suggest limited support for joint action against creditors and no movement toward a debtors' cartel. A surge in interest rates or a perceived continued lack of progress toward easing the debt burden during the summer could yet, however, forge closer links among these disparate governments. 25X1

19 **El Salvador: Economic Challenges Facing the Duarte Government** 25X1

Despite the $240 million in US economic aid slated for El Salvador this year, we believe that output will decline—albeit slightly—for the sixth consecutive year. For now at least, President Duarte's focus on political and military matters and his strong commitment to redistributing economic and social power are delaying the tough actions needed to stimulate the economy. 25X1

25 **The Caribbean Area: No Economic Recovery in Sight** 25X1

The Caribbean area shows little indication of pulling out of its economic slump any time soon. We expect the region to show little or no growth and unemployment rates to range between 20 and 40 percent in most countries over the near term. The result is likely to be increased requests for US assistance, as well as stepped-up pleas for US intercession with the IMF and other donors to ease aid requirements. 25X1

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Perspective

West Germany: Implications of the Metalworkers Strike [redacted] 25X1

The West German economy experienced a significant loss in output as a result of the seven-week metalworkers strike—the country's largest postwar labor dispute. The uncharacteristic militancy of both sides during the dispute, moreover, signaled a step back from the cooperative spirit that has generally characterized postwar labor-management relations in West Germany and has contributed significantly to the country's prosperity. The Kohl government's open criticism of the union's demands, which was a break from the tradition of government neutrality in labor negotiations, also helped to poison the atmosphere. [redacted] 25X1

On balance, the settlement appears to favor the interests of labor. Although the original goal of a 35-hour week was not achieved, the 90-minute cut in working hours is close to what the leadership of the metalworkers realistically hoped to get. Furthermore, management's agreement to maintain current pay levels after the shorter workweek takes effect was a significant achievement—at least for those members who currently are at work. Additional pay increases and a $90 lump-sum payment to cover the five-month period since the old contract expired sweeten the pie. The pay hikes—3.3 percent effective 1 July and 2.0 percent next April—are modest when measured against current and projected West German inflation of about 3 percent. [redacted] 25X1

The metalworkers union, with 2.5 million members, is West Germany's largest, and its settlements have long served as a model for those in other industries. The union, for example, spearheaded several previous drives for a shorter workweek, with enough success to bring the national average for hours worked down to 40 from the 1950 average of 49. The smaller printers union—which also was on strike—accepted terms close to those of the metalworkers, and new contracts in other industries already are being worked out along similar lines. We also expect unions in other West European countries—with the metalworkers as an example—to achieve comparable settlements. [redacted] 25X1

Management did not come away emptyhanded, although the utility of the concessions it gained is more problematic. A major achievement was a clause permitting individual companies to vary workers' schedules between 37 and 40 hours, provided that the average workweek over a two-month period is 38.5 hours. This flexibility at the shop level—a first in industry dealings with the metalworkers—should boost productivity and enable manufacturers to offset some of their increased costs. In addition, the delay in implementing the reduction in working hours until next April will give individual manufacturers time to consider how to handle the cut most efficiently. Since the new contract will run until October 1986, manufacturers will also benefit from predictable labor costs for the next two years. [redacted] 25X1

Publicly, the leadership of the metalworkers justified their push for a 35-hour week in terms of job creation. Their demand for full compensation for the shorter week suggests, however, that they are more concerned with protecting existing jobs than with putting unemployed metalworkers back to work. In light of the overcapacity in certain branches of the industry, such as steel production, that clearly threatens jobs, this priority is understandable. Most West German economists are skeptical that the shorter week will reduce joblessness significantly, and even the arbitrator who worked out the compromise settlement said it will not create jobs although it may stabilize existing ones. [redacted] 25X1

Awareness of the worsening labor-management climate could sharpen the image in investors' minds of a more hesitant, less dynamic West German economy. If investors' confidence is shaken, economic growth over the next few years could be slower than the Kohl government expects. [redacted]

25X6 [redacted] Kohl is likely to be especially apprehensive about the national election scheduled for 1987. The metalworkers' contract will expire in late 1986, and the union will almost certainly press for further reductions in the workweek. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

Soviet Oil Production Problems Reviewed

According to press reports, Soviet officials have indicated that production at several giant West Siberian fields has peaked and that the era of powerfully flowing wells has passed. To raise production at Tyumen'—which provides nearly two-thirds of all Soviet production—oil increasingly will have to be extracted by pumping. Production problems at Tyumen' are not being resolved, and no short-term solutions have been recommended. A recent press article reported that 2,000 wells above the norm were idle and that their number is growing. There are 350 well-repair crews working in Tyumen', but 200 more crews are needed. Reported shortages of oil well pumps and oil-well-repair rigs appear to be greater than in the past. Over the long run, supply and quality improvements are possible with more investment in the petroleum machinery and equipment manufacturing industry. Costs will be high, however, and realization of these improvements would claim an even larger share of investment funds. 25X1

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Progress on Iraqi–Saudi Arabian Pipeline

[redacted]

Contracts to build the oil pipeline spur linking Iraq to Saudi Arabia's Petroline will be awarded by September and construction will begin in October, [redacted] Riyadh plans to expand Petroline's 1.85-million-barrel-per-day capacity to accommodate the additional 500,000 barrels per day Iraq wants to export by adding a line through some existing pumping stations. Despite the priority it attaches to the project, Baghdad is likely to engage in rigorous contract negotiations on both technical and financial arrangements, and construction is likely to take longer than the projected 10 to 11 months. Even if no other major obstacles develop, Iraqi crude is not likely to begin flowing through Petroline before 1986. [redacted] 25X1 25X1 25X1

Oil Development in Sudan Curtailed

[redacted]

Chevron's oil exploration in Sudan continues to be curtailed by insurgent activity. According to Embassy reporting, Chevron is confining its efforts to a secondary area about 175 miles northwest of Sudan's main oilfield at Bentiu. Chevron operations at Bentiu were suspended after the insurgents attacked company facilities there in February. The Sudanese Government has been prodding Chevron to resume operations [redacted] development of the Bentiu oilfields requires Western technology, and Khartoum and Chevron appear to have reached an accommodation whereby the company will resume activity in the south once it is safe. [redacted] 25X1 25X1 25X1 25X1 25X1

Chevron also has delayed construction of the White Nile pipeline because of uncertainty over development of Bentiu, which would be its main feeder oilfield. Moreover, financing for the $1.1 billion pipeline is about $200 million short. Khartoum appealed to Chevron and Saudi Arabia to fill the gap. Chevron has declined [redacted] 25X1

International Finance

Philippine Banking Crisis

[redacted]

Growing evidence suggests that repercussions from the Philippines' foreign-debt crisis threaten the country's domestic financial system. In recent weeks, the Central Bank has been forced to close six banks and organize financial bailouts for several others. Banco Filipino, one of the country's largest savings institutions with nearly 4 million depositors and 89 branches, was forced to close last weekend after a mild run on deposits escalated to panic withdrawals. 25X1 After providing Banco Filipino with over $40 million in emergency financing, the Central Bank decided to seek new ownership for the troubled bank rather than continue rescue operations. The move has left Central Bank Governor Fernandez vulnerable to press criticism. Banco Filipino is apparently an early casualty of Manila's efforts to comply with IMF austerity targets. The Central Bank has moved to reduce the money supply by drawing reserves away from private banks--driving short-term interest rates up to over 30 percent. Its ability to pump rescue funds into weaker financial institutions is limited by the Fund's monetary reserve targets. [redacted] 25X1

The banking crisis has encouraged the opposition to challenge the government's economic management record. In addition, President Marcos's business associates, whose economic privileges have been eroded by economic reforms, are launching new attacks on technocrats and the policies prescribed by the IMF. With a Fund rescue package on hold and the economy steadily worsening, Marcos will be increasingly tempted to divorce himself from the technocrats to deflect mounting criticism. [redacted] 25X1

New Mexican Loan Requests

[redacted]

The Mexican Government is backing away from earlier statements that it would not seek new credits from international banks for 1985, partly because it fears that world interest rates will rise further. Officials now plan to ask for a 25X1 new $1.6-2 billion credit line from commercial banks to handle financial contingencies next year. To avoid almost certain rejection by a large number of banks that are already upset by the breadth of its requests for debt rescheduling, Mexico will call for voluntary participation and count on money-center banks to cover any shortfall. Mexican officials now project their requirements for new commercial borrowing to increase an average 4 percent each year through 1990. [redacted] 25X1

Chile Ponders Devaluation

[redacted]

Chile's deteriorating balance of payments may force Santiago to devalue the peso before the end of August, despite probable adverse domestic consequences. The Central Bank now projects a $1.8 billion current account deficit 25X1 for 1984, a 30-percent increase over earlier projections. Higher-than-anticipated import growth, coupled with the dampening effect of depressed copper prices on export earnings, will reduce the expected trade surplus by some $300 million and the Central Bank estimates that higher interest rates will add $126 million to the deficit. [redacted] 25X1

[redacted] 25X1

In response to the worsening payments position, the free market peso is trading at a 30-percent premium above the official exchange rate, increasing the prospect of capital flight—a factor that has precipitated devaluation in the past. [redacted] 25X1 A devaluation would increase the burden of servicing dollar-denominated foreign loans and cause real wages to drop by spurring inflation. Pinochet probably anticipates widespread public criticism if he devalues, but he may be more concerned that delaying this move will erode Chile's ability to comply with its IMF program. [redacted] 25X1

Cuba's 1984 Debt Rescheduled

[redacted]

Agreements for rescheduling about $365 million of Cuban debt payments falling due this year were reached separately with Western creditor governments and commercial banks during the past week. Both provide for a four-year repayment schedule following a five-year grace period. The interest spread on commercial debt will be 1.875 percentage points above LIBOR. Cuba last year obtained only a three-and-a-half-year grace period while having to pay 2.25 percentage points above LIBOR. [redacted] 25X1 25X1

Colombian Troubles With Bankers Continue

[redacted]

Lenders are indicating that Bogota will have difficulty securing a $700 million loan this year for energy development projects. The press reports that former Finance Minister Gutierrez told British bankers in London that Chase Manhattan Bank is willing to lead the syndication [redacted] 25X1

Bankers are concerned about: Colombia's low level of official reserves, Bogota's refusal to aid the ailing Banco de Colombia, the country's largest private bank, and sluggish economic conditions. Moreover, we expect the upcoming IMF consultative mission to render a negative evaluation on Colombia's trade, fiscal, and monetary policies. The IMF will most likely recommend that Colombia take a strong dose of austerity. Such a measure would meet strong political resistance, but Bogota probably will have difficulty securing credit support and rescheduling its debt unless it goes along with IMF prescriptions. [redacted] 25X1 25X1

Haitian Financial Problems

[redacted]

Haiti is at least $15 million over the budget deficit target of its IMF standby program because of a surge of expenditures last month. According to the IMF, about half of these expenditures were commercial purchases and emergency relief. Haiti also recently contracted to purchase $12 million in armaments. The food riots in May apparently have weakened Port au Prince's resolve to abide by IMF guidelines. The Duvalier regime probably is trying to improve its public image by financing some domestic growth through government 25X1 spending. Over the short term, problems with the IMF and irresponsible government spending will reduce business confidence and increase capital flight. Without significant foreign aid—an unlikely prospect—Haiti will have a difficult time getting its budget back on track before its next IMF review in September. [redacted] 25X1

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[redacted]

Zambian Debt Rescheduling

[redacted]

Zambia has arranged to reschedule nearly $200 million in foreign debts, thus paving the way for another $220 million in IMF loans, according to press reports. Zambia had faced debt service payments of $609 million compared with only $42 million in available funds. Payments to Western creditors will be spread over five years preceded by a five-year grace period. The IMF loan, tentatively approved last week pending the debt rescheduling, probably will be granted. The Zambian economy has been hit hard by the low price of copper, which provides as much as 90 percent of foreign-currency earnings. Recent loans to Zambia have been targeted at strengthening agriculture and diversifying exports to lessen dependence on copper. [redacted] 25X1

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Global and Regional Developments

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[redacted]

[redacted] 25X1

First Sale of Fokker's New Passenger Jet

[redacted]

The Netherlands' Fokker aircraft company received its first order for the Fokker 100, a twin-engine passenger jet now in development. Swissair, which bought eight F100s for delivery starting in 1987, paid about $19.5 million for the 85-passenger luxury configuration. We believe the price for the standard 100-to-105-seat version will be $16-17 million, comparable with Boeing's 737-200. Fokker won the Swissair sale against strong competition from British Aerospace, Boeing, and McDonnell Douglas. Fokker is pushing for a quick succession of orders for the F100 in Western Europe and the Third World and is expected to mount a major marketing effort in North America [redacted] 25X1 25X1

[redacted] 25X1 25X1

Tokyo's Aid to Iran

[redacted]

Japan will provide technical assistance to Tehran for the first time since the Iranian revolution began in 1979. According to press reports, the Japan International Cooperation Agency and the Government of Iran signed an agreement on 19 July to cooperate in an agricultural development project in Mazanderan Province. Foreign Minister Abe promised assistance for this project and for an urban transport project in Tehran during his visit to Iran last year. Tokyo probably granted the aid at this time in an effort to deflect criticism of its recent reduction in oil imports from Iran. [redacted] 25X1 25X1

Possible Airbus Deal With Pan Am

[redacted]

Western Europe's Airbus Industrie is negotiating a leasing and sales agreement with Pan American Airlines for up to 67 aircraft valued at $2 billion. A sale of this size would allow Airbus to clean out its inventory of some 20 unsold A-300 and A-310 wide-bodies; the deal would also mark the first sale of A-310s to a major US carrier. According to key industry spokesmen in Western Europe and the United States, Pan Am can expect favorable price or leasing offers that would be likely to include an option to exchange some A-300s or A-310s for the new 150-seat A-320 when it becomes available in 1988. We believe the sales would add prestige to the Airbus worldwide marketing campaign, lead Airbus officials to put renewed emphasis on the North American market, and enhance the long-range sales potential of the A-320 around the world. [redacted] 25X1 25X1

National Developments

Developed Countries

Tightened Israeli Foreign-Currency Restrictions

[redacted]

The Israeli Government announced a series of foreign-currency restrictions this week to stem the decline in foreign exchange reserves and reduce imports. According to press reports, the new measures include:

- A ban on the transfer of foreign currency as a gift to relatives abroad unless prior approval is granted by the Bank of Israel. Israelis had been allowed to send $2,000 per person per year. 25X1
- Imposition of a 15-percent value-added tax on imported goods, foreign purchases made with credit cards, and hotels, meals, and car rentals made through Israeli travel agents.
- A ban on advance payments for imported goods.

We believe these restrictions will be counterproductive unless the government cracks down on the black market. Israelis have become adept at getting around such controls, which had existed until October 1977. [redacted] 25X1

Tokyo Setting Another Tight Budget

[redacted]

Japan's Ministry of Finance is pushing for a 10-percent cut in current expenditures for most ministries and a 5-percent reduction in public works spending in the budget for fiscal year 1985. Spending on defense, foreign aid, and personnel will increase, but the Ministry wants to keep total spending at about the level of this year's budget—already the tightest in over 30 years. Prime Minister Nakasone, who faces an election for the Liberal Democratic Party (LDP) presidency in November, has encountered mounting pressure from within the LDP for increased spending. Last weekend two of his potential rivals—Toshio Komoto, a faction leader and chief of the Economic Planning Agency, and Kiichi Miyazawa—criticized his economic policy. [redacted] 25X1 25X1

Japan's leading business federation, on the other hand, has publicly reiterated support for budget cuts. Nakasone backs the Ministry of Finance targets but has decided to use the word "standards" instead of "ceilings" for the spending limits to provide himself with more flexibility later in the year when revenues will be easier to forecast. [redacted] 25X1

Militant Union Backs Australian Wage Accord

[redacted]

Prime Minister Hawke's wage accord--the centerpiece of his government's economic policy--received a boost last week as trade union leader Norm Gallagher pledged to reduce the number of strikes in the construction industry. Gallagher controls the 24,000-member Building Laborers' Federation, a leftwing union whose militancy in pursuit of wage increases had posed one of the greatest threats to Hawke's wage policy. Gallagher reportedly gave his pledge in order to preempt a move by employers to have the union deregistered by the federal court--a move which would have denied the federation the benefits of Australia's industrial arbitration system. [redacted] 25X1 25X1

Less Developed Countries

[redacted] 25X1

Philippine Rice Imports Up

[redacted] 25X1

The Philippines—a rice exporter in recent years—is importing 150,000 tons of Asian rice to quiet public protests over inflation and rumors of impending rice shortages. Although the Philippines has enough rice to meet domestic needs, traders and farmers are withholding supplies from the market in anticipation of an increase in the government-controlled price. Manila's decision to import rice rather than raise the price—despite a severe foreign exchange shortage—stems from a fear of aggravating the 40-percent annual rate of inflation. Imports probably will stabilize the domestic price of rice and assure adequate supplies for the capital. Recent Philippine rice purchases are likely to tighten available export supplies of non-US rice and probably exert upward pressure on international rice prices. Other developing countries that import rice and have not already lined up their supplies may find little rice available at affordable prices until late fall. [redacted] 25X1

Argentine Sugar Earnings To Fall

[redacted]

Argentina's sugar export earnings are expected to fall by one-third to about $88 million in the current marketing year--June 1984 to May 1985. A smaller sugar crop, a reduced US import quota, and depressed world sugar prices are the major contributing factors. Argentine sugar export volume is forecast by the US Department of Agriculture at 580,000 metric tons, down sharply from the record exports of 760,000 tons registered in the last marketing year. 25X1
Argentine shipments to the United States under the sugar import quota system will amount to about $35 million, a 5-percent drop from marketing year 1983/84. Argentine earnings from shipments to non-US markets are expected to total only $53 million compared with about $100 million in the 1983/84 marketing year. [redacted] 25X1

Communist

Soviet Grain Prospects Deteriorate

[redacted]

Recently available meteorological data show that about half of the grain crop in Kazakhstan was hit with hot, dry winds from 9 to 12 July. Soviet weather stations reported temperatures as high as 107 degrees Fahrenheit and winds of 10 to 15 knots. [redacted] 25X1
[redacted] prolonged, excessive rainfall in the western Ukraine and Belorussia has cut potential yields there as well. The affected areas account for about 10 percent of the annual harvest. Because the winds occurred during the critical flowering period—when maximum potential yields are determined—as much as 3 million tons of grain may have been lost in Kazakhstan. Although damage in the Ukraine and Belorussia so far has been minimal, sizable losses are in prospect if the fields do not dry out in the next few weeks. Even with normal weather for the remainder of the year, total Soviet grain production is likely to be only about 190 million tons, 5 million less than the estimated output last year. [redacted] 25X1

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Stepped-Up Soviet Grain Imports

[redacted]

Moscow has bought more than 700,000 metric tons of new crop corn from the United States in the past two weeks, bringing total corn purchases to 2.1 million tons so far this marketing year. The Soviets have also continued their purchases of US wheat, buying some 2 million tons since the middle of last month. Since then Moscow has also purchased at least 2 million tons of grain from the EC and possibly 750,000 tons from Australia. This brings total purchases from all sources to at least 12 million tons and perhaps as much as 15 million tons this marketing year. [redacted] Moscow is buying, in part, to stockpile grain this year. The Soviet purchases of US corn are scheduled for delivery after September and will be counted in the new year of the current US-Soviet Long-Term Agreement (LTA), which begins on 1 October 1984. The 2 million tons of wheat will be exported under the current LTA year. This raises total Soviet purchases in the current LTA year to 12.3 million tons—4 million tons above the required minimum. [redacted] 25X1

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Moscow appears to be stepping up grain imports for a number of reasons. Adverse weather has reduced the crop, and a slow start in harvesting the forage crop will mean lower supplies this year. On the other hand, domestic grain demand is higher because of an increase in livestock herds to record levels. If reports of grain stockpiling are correct, the Soviets probably will have to import more than 40 million tons. Some of the increase in US grain purchases probably is due to delays in Argentine shipments to the USSR. Although the USSR has been buying grain from Canada this marketing year, the Canadians could not fill the latest grain orders because of limitations on their ability to transport large quantities of grain on short notice. 25X1

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Yugoslav Economic Problems

Falling living standards are prompting new concern in Croatia about potential unrest. The US Consul General in Zagreb reports that Croatian workers' income is not keeping up with inflation. Consulate sources worry that new government-imposed austerity measures—including pay cuts in the most troubled enterprises—will accelerate the decline in living standards, increase the number of strikes, and pose a threat of mass protests. Yugoslav workers continue to show restraint in the face of economic decline, but their patience probably is wearing thin. Significant unrest in Croatia almost certainly would spill over into other parts of the country where ethnic tensions and similar economic privations exist. Croatian leaders might use this threat to press Belgrade to ask the IMF for more relaxed performance conditions on the current standby agreement. The Yugoslav leadership, however, is increasingly divided over economic policy and probably would not unite behind a request to the IMF that would call into question its economic stabilization program. 25X1

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Soviet Computer Initiatives

An unconfirmed report in a Western computer industry publication says the Academy of Sciences of the USSR will include a fifth-generation computing research program in its next five-year plan. Western computer scientists expect to develop a generation of computers capable of a high level of deductive reasoning, which could, for example, make medical diagnoses. 25X1 25X1

As recently as November, leading Soviet computer scientists showed little interest in logic programing, a topic that is central to fifth-generation computer efforts. The Soviets presumably want to keep from falling further behind the highly publicized Western fifth-generation initiatives and, in particular, to acquire enough knowledge to exploit any Western advances. 25X1

Soviets Buying Biotechnology To Reduce Grain Imports

Open source reports indicate that the USSR—in an effort to become less dependent on imported grain—is using biotechnology to produce protein supplements for use in livestock feeds. The Soviets have acquired chemical-processing plants and are negotiating with several West European nations to buy operational protein-supplement-production facilities. The Soviets probably will secure the protein-supplement facilities and succeed in using the Western biotechnology to make significant gains toward agricultural self-sufficiency. By 1990 the Soviets should have the capability to produce enough protein supplements to reduce their annual grain imports by 6 million to 11 million metric tons—a substantial decrease from the 33 million tons of grain Moscow imported in 1982. 25X1

International Financial Situation: Latin American Debt Update

25X1

The results of the Cartagena Conference last month suggest limited support for joint action against creditors and no movement toward a debtors' cartel. Nevertheless, the participants cited unanimous concern over rising interest rates, repayment terms, and IMF conditionality, and they formed a secretariat to coordinate positions on these issues. It appears that the debtors believe the conference advanced their efforts to obtain easier repayment terms, even though our review of developments indicates that the situation remains essentially unchanged. We expect the gap between debtors' expectations and market realities to come into clearer focus at the Cartagena working group meeting scheduled for 2 August in Buenos Aires. The result is likely to be increased criticism of creditors and redoubled efforts to forge common positions.

Cartagena in Perspective

The Cartagena Conference established a permanent political forum to voice Latin concerns, but it did not change the current approach of negotiating with creditors on a bilateral basis. The delegates reached no consensus on radical proposals, such as a unilateral moratorium on interest payments. The conference, by limiting itself to the lowest common denominator, helped to reinforce the moderate position taken by Brazil, Mexico, and Venezuela.

The results of the conference suggest that Latin debtors would support joint action only if it does not threaten their ability to negotiate individually with commercial banks and creditor governments. While many of the participants at Cartagena apparently believe there are at least political benefits in coordinated positions, the final communique indicates an unwillingness to reject the current case-by-case approach to debt renegotiations. Whether this attitude persists probably will depend on a number of developments:

- The Cartagena participants are waiting for a response from creditors to the concerns they expressed in the communique. They are asking for more concessions from commercial banks and a dialogue with industrialized countries aimed at changing trade-related policies of the IMF and multilateral development banks.

- A significant increase in the US prime rate and LIBOR would have a highly charged emotional effect on Latin governments and encourage them to seek a joint solution to the interest burden.

- Argentina's debt situation and Mexico's negotiations with creditor banks will be closely watched this summer by the Cartagena participants. Insufficient progress could make the next Latin debtor meeting in Buenos Aires—tentatively scheduled for September—much less moderate. 25X1

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Despite the conciliatory tone of the Cartagena consensus, the creation of the consultative secretariat is the first concrete step toward a unified stand on debt issues. It will enable the Latin debtors to coordinate their actions more effectively by sharing information on IMF and debt negotiations. Moreover, it indicates a heightened political willingness to press for financial reforms, which is confirmed by the selection of Argentina as the first coordinating secretary of the consultative mechanism. 25X1

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IMF Developments

[redacted]

Despite the lack of an accord with the IMF, *Argentina* and its bank advisory committee worked out an arrangement that allowed Buenos Aires to slip past the 30 June deadline for settling interest arrearages. We see signs, however, that Buenos Aires is adjusting its economic policies in the direction sought by the IMF. Buoyed by several political successes, President Alfonsin seems more willing to confront labor and demand sacrifices, promising only to shelter the lower wage earners. He put a 12-percent cap on wage increases for July despite an 18-percent rise in prices in June, and he has raised gasoline prices and transport fees to reduce the need for subsidies. Economy Minister Grinspun told the press again recently that an IMF agreement will be reached within weeks. An Argentine press article, claiming to quote informed sources, says that an IMF agreement will be reached by 15 August and that the government is prepared to put into place tough economic measures to bring inflation down to 200 percent by June 1985. The article said that the government intended to restrict wage increases and bring the official exchange rate closer to that of the black market. [redacted] 25X1

Venezuela's bank advisory committee agreed to begin debt rescheduling after IMF representatives commented favorably on Venezuela's self-imposed economic adjustment efforts. [redacted] 25X1 The US Embassy reports that Venezuela is likely to propose rescheduling $22 billion in debt over a 15-year period and adopting an interest rate ceiling, with interest charges above it added to unpaid principal. Although Caracas probably will accept other IMF terms, progress in rescheduling will be slow until the government settles past-due debt payments. [redacted] 25X1

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Bank Negotiations

Mexican rescheduling talks began this week in New York and apparently are raising questions rather than defining areas of consensus. In our judgment, substantial concessions from both Mexico and commercial banks will be needed for any tentative settlement, and convincing US regional and West European bankers to accept the agreement will be even harder. [redacted] 25X1 [redacted] bankers are reluctant to give Mexico favorable terms because they realize other LDC debtors will be watching these negotiations closely and will seek similar deals. 25X1 The thorniest questions revolve around coverage of rescheduled debt, financial concessions, and continued monitoring of the deal, [redacted] The amount of debt restructured will range from $20 billion to $60 billion. 25X1 Mexico wants to reschedule obligations falling due through 1990 at an interest spread of less than 1 percentage point above LIBOR, but most banks prefer a shorter restructuring period covering repayments due through

1988 at a spread of at least 1.5 percentage points. Bankers are demanding some continuing role for the IMF through the period of the rescheduling. They particularly want some assurances for policy continuity in the administration that begins in 1988. Mexico City, however, will find it hard to accept conditionality past the current three-year IMF agreement, which expires next year. [redacted] 25X1

Chile's worsening payments position is heightening the need for additional money this year. [redacted] 25X1

[redacted] 25X1

[redacted] Chile will need $1.5 billion in new money next year, according to US Embassy reports. Given the difficulties in lining up the recent credit, we believe banks will be unreceptive to such a request for more money this year and reluctant to lend even one-third of what is needed next year. Meanwhile, the Finance Minister will seek $75 million in compensatory financing from the IMF and draw down foreign reserves by $200 million to cover the expected shortfall in copper revenues, according to press reports. We believe Chile will need to draw down at least $450 million in foreign reserves or delay some interest payments if Santiago fails to obtain another loan this year. [redacted] 25X1

Peru's failure to meet a $26 million interest payment to foreign banks on 5 July is jeopardizing the remaining $100 million tranche from the jumbo loan negotiated in 1983. Peruvian financial officials argued that the Central Bank could not finance the interest payment without violating IMF targets for net government indebtedness and net domestic assets. According to US Embassy reporting, Peru had requested a $90 million bridge loan from its creditor banks to cover this overdue debt payment, but the loan was rejected. [redacted] With little external financing now available and strong domestic political pressure to relax austerity, President Belaunde will have great difficulty meeting commercial debt payments and maintaining compliance with IMF performance criteria in coming months. [redacted] 25X1

[redacted] 25X1 25X1

Bolivia met with its private creditors recently to discuss its unilateral payment suspension. The US Embassy reports bankers granted La Paz a 90-day truce—not a moratorium—to work out a final debt-rescheduling agreement. Finance Minister Bonifaz claimed La Paz needs the 90 days to try to obtain labor support for the negotiations, but assured bankers that Bolivia intends to pay its debt with or without labor backing. Bankers indicated to Finance Minister Bonifaz that failure to make progress during the 90-day period would terminate debt-refinancing talks and leave bankers free to take legal action against Bolivia. [redacted] 25X1

[redacted] Bolivia's failure to reach a debt-rescheduling agreement this time probably will block for the foreseeable future new credits to finance development projects that are needed to resuscitate the ailing economy. [redacted] 25X1 25X1

Lenders also are indicating that *Colombia* will have difficulty securing a $700 million loan this year for energy development projects. [redacted] We expect that Bogota probably will encounter problems securing new credit and rescheduling its debt unless it agrees to an IMF-supported adjustment program. [redacted]

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Implications

As part of the collaborative effort established at Cartagena, a working group of the Latin debtors will meet on 2 August in Buenos Aires. The group probably will review financial developments since Cartagena and share technical information concerning their debt talks. As a result, we expect that the gap between debtors' expectations and market realities will come into clearer focus, prompting criticism from the participants about the lack of progress toward a solution to their repayment problems. Although we still expect no movement toward a debtors' cartel, a surge in interest rates or a perceived continued lack of progress toward easing the debt burden during the summer could yet forge closer links among these disparate governments. This would encourage concerted action on debt at the ministerial meetings slated for Buenos Aires in late September. [redacted]

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[redacted]

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El Salvador: Economic Challenges Facing the Duarte Government

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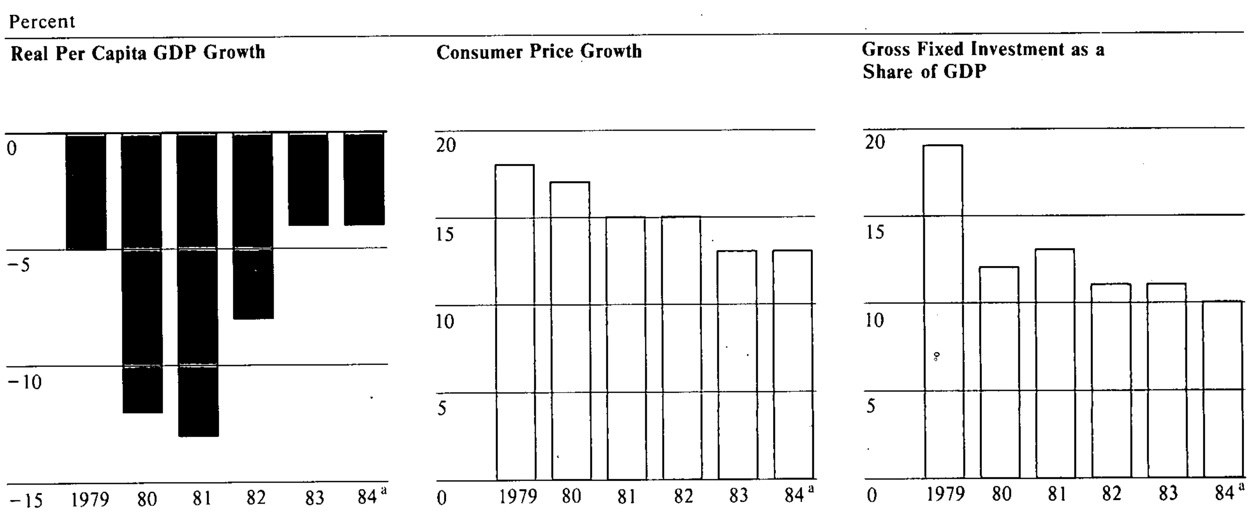
Despite substantial US aid, we believe that economic activity in El Salvador will decline—albeit slightly—for the sixth consecutive year and that little recovery will occur before early 1985. For now at least, President Duarte's focus on political and military matters and his strong commitment to redistributing economic and social power are delaying the tough actions needed to stimulate the economy. Duarte's economic maneuvering room is narrowing, however, as the country faces a rising number of guerrilla strikes at economic targets, increasing leftist-inspired labor unrest, and rightist opposition to present economic policies. In these circumstances, we believe Duarte will continue to avoid a currency devaluation and other measures requested by the IMF as long as possible. Instead, he probably will go on pressing Washington to relax the conditions of its economic assistance and to increase El Salvador's US sugar quota. 25X1

The 1983 Record

Compared with the dramatic decline in the previous four years, the economy was calm in 1983. The torrent of private capital flowing out of the country slowed substantially. Buoyed by US funds and the reallocation to El Salvador of a large share of Nicaragua's sugar quota in the US market, export earnings rose 5 percent, after dropping 12 percent in 1982. Improved security in San Salvador and

El Salvador: Economic Indicators, 1979-84



[a] Projected.

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other major cities helped deter guerrilla attacks on factories and commerce.

Although we cannot measure El Salvador's economic performance with certainty, we believe a variety of factors depressed real GDP slightly in 1983—perhaps 1 percent—leaving domestic output more than 25 percent below the 1978 peak. USAID estimates indicate that the manufacturing sector declined 3.2 percent; this probably reflects continuing shortages of domestic and foreign credit, reduced trade within the Central American Common Market, and the lack of new investment to replace wornout plant and equipment. Improved agricultural performance partly compensated for this decline as the production of basic grains and sugar increased in 1983. Unfortunately, much of this improvement was offset by inadequate maintenance of plantations, the spread of coffee rust, sluggish world demand, and guerrilla damage to agriculture—estimated by the US Embassy at $90 million last year.[1]

Duarte's Initial Approach

Duarte's relatively narrow election victory in May 1984—he received 54 percent of the vote—has prompted him to move cautiously. Duarte has assuaged military fears that he might accept a power-sharing arrangement with the insurgents by challenging the guerrillas to lay down their arms and participate in the democratic process before beginning talks. He has yet to convince the business community, however, that it stands to gain from his economic policies.

Duarte and his key economic advisers have stressed publicly that their vision of social justice will take priority over government efforts to promote economic recovery and to assist large businesses. Duarte already has met on several occasions with private-sector representatives, an indication that he

[1] The US Embassy calculates that total direct economic damage and production losses reached $230 million in 1983, bringing the five-year total to about $800 million.

El Salvador: Balance of Payments *Million US $*

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	1982	1983	1984 [a]
Trade balance	−263	−219	−297 to −414
Exports, f.o.b.	700	737	730
Coffee	403	403	405 [b]
Cotton	45	55	40
Sugar	16	41	41 [c]
Shrimp	19	13	14
Manufactures to CACM	174	170	165
Other	43	55	65
Imports, c.i.f.	963	956	1,027 to 1,144
Military goods	80	87	127 to 244
Net services and transfers	106	89	173 to 290
US grant aid [d]	187	160	250 to 367
Current account balance	−157	−130	−124
Capital account	53	172	120
Of which:			
US loans [d]	92	122	115
Changes in net reserves	**−104**	**42**	**−4**

[a] Projected.
[b] Includes $50 million worth of prior years' production that El Salvador intends to sell this year.
[c] Assumes US quota remains at current levels.
[d] Estimates for 1983 include one-fourth of the FY 1984 appropriation. Projections for 1984 are based on the presentation to Congress.

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is not insensitive to their concerns. Nonetheless, his deeply held commitment to restructuring El Salvador's social, political, and economic institutions has led him to strongly resist proposals to devalue the currency or to raise guaranteed coffee prices to realistic levels, because these measures would raise the profits of large coffee growers at the expense of the urban poor and small nonagricultural businesses. In his initial public speeches, newly appointed Minister of the Economy Ricardo Gonzalez Camacho has indicated that the government may impose additional price controls, that the nationalized banks may divert scarce credit to smaller business-

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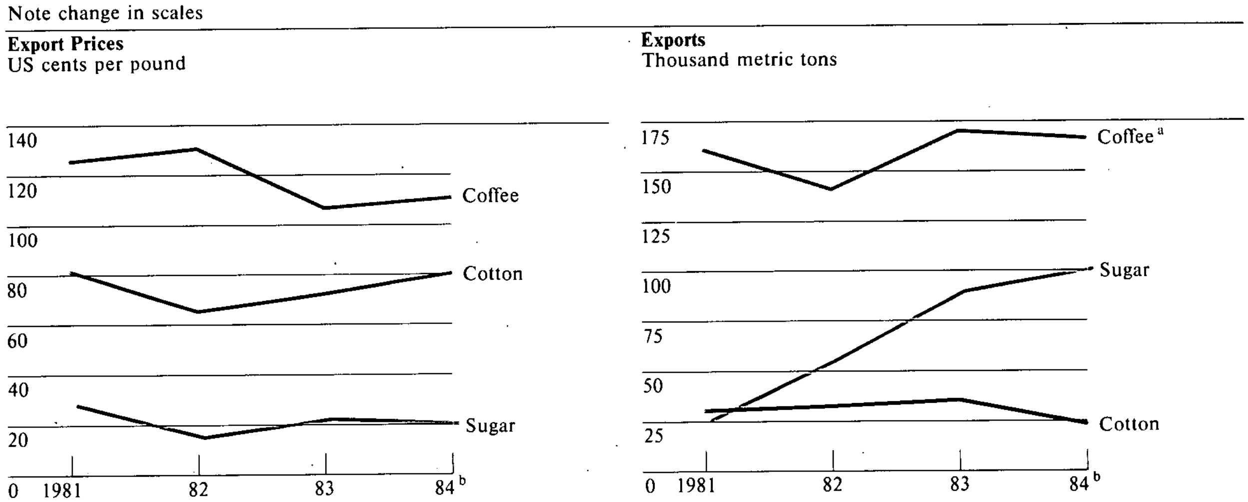
El Salvador: Agricultural Exports, 1981-84



[a] Including export of about 20,000 tons stored from prior year's production.
[b] Projected.

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es, and that "consumer protection" will be a major government concern. 25X1

Disappointing External Factors

We judge that only one of the major external forces affecting El Salvador's economy—the strength of US demand—is likely to improve much in the near term. Robust US economic growth and the tariff benefits afforded by the Caribbean Basin Initiative offer Salvadoran exporters an excellent opportunity to expand manufactured exports to the US market. The US recovery, however, probably will provide only small immediate benefits. Even assuming Salvadoran sales of manufactured goods to the United States increase 20 percent this year, export earnings would rise only $10 million or 1 percent. World prices for the agricultural exports—coffee, cotton, and sugar—that account for the bulk of El Salvador's exports and one-fourth of its GDP are projected to rise little, if at all, over the next year. Meanwhile, rising US interest rates and a strong US dollar are likely to encourage illegal capital flight and to raise the costs of servicing El Salvador's foreign debt. Other CACM economies that have traditionally bought nearly all of El Salvador's manufactured exports will continue to be hobbled by severe foreign exchange difficulties and curtailed domestic demand. 25X1

Since the expiration of El Salvador's $85 million IMF standby agreement last year, the United States has shouldered the bulk of foreign financial support for the Salvadoran economy. For 1984, some $240 million in US economic aid (and as much as $244 million in military aid) is tentatively slated for El Salvador. About half of the economic assistance is earmarked for the private sector in direct support of production and exports. 25X1

El Salvador: Projected US Assistance for FY 1984 [a]

Million US $

Total	**371.4 to 488.4**
Economic support fund	120.0
Development assistance	43.1
PL-480	51.3
Loan guarantees	30.0
Military	127.0 to 244.0

[a] State Department estimates of the amount that will be obligated by end of FY 1984.

[redacted]

Other donors will provide much smaller amounts:
- West Germany and Japan have agreed to provide economic aid, but the amounts will be relatively small.
- Under the provisions of the San Jose Accord, Mexico and Venezuela together are offering petroleum price discounts that probably will be worth about $30 million.
- The Inter-American Development Bank is expected to disburse $40 million in development assistance.

International commercial banks continue to scale down their exposure in El Salvador. According to a preliminary government estimate, El Salvador expects to receive no more than $26 million in net nonguaranteed commercial bank credit this year. [redacted]

Domestic Challenges

Although the availability of foreign exchange is a critical problem, we believe that internal developments will be the most important factors influencing the Salvadoran economy over the next year. Some indicators suggest that the rise in guerrilla attacks aimed at the economy, coupled with leftist-inspired labor unrest and the Duarte government's approach to socioeconomic reform, could well heighten capital flight and undermine recovery in 1984. [redacted]

Guerrilla Activity. The guerrillas recently stepped up their campaign to destroy the economy after a series of government successes since last summer put them on the defensive. Shortly after Duarte's election, for example, guerrilla leaders publicly declared the start of a new effort to disrupt cotton farming. In June, the insurgent Radio Venceremos announced a campaign to halt traffic on the nation's main transport routes. Increased insurgent attacks on communications and power installations periodically have choked commerce in several eastern provinces, and even small commercial facilities in the capital are again being sabotaged, according to the US Embassy. [redacted] 25X1

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In addition to hitting these lightly defended, low-value targets, the guerrillas retain the ability to attack major economic installations. In late June, FMLN forces launched a raid against the largest hydroelectric dam in the country, damaging a substation near the dam and holding a large part of the complex for several hours before it was retaken by the Army. Although government counterinsurgency operations have improved over the past year, we believe the Army will not be able to prevent the guerrillas from attacking more such targets during the insurgents' planned late-summer or early-fall offensive. [redacted] 25X1

Labor Unrest. The guerrillas also are trying to foment labor unrest to undermine the government. [redacted] 25X1 25X1

[redacted] since Duarte's election, two leftist-dominated government unions have already gone on strike and several more are reportedly planning to do so. A six-week-long strike by postal workers temporarily disrupted the flow of remittances into El Salvador from workers in the United 25X1

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States and elsewhere. [redacted]

Faced with continuing double-digit inflation and a budget deficit projected to exceed 10 percent of GDP this year, the government can ill afford a general round of wage hikes. In addition, Duarte almost certainly would improve his standing with rightist elements by taking a hard line with strikers. Nonetheless, if intransigence on both sides results in widespread, prolonged strikes, it would deal a substantial blow to internal commerce and export earnings. [redacted]

Business Uncertainty. The highly conservative "traditional" private sector in El Salvador—the wealthy businessmen and plantation owners who had a lock on El Salvador's economic life before 1979—are deeply opposed to much of Duarte's economic agenda. Still rankled by the 1980 nationalization of banks and the establishment of government monopolies for marketing coffee and sugar, the business sector worries that Duarte's strongly held views on social justice will lead him toward additional nationalizations and expropriations. Duarte and his ministers, meanwhile, have rejected policies that could most immediately bolster business profits and have called for sacrifice and social solidarity by the traditional sector. [redacted]

As the US Embassy has noted, most members of the traditional sector reject any suggestion that El Salvador's political and economic troubles are attributable to the middle or upper income business classes. Appeals for them to take the brunt of any additional hardships will encounter stiff resistance. As long as these classes perceive that Duarte is a serious threat to their fundamental interests, we believe they are likely to exploit available opportunities—including abusing the access to foreign exchange afforded by US aid to the private sector—to transfer additional funds out of the country into such safehavens as Miami and to shun the industrial and agricultural investment at home needed to revitalize the economy. Despite stepped-up government efforts to curb capital flight, we believe that current controls could be evaded with relatively little difficulty. Efforts to get capital out of the country will be intensified by the recently enacted land reform program that requires all individual land holdings above 245 hectares to be sold. [redacted]

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Near-Term Outlook

We believe the cumulative effects of these factors will cause economic activity to dip slightly again this year. Even if the armed forces can keep the guerrillas on the defensive and Duarte can mollify leftist unions and rightist business elements, the poor outlook for world commodity prices and neighboring economies would preclude much economic expansion at least until the next harvest season ends in early 1985. Coffee production probably will decline significantly in the next harvest as the failure to replant coffee lands during the early years of land reform begins to take its toll. We doubt that the nationalized banks and land reform agencies will become much more efficient in processing loans and giving technical assistance to farmers. Moreover, government borrowing to finance rising war expenses and higher salaries probably will preclude much expansion in domestic credit to the private sector. [redacted]

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We expect that over the next few months Duarte will move slowly, if at all, on such issues as higher prices for coffee growers and devaluation—the colon has remained at the same fixed rate to the US dollar for 50 years. Devaluation of the colon is a central element of conditionality for both US aid 25X1

The Status of Land Reform

The Salvadoran land reform program, which is far more ambitious than that implemented to date by the Sandinista regime in Nicaragua, is regarded by many observers as the key to successful redistribution of income in El Salvador. Begun in early 1980, the program has achieved greater results in redistributing legal titles than in providing the management assistance, credit, and technical support to make it an economic success. About one-fifth of El Salvador's land under cultivation has been redistributed.

Phase I, the expropriation of farms over 500 hectares, is complete. Some 439 estates, accounting for 15 percent of El Salvador's cultivated land, have been converted into cooperatives. Slightly more than half the former owners of these estates have been compensated so far, mostly by 30-year, 6-percent bonds—which many former owners fear will never be redeemed. About 190,000 Salvadorans (including family members) are beneficiaries of Phase I. The Salvadoran Institute of Agrarian Reform (ISTA), the government agency designed to funnel credit and other assistance to the cooperatives, has been plagued with poor administrators and a lack of funds. Many heavily indebted cooperatives are finding it difficult or impossible to repay their loans. Moreover, from 1982 until Duarte's election, ISTA was run by a partisan of the rightwing ARENA party and was used to undermine reforms and to recruit votes for ARENA.

After a prolonged political struggle, Phase II of the land reform program was written into the new constitution in late 1983. Originally designed to break up the remaining holdings between 100 and 500 hectares, the Assembly compromised on an upper limit of 245 hectares per owner. Landowners holding more than 245 hectares now have until the end of 1986 to sell the excess. Several apparent loopholes in the law, however, suggest that current owners will be able to evade Phase II by putting excess land in the name of a corporation. Few of the roughly 20,000 hectares affected have been sold.

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Phase III gave tenant farmers the right to claim 7 hectares of the land that they were tilling when the reform was initiated. About 40,000 hectares, or 6 percent, of all farmed land had been redistributed under this phase by the time the filing period expired in June 1984. Of some 117,000 potential claimants, only about half filed claims; just 9,000 of those have received permanent titles to the plots. National Financiers of Agricultural Lands (FINATA), the agency created to process tenant claims, has a huge backlog of cases and, like ISTA, has suffered from incompetent employees. Landlords have evicted about 7,000 of the Phase III claimants since 1980, but most of them eventually regained access to their land with assistance from the military. Duarte recently pledged that the government would buy additional land to distribute to those tenant farmers who had not filed claims by the time the Phase III filing period expired.

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and any future IMF relief package. We expect that, as a result, Duarte will drag his feet on a new IMF accord and will continue efforts to persuade the United States to ease its conditionality requirements. He will also try to persuade Washington to increase the amount of sugar El Salvador is permitted to sell to the United States at preferential prices. In these circumstances, foreign investors and lenders will remain chary of El Salvador.

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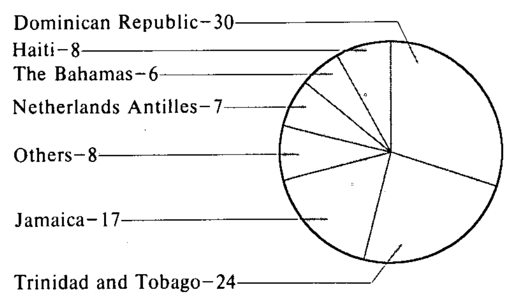
The Caribbean Area: No Economic Recovery in Sight

The Caribbean area shows little sign of pulling out of its economic slump any time soon. Although the output of the major Caribbean countries fell only slightly in both 1982 and 1983, many of the ministates performed substantially worse. High oil prices, low world commodity prices, rising foreign competition for tourists, and government mismanagement were largely responsible. Some Caribbean governments are adopting a more rational approach to economic decision making than previously. However, growing popular resistance to austerity, a tentative world recovery, and the general cut in commercial lending to Latin America will make it difficult to secure or retain IMF programs designed to restructure the region's economies over the longer run. Consequently, we expect the region to show little or no growth and unemployment rates to range between 20 and 40 percent in most countries over the near term. The result is likely to be increased requests for US assistance as well as stepped-up pleas for US intercession with the IMF and other donors to ease aid requirements.

The Caribbean: GDP by Major Contributor, 1981

Percent



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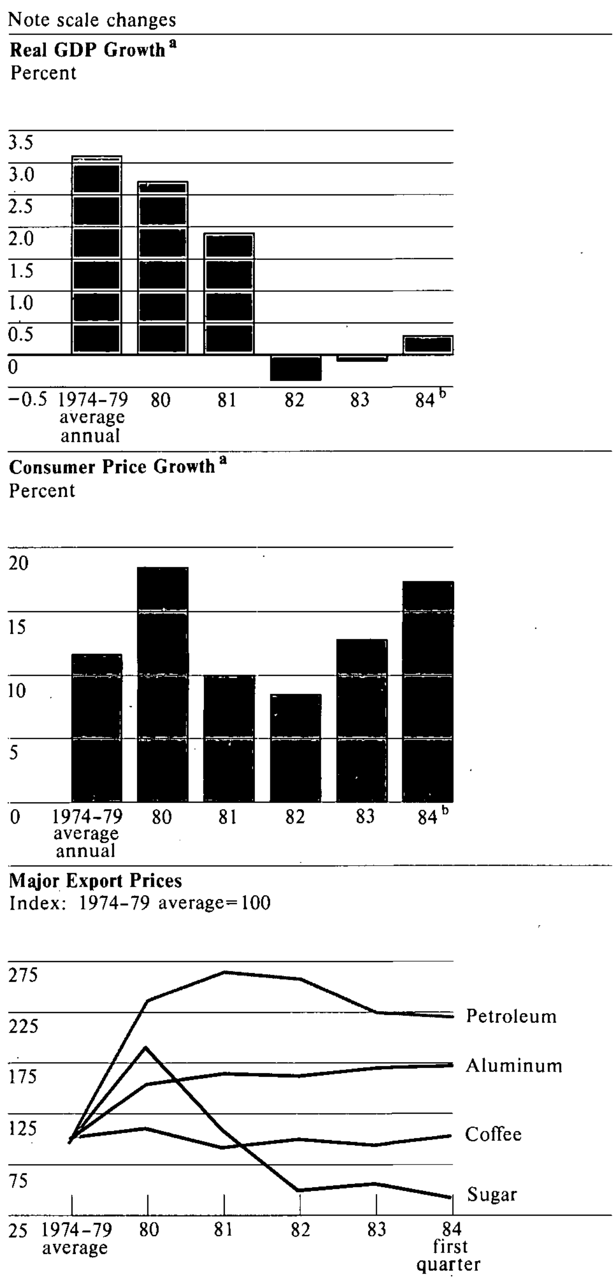
Prolonged Economic Difficulties

The 1973 oil price hikes were particularly disastrous for most Caribbean countries because they came at a time of sluggish world demand for the region's primary exports. The world recession in the mid-1970s further curtailed demand for tropical and mineral products and battered tourist earnings. Most of those hardest hit resorted initially to borrowing on commercial markets, seeking economic aid, accumulating payments arrears, and drawing down international reserves to make ends meet. A few—Trinidad and Tobago, the Netherlands Antilles, and The Bahamas—experienced oil-based economic booms. Nonetheless, weighted average growth in the Caribbean region's output—barely comparable in size to that of Colombia—slowed to little more than 2 percent annually during 1974-79, less than half the Latin American average.

The second round of oil price hikes, the world recession, and subsequent belt tightening in many countries reduced real GDP growth to roughly 1 percent annually during 1980-82. To qualify for IMF funding, Haiti, Barbados, and Dominica imposed strict import controls and public-spending cuts. Jamaica, struggling to overcome seven consecutive years of economic decline, experienced a spurt in growth largely owing to massive, but short-lived, injections of foreign aid following President Seaga's election in October 1980. Despite a surge in investor interest, few projects got off the drawing boards because of bureaucratic redtape and a shortage of skilled labor. Squeezed by the 1982 drop in oil prices—and in the case of Trinidad, falling production—even the oil-based economies experienced economic slowdowns. Meanwhile, the smallest islands continued to face intractable development problems. Moreover, a series of hurricanes slashed

The Caribbean: Economic Indicators, 1974-84



[a] Excluding the smallest islands, for which data are incomplete.

[b] Projected.

[redacted]

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banana production—which contributes 40 percent of their export earnings—causing real GDP in 1982 to fall well below the 1979 level. [redacted] 25X1

Only steady emigration kept unemployment within the 20-to-40-percent range in most countries. However, the continuing exodus also drained much of the manpower needed to promote economic development. Making matters worse, the wealthier economies—which had become magnets for many Caribbean nationals seeking jobs surreptitiously—began to crack down on illegal immigrants. [redacted] 25X1

Recent Economic Performance

Despite deep import cuts that reduced the region's current account deficit below $1.5 billion in 1983—the first improvement in six years—serious foreign payments problems persist in most countries. The pace of OECD recovery has not been robust enough to boost demand for Caribbean exports. In addition, bauxite/alumina earnings have been hurt by continuing depletion of richer ores and high industry wages that prompted several US companies to close their operations. Tourist earnings have picked up only slightly because of the strong US dollar and intensified competition from Western Europe and other areas. Although the region's $7 billion external debt is dwarfed by that of the largest Latin American economies, debt servicing has become a major burden for many Caribbean countries. Although a number of Caribbean countries increasingly are involved in narcotics trafficking as money-laundering centers or transshipment points, individual economies appear to benefit little from drug income except in Jamaica, where the rural sector depends heavily on marijuana earnings.

[redacted] 25X1

Tighter austerity has yielded some longer term benefits but has further depressed economic activity. Those countries with IMF relief packages have improved tax collection, trimmed and redirected the bloated public sector away from make-work projects toward more productive investments,

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raised interest rates to encourage domestic savings, and stimulated the search for foreign investment. Nevertheless, potential lenders have failed to respond adequately to the IMF lead. Moreover, popular protests against deepening austerity—particularly against currency devaluations and subsidy cuts that trigger immediate hardships—are complicating economic management. As a result, overall economic activity fell slightly in 1983.

In **Jamaica**, weak world demand for aluminum, prolonged drought, and low world sugar and banana prices kept 1983 export earnings nearly 25 percent below the 1981 peak. To cover import needs and debt-servicing costs, Kingston borrowed heavily—the external debt reached $2.2 billion by yearend 1983—and almost depleted the country's foreign exchange holdings. These actions took Jamaica out of compliance with IMF targets under the 1981 Extended Fund Facility (EFF), causing the program to be suspended in late 1983. New foreign credit dried up, rescheduling discussions with foreign creditors halted, and economic activity fell 1 percent last year. Despite popular resentment of austerity, Jamaica has instituted measures since then—including hefty devaluations—to win a new $140 million standby program in June. Meanwhile, the decision of Reynolds Metals to terminate its Jamaican bauxite operations has added 200 people to the unemployment rolls—Jamaica's unemployment rate already approximates 30 percent—and will cost Kingston $25 million in bauxite revenues in 1984.

To obtain a three-year, $408 million Extended Fund Facility in early 1983, the Jorge Blanco government in the **Dominican Republic** increased income taxes, slashed government expenditures, banned luxury imports, and transferred others to the costlier parallel exchange market. Jorge also rescheduled $600 million in overdue commercial debt. Under the Fund's tutelage, real GDP grew 1 percent in 1983 despite sluggish world demand for sugar and minerals—the country's major exports—and inflation and unemployment also moderated. In April 1984, widespread riots erupted in response to the government's imposition of food price increases and other budget-tightening measures needed to qualify for the second year of the EFF. Fearing that the IMF-required removal of petroleum subsidies would spark more violence, Jorge suspended talks in May. Meanwhile, the Dominican Republic is accumulating arrears, cutting imports, and courting emergency assistance from the United States and other Western donors to make ends meet. 25X1

By contrast, **Haiti** in late 1983 negotiated a two-year, $63 million standby program with the IMF, following the successful completion of a 13-month standby accord last summer. We believe Haiti's relations with the Fund have been smoother than most because the programs have emphasized the need to make Haiti's byzantine finances less opaque than drastic belt tightening. Except for some food rioting in May, the government has not been buffeted strongly by the uproar over austerity—partly because the Haitian population generally is more quiescent and labor is not permitted to organize. 25X1

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Nevertheless, major problems persist. Economic activity has stagnated over the past 18 months, resulting in a 3-percent decline in per capita income. Export earnings remain flat largely because of low prices for coffee—Haiti's main export. Despite Haiti's low wages, the country's underdeveloped infrastructure has limited foreign investment. Living conditions in the countryside and Port-au-Prince continue to deteriorate gradually as unemployment spreads in response to cuts in development programs and food becomes increasingly unaffordable for many. 25X1

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The sharp drop in oil output—nearly 8 percent below the 1982 level in **Trinidad and Tobago**—has tightened austerity in the oil-based economies. These countries also are hurt by the continued slump in tourism—their second-largest foreign exchange earner—and depressed island-based shipping. As a result, combined real GDP in Trinidad and Tobago, **Netherlands Antilles**, and **The Bahamas** fell 1 percent last year, a far cry from the 8-to-9-percent growth rates achieved during 1978-80.

Moreover, in early 1984 some oil refiners—Texaco in Trinidad and Exxon and Shell in Netherlands Antilles—moved to curtail or shut their operations.

Suriname has faced severe foreign-payments problems since the Bouterse regime's execution of 15 opposition leaders in December 1982 prompted the Netherlands and other Western donors to suspend assistance. Paramaribo turned to Cuba in early 1983 for help but received little, if any, financial support, and it later pulled back from economic and technical accords signed with Havana—throwing out all Cuban personnel last October—partly in the unrealistic hope of attracting sizable Western aid. Real GDP fell 3 percent last year despite government efforts to prop up the economy by borrowing domestically and depleting foreign reserves. A bauxite strike in January 1984 cost Suriname some $75 million in foreign exchange earnings, and occasional food and raw materials shortages have appeared in recent months. Nonetheless, according to the US Embassy, Suriname has abandoned efforts to negotiate with the IMF for fear that tighter austerity would prompt violence.

Despite **Guyana's** wealth of resources, its economy is in a shambles. Output of the main exports—bauxite, alumina, sugar, and rice—is declining steadily as a result of pervasive corruption, mismanagement, and costly labor disputes. The resultant decline in foreign exchange earnings, coupled with a chronic inability to maintain support from multilateral institutions, forced Guyana to impose stringent import restrictions last year. As a result, real GDP plummeted 13 percent in 1983, to barely 65 percent of the 1976 peak. To sustain even this level of activity, the Burnham government primed the money pump to cover a budget deficit exceeding 50 percent of GDP. President Burnham nonetheless steadfastly refuses to take the steps needed to regain IMF financing. In fact, Guyana has become the first country declared ineligible for IMF funding, due to Burnham's refusal to repay the Fund and to initiate a restructuring of the economy. Endemic shortages of food, drugs, transportation, electricity, water, and jobs have worsened.

In the eastern Caribbean, economic performance generally remains weak. The rise in tourist receipts has been too little to offset sluggish export earnings. Moreover, intra-CARICOM trade disputes have limited local markets in the fledgling light-manufacturing industries that dot the ministates. Only **Barbados** and, to a limited extent, **Grenada** are exceptions to this otherwise gloomy picture. Barbados' generally sound economic management and aggressive lures to investors have helped to keep that economy on relatively solid footing. In Grenada, sizable aid infusions after the US-led intervention last October offset some lost tourist earnings and IMF monies—after the Fund suspended its program in late 1983—and prompted a slight recovery during the first six months of 1984. Nevertheless, financial shortfalls continue—government salary payments in June apparently were missed—and many domestic problems remain; electricity, for example, is available only three hours daily.

The Next Few Years

The traditionally strong link between OECD and Caribbean growth appears to be weakening. Shifting tourist patterns and growing competition from other LDC producers of tropical products, light manufactures, and bauxite/alumina are largely responsible. Consequently, even if near-term OECD economic growth exceeds expectations, it is unlikely that Caribbean growth would rise in tandem. As matters stand, we expect OECD recovery over the next year or two to be moderate and Caribbean growth to be slight, at best.

In these circumstances, Caribbean countries must try even harder to revamp and streamline their economies with an eye toward raising productivity and trimming consumption. In addition to these difficult domestic adjustments, aggressive marketing strategies and new labor-intensive products aimed at markets outside the region are needed to offset poor prospects for traditional exports. We

The Unraveling of CARICOM

CARICOM, the 13-member Caribbean Economic Community, was formed in 1973 to promote economic integration through a common market. In recent years, however, individual attempts to solve common economic problems have heightened intra-CARICOM trade squabbles and brought the organization near collapse. For example:

- *Jamaica last year irked member states by imposing a two-tiered exchange-rate system. In retaliation, Barbados floated its currency while Trinidad and Tobago slapped a licensing requirement on all Jamaican goods. Jamaica's trading partners have balked at its recent devaluations, which have reduced the competitiveness of their exports.*

- *Other community members are angered by Trinidad and Tobago's recent cut in imports—especially since Trinidad is CARICOM's wealthiest member—and its decision to require import licenses across the board.*

Disagreements over the CARICOM Multilateral Clearing Facility—a clearinghouse for settling trade accounts and financing transactions through short-term credits—have been most debilitating. The failure of Guyana, which holds the lion's share of this debt, to repay Barbados, which underwrote the $100 million facility, led Barbadian Prime Minister Adams to unilaterally end it last year. All intra-CARICOM trade now is conducted on a bilateral basis because even Trinidad and Tobago—which since 1974 has provided $400 million in aid to the community—can no longer afford to finance trade ventures. 25X1

Political infighting has only exacerbated trade problems. The organization over the years often split along ideological lines, especially when Maurice Bishop still represented Grenada, but the schism between the more moderate countries and the left-leaning states became even more dramatic following the intervention in Grenada. The incursion was not supported by Trinidad and Tobago, Guyana, Belize, and The Bahamas. 25X1

Members put aside political and economic differences at least temporarily at their summit meeting this month in Nassau. The participants tentatively agreed to eliminate some trade barriers and to grant observer status to the Dominican Republic, Haiti, and Suriname. Nevertheless, no substantial progress was made in dealing with the region's basic economic troubles. 25X1

believe agricultural diversification geared to high-value products such as flowers, spices, and winter vegetables could provide the quickest results. Other efforts require large cash injections that are unlikely to materialize from donors and commercial bankers. Still, the adoption of growth-generating policies would go a long way toward enticing what financing and technical expertise is available—especially under the Caribbean Basin Initiative. Steps to eliminate growing intraregional protectionism should also be taken.

Over the near term, countries already in various stages of IMF adjustment programs are likely to continue reform efforts wherever possible, hoping to revive economic growth. The next steps will not be easy, however, because long-term adjustment measures will compound consumer hardships over the short run. Moreover, with educational levels high and labor unions strong, most Caribbean constituencies closely scrutinize economic issues so that political leaders are likely to procrastinate in setting tough policies. In Jamaica, the new IMF program could still fall apart should riots or demonstrations by opposition parties or organized labor seriously threaten the Seaga government. In the Dominican Republic, the issue of electricity price increases threatens to upset an agreement even 25X1

The Caribbean Basin Initiative

The Caribbean Basin Initiative, in place since January 1984, is a US program of trade and tax measures designed to help 27 Caribbean and Central American countries expand employment and raise living standards. The program's centerpiece consists of 12-year, duty-free access to US markets for a wide range of agricultural and manufactured goods. To foster tourism, the CBI also allows US tax deductions for the cost of attending business conventions in the Caribbean Basin.

To date, the combination of tariff and tax advantages, relatively low wages, proximity to the US market, and the expected hardening of terms for LDCs under the Generalized System of Preference (GSP) after December 1984 appears to be attracting the attention of many investors. The most interest has come from businessmen in the Far East—Taiwan, Hong Kong, South Korea, and Singapore—where wage rates are rapidly rising and transport costs to the United States are high. Hong Kong's scheduled takeover by China in 1997 also has sparked consideration of the Caribbean as an alternative business base.

It is too early to tell how much the Caribbean economies will benefit from the CBI. US trade officials estimate that the initiative eventually will boost exports to $9.5 billion annually—still below the $10.3 billion peak in 1980. About 80 percent of Caribbean-produced goods already enter the United States duty free under the GSP. Infrastructural development is so weak in the smallest economies that the bigger ones are likely to continue to attract the largest chunk of any new investment. In addition, many of the products the Caribbean countries could produce most easily because of underutilized capacity—textiles, apparel, footwear, leather goods, canned tuna, and petroleum products—are exempt from the CBI in order to protect US industries.

before it is formally signed. Growing problems in maintaining austerity in Haiti already show signs of threatening the current standby. Regardless of their efforts, these countries are likely to experience little or no recovery over the next year or so as new austerity measures take hold and demand for their traditional exports remains weak. Nevertheless, these countries stand to profit most from the CBI over the longer term because of their relatively large economies and labor pools. 25X1

The oil-based economies also face continued tough times. Over the near term, we believe they will 25X1 postpone such needed adjustment measures as slashing government subsidies and payrolls because they are unaccustomed to the seriousness of the problems that have beset their economies recently. Instead, they appear to be hoping—unrealistically, in our view—to ride out the world oil slump. We do not expect oil prices to rise much until the late 1980s, a factor that will encourage foreign refiners to further curtail their operations. 25X1

Other countries face intractable problems. Under their present regimes, Suriname and Guyana will 25X1 continue to resist any moves to revamp their economies, especially under IMF aegis. According to the US Embassy, Suriname instead will try to lure Western aid, but is unlikely to succeed without an IMF accord. In these circumstances, Army Commander Bouterse is likely to warm up to the left at home and abroad. In Guyana, President Burnham probably will continue to seek Communist assistance, but any agreements are likely to be too insubstantial to ease the country's pressing financial needs. Many of the smallest economies are not viable without infusions of aid, so that any restructuring will have limited results, at best. 25X1

Although the region is troubled, it probably will not attract significant Cuban meddling unless the Castro regime—embarrassed by the Grenada and Suriname debacles—stumbles onto a clear opportunity for influence. Cuba, in the face of tough US 25X1 policies, has largely withdrawn its destabilizing tactics, concentrating instead on strengthening ties with leftists in the region, who are currently in disarray. Left-leaning trade unionists, opposition political figures, journalists, and youth leaders—those most likely to spearhead any protests to austerity—are being targeted. To supplement these activities, Havana is also expanding contacts in the region through diplomatic approaches, commercial dealings, and social and cultural activities. Prospects for increased trade appear to be the bait that Havana is using to lure Trinidad and Tobago into a closer relationship. In some of the smallest islands, Havana is offering special scholarships at Cuban universities to promote a better image and expand contacts. Guyana seems destined to replace Grenada as Cuba's base of operation in the Caribbean, although mutual distrust between Castro and Burnham probably will inhibit close bilateral ties. Cuba is not abandoning Grenada, however [redacted]

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