Directorate of Intelligence

~~Secret~~

25X1

file copy

do not remove

5 art
32 graphs

International Economic & Energy Weekly

25X1

11 January 1985

~~Secret~~

DI IEEW 85-002
11 January 1985

Copy 683

Page Denied

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707350001-0

 25X1

International Economic & Energy Weekly

25X1

11 January 1985

25X1

25X1

Comments and queries regarding this publication are welcome. They may be directed to Directorate of Intelligence 25X1 25X1

[redacted] 25X1

International Economic & Energy Weekly [redacted] 25X1

Synopsis

1 **Perspective—*Players and Issues for the Bonn Economic Summit*** [redacted] 25X1

The next Big Seven Economic Summit, set for 2-4 May in Bonn, will cover the same basic agenda—economic growth, trade, international monetary relations, north-south issues, East-West relations, and energy—used since the first summit a decade ago. Nevertheless, each gathering develops its own theme and character, often at the last minute. [redacted] 25X1

13 **International Trade in Services: An Emerging Policy Issue** [redacted] 25X1

Many nations are suspicious of US initiatives to include services in a new round of multilateral trade negotiations. Nonetheless, a preliminary examination of services trade patterns indicates that both developing and industrialized countries have an important stake in this sector. [redacted] 25X1

19 **West Germany: Taking a Lead on the Acid Rain Issue** [redacted] 25X1

Chancellor Kohl, host this May for the annual Big Seven Economic Summit, intends to make environmental protection one of his main themes. Domestically, the West German actions on this issue could affect Bonn's relations with West and East European neighbors—major sources of pollution—and with the European Community. [redacted] 25X1

23 **Argentina's Grain Outlook: Challenges for Alfonsin** [redacted] 25X1

The year-old government of President Alfonsin is counting on a major expansion in Argentina's grain exports to help service its $46 billion debt. Its success will depend, to a large extent, on Argentina's relationship with the Soviet Union, its largest grain buyer and a key bidder on a necessary grain port expasion project. [redacted] 25X1

27 **Israel: Facing Revenue Shortfalls** [redacted] 25X1

Since assuming power in September, a continuous decline in revenue has undercut efforts by Israel's unity government to trim the growing budget deficit. [redacted] 25X1

31 **India: Bhopal's Limited Backlash** [redacted] 25X1

The unprecedented chemical plant disaster in Bhopal, India, is not likely to slow India's industrial modernization or its effort to obtain foreign technology. [redacted] 25X1

Secret
DI IEEW 85-002
11 January 1985

International Economic & Energy Weekly [redacted] 25X1

11 January 1985

Perspective

Players and Issues for the Bonn Economic Summit [redacted] 25X1

The next Big Seven Economic Summit, set for 2-4 May in Bonn, will cover the same basic agenda—economic growth, trade, international monetary relations, North-South issues, East-West relations, and energy—as that of the first summit a decade ago at Rambouillet, France. Prime Minister Brian Mulroney of Canada and EC Commission President Jacques Delors are the only new leaders, producing considerable continuity in personalities and issues. Nevertheless, each gathering develops its own theme and character, often at the last minute.

- ***Economic Growth.*** Restructuring problems and high unemployment, particularly in Western Europe, will be key topics, but the West Europeans are unlikely to accept US suggestions that government spending, particularly on social welfare, be scaled back to accommodate growth, or that subsidies be reduced to foster greater flexibility and market response. The most that can be expected is an agreement for more extensive work in the OECD on restructuring. [redacted] 25X6 For their part, all the foreign leaders will express varying degrees of distress at the US budget deficit and its impact on financial markets, as well as fear of a rapid decline of the dollar.

- ***International Trade.*** The French and Italians will be reluctant to go beyond promises to limit protectionism, but agreement to begin preparations for a new round of trade negotiations in 1986 appears likely. All countries will express concern about protectionism, with the United States receiving perhaps the most heat. In addition, the mixed credit export promotion practices of France [redacted] 25X6 The French have argued in recent years that progress in trade liberalization must await a revamping of the international monetary system, and they may make this point again.

- ***International Monetary Relations***. Studies in the Group of 10 on improving the monetary system have been under way since the Williamsburg Summit in 1983 but will not be ready for review at Bonn. The French Finance Minister has told US officials that another call for a "new Bretton Woods" conference to reform the system would be unproductive. The French nevertheless remain convinced that all countries (read the United States) must follow the same international policy rules. At a minimum, Mitterrand will reiterate France's position and may even hold trade talks hostage to progress on the monetary front.

- ***North-South Issues***. Bonn tentatively plans to promote a North-South conference similar to the 1981 Cancun Summit, perhaps to be initiated by Mexico and Austria, as was Cancun, and endorsed by the Bonn Summit. An "Action Program for Africa," concentrating on food aid, is also likely to be discussed, and the leaders will agree to continue efforts to contain the debt crisis through prudent debtor policies and case-by-case help from creditors. The tone and results of the IMF's April Development and Interim Committee meetings—where medium-term solutions to the debt crisis will be discussed—will figure prominently in summit discussions and statements. 25X1

Nontraditional and political subjects will also occupy considerable time:

- Enhanced cooperation against terrorism also is likely to be discussed; the Bonn Declaration on hijacking, for example, may be extended.

- Bonn, for example, is hoping for a major policy statement on the importance of ensuring that growth and environmental policies are fully compatible. Bonn will be looking for support from Canada, particularly on acid rain, but the Mulroney government's position thus far is that acid rain is primarily a bilateral issue.

- The United States is likely to register some success in obtaining statements supporting North Sea energy resource development and Big Six participation in the manned space station. 25X1

The issue carrying most potential for disruption is outside the summit format: the 40th anniversary of VE Day on 8 May. The West Germans were embarrassed by the coincidence of the Normandy anniversary ceremonies with last year's London Summit. As hosts, they were able to move the summit forward to precede the VE anniversary (and to gain the coalition some political capital for state elections in mid-May). The effort may backfire, however. The several thousand journalists present for the summit and the anniversary will naturally be looking for differences and controversies to report, and the resulting hoopla could overwhelm the summit. 25X1

25X1

Briefs

Energy

Spot Oil-Market Trends

[redacted] 25X1

Spot prices for several key crudes—particularly US West Texas Intermediate and UK Brent—have dropped over $1.50 per barrel in the last few weeks. Although Arab Light spot prices were relatively unchanged during this period—selling at about $27.85 per barrel—the spot price remains about $1 below the official level. Depressed spot prices are indicative of relatively weak winter demand and OPEC's declining credibility with oil traders. A sudden burst of cold weather in Europe has strengthened spot prices only marginally and, despite the current low level of oil inventories, prices probably will remain weak because buyers are already anticipating the seasonal falloff in oil use. [redacted] 25X1

Mexican Oil Production Goals

[redacted] 25X1

Mexico City's recently announced plan to boost oil production substantially over the next five years is likely to prove overly ambitious. The state-owned oil company announced last week that it would increase petroleum output 58 percent by drilling 1,000 new wells. According to the announcement, the decision is in response to the government's projection of a 5-percent annual increase in domestic consumption. By drilling 1,000 new wells, Mexico probably will be able only to increase output by about 10 percent over the five years. If increases in domestic consumption begin to squeeze export capacity, the government probably would choose to raise domestic oil prices or impose other economic restrictions rather than reduce exports. [redacted] 25X1

UK-Norwegian Gas Deal in Danger

[redacted] 25X1

Weakening British Government support for the purchase of natural gas from Norway's Sleipner field may cause the deal to collapse and have repercussions on future supplies of North Sea gas. The US Embassy reports that, since the contract was initialed last February, the deal for 10-12 billion cubic meters of gas per year has been held up by disagreements over the British need for the gas, pricing terms, construction awards going to UK firms, and the balance-of-payments impact. Norway's Energy Minister presented the final offer to his British counterpart late last month in an effort to overcome unresolved problems. Gas from Sleipner probably will go to continental West European purchasers, if the United Kingdom refuses the Norwegian offer, but development of the Troll field almost surely will be delayed. [redacted] 25X1

Pressure on Striking UK Miners

[redacted] 25X1

The Thatcher government is increasing efforts to break the morale of striking coal miners amid growing signs that this winter's weather will not cause an energy crisis. Last week, Energy Secretary Walker pledged that there would be no electric power cuts this year and again appealed to miners to end their walkout. The US Embassy says its estimates of energy supplies bear out the Energy Secretary's optimism; the winter so far has been mild, the United Kingdom has stepped up imports of coal, power stations are burning oil and gas, and transport workers continue to move coal supplies. According to the press, almost 40 percent of the miners are working, with 300 of them returning to work since Christmas. The Coal Board is emphasizing that tax breaks are available to those who return to work before April. The Embassy also reports that, for the first time, criticism of the failure of Union President Scargill to keep the union together is being expressed in South Wales, one of the most militant regions in the United Kingdom. [redacted] 25X1

Iran Plans Petroleum Shuttle Operation

[redacted]

Iran is developing plans to shuttle oil from Khark Island to two ultralarge crude carriers permanently anchored near Sirri Island in the southern Gulf, [redacted] Oil would be transferred to tankers 25X1 unwilling to risk the voyage to Khark. The shuttle service would add flexibility 25X1 to Iran's oil export operations but is not likely to lead to increased Iranian exports or even substitute entirely for Khark exports. Besides the continuing Iraqi threat to shuttle tankers, pumping and storage limitations aboard the tankers off Sirri are likely to limit transshipment capability substantially. Similar efforts earlier in the conflict proved largely ineffective in sustaining Iranian crude exports. [redacted] 25X1

[redacted] 25X1

Austrian Power Project Blocked

[redacted]

A court injunction has resolved temporarily the stalemate between the Austrian Government and environmentalists opposing the Hainburg hydroelectric project. The court ruling, however, will delay for at least one year construction of the controversial power station, which will produce 5 percent of current electricity consumption. 25X1 While unions support the project for the jobs it will create, environmentalists claim the dam will destroy one of Europe's last remaining river wetlands and endanger Vienna's drinking water. When the government began site clearing last December, protestors denied access to workmen, provoking several clashes with police. Intensive negotiations between Chancellor Sinowatz and protest leaders failed to resolve the standoff, and front-page treatment of the controversy helped turn public opinion from indifference to 50-percent opposition. [redacted] 25X1

International Finance

Mexican Debt-Rescheduling Update

[redacted]

Final agreement on Mexico's $48 billion debt rescheduling probably will be held up at least another two to three months. The Central Bank is struggling with the massive paperwork to implement the currency conversion option that was included at the urging of European financial officials. It allows each creditor to demand repayment in currencies other than dollars. Last week, Mexico City made a $250 million "good faith" payment on its 1983 jumbo loan and promised to pay an additional $950 million as soon as the agreement with Mexico's 530 foreign bank creditors is completed. This gesture—the first principal repayment by a major Latin American debtor since 1982—probably was intended to enhance Mexico's creditworthiness for new money in 1985. [redacted] 25X1

25X1

Nicaraguan Debt Talks

[redacted]

Talks between Managua and its foreign bank creditors, postponed several times in late 1984, have been reset for late January [redacted] 25X1
[redacted] Nicaragua has made no payment on its commercial bank debt in over a year. It claims that losses caused by the insurgency prevent compliance with bank demands for a token remittance. One billion dollars of Nicaragua's $4 billion foreign debt is owed to commercial banks, and interest arrearages now amount to over $170 million. Managua has little hope of reversing its critical shortage of hard currency, because levels of foreign assistance are declining, and the regime already has spent the receipts expected from the current harvest. The Sandinistas probably will continue reneging on payments, while requesting yet another rescheduling to avoid legal action by the banks. [redacted] 25X1

25X1

25X1

Ecuador's Financial Prospects Brighten

[redacted]

Ecuador's external payments difficulties will probably ease considerably in 1985. The bank advisory committee, which agreed to reschedule $4.3 billion in maturities falling due in 1985-89, expects the rest of Ecuador's creditors to approve the package by April 1985. [redacted] bankers also agreed to renew a $750 million trade credit and grant $350 million in new medium-term loans. Once the IMF approves a standby loan—probably in February—the country's external financing requirements should be covered through the end of the year. Moreover, Ecuador and the US agency OPIC signed a political risk insurance package—the first involving an Andean Pact country since 1971—which will improve prospects for foreign investment. [redacted] 25X1

25X1

25X1

Continuing Cuban Debt Pressures

[redacted]

Havana has approached its commercial and Western government creditors on refinancing its principal payments due in 1985, only weeks after concluding the 1984 rescheduling agreement with private banks. A task force of official creditors is planning to travel to Havana in March or April to assess compliance with 1984 performance targets and to open the third round of negotiations on Cuba's debt. Judging from a recent report by the National Bank of Cuba, which shows a surge in hard currency imports and lackluster 25X1 exports during the first part of 1984, Havana probably missed creditors' targets for convertible currency trade and balance of payments. Nonetheless, Havana will probably cite its success in rescheduling its Bloc payments, a recent agreement allowing Cuba to continue to resell Soviet-supplied petroleum products for hard currency, and President Castro's calls for economic austerity measures as evidence of Cuba's creditworthiness. 25X1

Japanese Concessions on Euroyen Markets

In early January, Tokyo's Finance Ministry improved the prospects for yen internationalization by agreeing to remove withholding taxes on nonresidents' purchases of Euroyen bonds and to permit medium- and long-term Euroyen lending. Neither measure will be implemented before spring but both, we believe, constitute important concessions. Finance Ministry officials initially objected to removal of the withholding taxes, which bring in an estimated $40 million annually, because Tokyo is trying to pare its budget deficit. 25X1 25X6

The Ministry held off endorsing long-term Euroyen lending partly because of Japanese bankers' fears that such activity could undermine the country's regulated interest rate structure. 25X1

Global and Regional Developments

Debtor LDC Imports of Capital Goods Bottoming Out

According to trade data for the four largest industrial countries, key debtor LDC imports of capital goods seem to be bottoming out. Data for the first three quarters of 1984 show key debtor LDC imports of capital goods up 2 percent, in sharp contrast to the 32-percent drop recorded in 1983. Trade statistics for the United States, Japan, West Germany, and France indicate that Brazil and Mexico accounted for the bulk of the increase. Most of the gain in Brazil's capital goods imports reflected a 23-percent rise in purchases of electrical machinery, while increased imports of farm machinery accounted for most of Mexico's gain. While capital goods imports continued to fall in Colombia, Nigeria, and Peru, the pace of decline seemed to have slowed. The Philippines, however, sharply cut back its capital goods imports in response to mounting financial difficulties. In the near term, we believe total capital goods imports by the debtor LDCs should continue to turn upward as some countries such as Ecuador, Chile, and Colombia selectively ease their import restrictions to undertake development projects. 25X1

25X1

[redacted]

25X1

Growing Thai-Japanese Trade Frictions

[redacted]

Bangkok is becoming increasingly critical of Tokyo's refusal to take concrete steps to deal with the chronic trade imbalance between the two countries. Thailand's trade deficit with Japan rose to nearly $1 billion in the first half of 1984—almost two-thirds of its total deficit for the period. According to the US Embassy, Thai officials are especially disappointed that the trade liberalizations announced by Tokyo in mid-December will not effectively open Japanese markets to Thai commodity exports. For now, Bangkok is minimizing the possibility of strained relations with Japan—its largest aid donor—and Prime Minister Prem has publicly discouraged a student movement to boycott Japanese goods. Nonetheless, Bangkok is urging Tokyo to accept a plan to restructure trade between the two countries. [redacted]

25X1

25X1

National Developments

25X1

Developed Countries

[redacted]

Tokyo Approves Another Tight Budget

[redacted]

Japan's Cabinet has approved a $210 billion budget for Japanese fiscal year 1985, which begins 1 April, paving the way for Diet debate in late January. Total spending will be up by 3.7 percent over the initial 1984 budget, but general expenditures—less debt service and revenue sharing with local governments—will decline for the third year in a row. The Fiscal Loan and Investment Program, which includes expenditures on roads, water supply, and sewers, will drop by 1.2 percent—the first such cut in 31 years. Defense spending, however, will be up 6.9 percent, bringing it near the 1-percent-of-GNP limit, and foreign aid will rise by 10 percent. Japan's deficit will amount to 22 percent of total spending, down slightly from last year, but debt service

25X1

costs will jump by 11.7 percent, to $45.4 billion, surpassing social security for the first time as the largest item in the budget. Some taxes will be raised to cut new bond issues by $4 billion from last year's level.

25X1

Japanese Trade Ministry Proposes High-Technology Legislation

Late last month the Ministry of International Trade and Industry (MITI) submitted legislation that would establish a basic technology research promotion center. The center would coordinate international and domestic basic research efforts and provide funding for research projects through grants, tax incentives, and long-term loans. MITI has requested approximately $2 million from the general account budget and $35 million from the Japan Development Bank to support loans for research projects. Although recent press reports indicate the center will be established before the fiscal year ends on 31 March, major funding issues have yet to be resolved. Finance Ministry approval of the use of Japan Development Bank funds for the center is uncertain. Moreover, MITI's funding request is $10 million less than the estimated cost of the research projects, and industry leaders are reluctant to make major contributions.

25X1

25X1

25X6

Australia–New Zealand Economic Cooperation Jeopardized

Wellington's recent rejection of a bid by an Australian company for a New Zealand packaging and building products firms sends confusing signals to potential Australian investors. After the July 1984 election, New Zealand's new Labor government lifted the previous government's embargo on Australian investment, devalued the dollar, and sponsored tours of New Zealand for potential investors. Prime Minister Lange, however, has now invoked his campaign position that he is only interested in ventures promising new jobs and

25X1

exports; takeovers of existing companies are not welcome. The Lange government was clearly disappointed last summer when Australia failed to reciprocate by lowering its barriers to New Zealand investment. In October 1984, the two countries began negotiations to standardize investment regulations, but the rejection of this bid is apt to complicate talks. [redacted] 25X1

Austria To Promote Microelectronics

[redacted]

The Austrian Government has announced a three-year, $43 million program to promote investment and R&D in small and medium-sized firms in the microelectronics industry. Government aid will focus on computer-assisted design and manufacturing and other areas of semiconductor applications. Vienna is concerned that its industry is lagging in a number of high-tech fields 25X1 and in innovation generally. The microelectronics program represents a pioneer government attempt to promote a specific industry. Biotechnology and advanced materials technology are leading candidates for similar programs. Also, Vienna plans to set up an office similar to the US Office of Technology Assessment to better evaluate the consequences of new technologies. [redacted] 25X1

Less Developed Countries

Mexico Releases Oil Shipment to Nicaragua

[redacted]

[redacted] Nicaragua late last month persuaded Mexico to 25X1 release an oil shipment after delays due to financial snags. This is the second consecutive month that Mexico has responded to oil shortages in Nicaragua with an unscheduled shipment. Unlike the November delivery, however, the latest shipment did not arrive in time to prevent a temporary shutdown of the country's only refinery. Meanwhile, a Soviet shipment en route to Managua 25X1 should fulfill February's requirements. Managua and Mexico City have not had a bilateral oil agreement since last August, although talks are scheduled for mid-January, presumably to address debt repayment and oil-supply arrangements. [redacted] 25X1 despite $600 million in arrears, we expect continued leniency by Mexico City under any future agreement. [redacted] 25X1

[redacted] 25X1

Honduran Banana Producer Considering Pullout

[redacted]

The largest banana firm in Honduras may have to divest its unprofitable operations, generating labor unrest among the company's 13,000 union workers threatened with sharp wage reductions or unemployment. Officials of 25X1 Standard Fruit Company claim that the high production costs could lead its financially troubled US parent company to close local operations, according to the US Embassy. According to the Embassy, government and union officials underestimate the possibility of a pullout and have ignored numerous attempts by Standard Fruit to obtain relief. The government continues to oppose exchange rate reforms and fears special tax concessions to Standard Fruit would worsen the fiscal deficit and bring demands for similar treatment by others. A decision to abandon the Honduran operation would harm export earnings—bananas account for 30 percent—and probably would spark additional union protests as the new owners probably try restoring profitability through wage cuts. [redacted] 25X1

Bolivian Ministers Differ on Economic Policy

[redacted]

Although former Planning Minister Fernandez drafted a tough stabilization plan last month, we believe division within President Siles's Cabinet over economic strategy probably will prevent the plan's full implementation. One group—primarily technical experts led by Fernandez—supports tough measures to break the hyperinflationary spiral and bolster the external accounts, including substantial devaluation, large tax increases, reduction of consumer subsidies, and restraints on wage increases. The other faction—dominated by Siles's political confidants—is reluctant to take any unpopular measures and apparently is holding sway, according to the US Embassy. Central Bank President Cardozo recently told US officials that the Fernandez plan is not supported by Siles's closest advisers or key Finance Ministry officials. Given the continuing political turmoil in Bolivia, opponents will demand concessions to labor, such as increases in wages or government spending. Consequently, we expect Bolivia's 2,000-percent inflation rate to rise further, paralyzing production and causing widespread unemployment and product shortages. With price increases quickly eroding last month's 656-percent minimum wage hike, we also foresee renewed labor strife and growing political woes for the Siles government. [redacted]

25X1

25X1

More Nigerian Austerity

[redacted]

Head of State Buhari has unveiled a more stringent budget for 1985, which could worsen already broad opposition to his regime. Recurrent spending has been reduced to \$7.1 billion from \$7.9 billion in 1984, a drastic cut in view of an official inflation rate of 40 percent. In his budget speech, however, Buhari emphasized increased spending for education and "adequate funding" for the armed forces, an apparent effort to please two opposition groups. The capital budget appears to grow from \$5.1 billion to \$7.5 billion, a real increase of about 5 percent, but for the first time this includes principal repayments on loans. Furthermore, funding of this budget is uncertain because Lagos is depending on \$6 billion in internal and external loans, which are not likely to be available. Allocations are still planned for several prestige projects, including the new federal capital at Abuja, steel projects, and a petrochemicals complex. Revenue projections are probably inflated by assumptions of oil production of 1.3 million barrels per day sold at current prices. [redacted]

25X1

25X1

Soviet Project in Nigeria Founders

[redacted]

Work on the iron and steel works at Ajaokuta, a Soviet-aided showcase project, has been halted after nearly 20 years of planning and construction. [redacted] Moscow had extended \$1.2 billion in credits for the project, which has been plagued by poor Soviet planning and design and has cost the Nigerians \$6.1 billion. More than 4,000 Soviet technicians have worked on the project during the last five years, but

25X1

25X1

they have completed only a fraction of the work. Both governments will be reluctant to abandon the scheme after investing so much hard currency and prestige. Nigeria continues to budget scarce resources for the project, and Lagos now says, unrealistically, that it will be completed in 1988. 25X1

Tunisian Budgetary Rigor

Tunisia's legislature has adopted a series of changes in the revenue codes to consolidate the ineffective tax system and deal with mounting budget and current account deficits. Taxes have been reduced by 50 percent on select agricultural crops to stimulate production and offset growing food imports. New measures will be implemented to reduce tax evasion by doctors and other wealthy Tunisians. In addition, the tax on alcoholic beverages will rise by 21 to 45 percent. The projected $15 million in additional tax revenues generated by these reforms, however, greatly understates their significance. The increasingly militant lower and middle classes will be particularly interested in how strongly the government leans on wealthy Tunisians to shoulder their share of taxes. More important, however, the increased taxes on alcoholic beverages—one of the last affordable luxuries—will be viewed by most Tunisians as the government's latest attempt to pick their nearly empty pockets. 25X1

25X1

Moroccan Budget Approved

Morocco's 1985 state budget pledging continued fiscal austerity passed Parliament after several weeks of stormy review, according to the US Embassy in Rabat. The approved budget projects no increase in overall spending, with expected improvements in revenue performance yielding a modest reduction in the deficit. The budget does allow for a 10-percent hike in minimum wage levels to dampen consumer disgruntlement over additional price hikes on subsidized goods scheduled for later this year. Morocco's ongoing financial crunch, however, probably makes even this budget formulation overly optimistic. 25X1

25X1

Indonesia To Boost Taxes, Raise Government Wages

In his annual budget message, President Soeharto announced plans to boost current expenditures to stimulate the recession-hit economy while calling for higher taxes to make up for declining oil revenues. Current expenditures are to rise nearly 25 percent in the fiscal year beginning in April, including a 20-percent pay hike for the military and civil servants. Fuel subsidies will be cut sharply, however, and capital expenditures will rise only 2 percent, considerably below the estimated 10-percent inflation rate for 1984. With the soft oil market, income from oil and gas, which accounted for 66 percent of government revenues in 1983 and 64 percent in 1984, will fall to 60 percent in 1985. Soeharto announced a new sales tax in April and stepped-up efforts to improve income tax collection to help offset this expected decline. 25X1

25X1

Communist

Soviet Trade Position Remains Strong

Moscow's hard currency trade position remained strong through the first nine months of 1984, despite an increase in imports in the third quarter. Hard currency imports during the period of January-September were 8 percent below the same period in 1983, and exports were down 4 percent. Meanwhile, the value of imports from, and exports to, CEMA countries rose 11 percent and 12 percent, respectively. The drop in hard currency imports was caused largely by a sharp reduction in purchases of machinery and equipment, and of pipe. The decline in hard currency exports was primarily the result of a large reduction in the value of arms exports to developing countries. The rise in hard currency imports in the third quarter was due mainly to a sizable increase in imports of grain from the United States.

25X1

25X1

Chernenko Confirms Soviet Economic Strategy

General Secretary Chernenko, in the latest issue of the Party's main journal called for greater efforts to move the Soviet economy into the technological age, stating that economic problems require "paramount" attention to achieve a "radial breakthrough" in economic efficiency by 1990. The breakthrough must come from "technological reequipping" of all branches of the economy, an indication that Chernenko sees capital investment, particularly in advanced machinery, as the key to economic progress. He indicated, however, that greater economic efficiency also depends on expansion of the Party's role at all levels of economic life, closer linkage of pay to performance, continued campaigns to improve labor discipline and end corruption, and streamlined economic management. Chernenko endorsed efforts to increase enterprise autonomy and responsibility, but he cited misuse of enterprise investment funds, possibly an oblique criticism of the experiment to increase the role of operating managers in investment decisions. Although Chernenko's article suggests little complacency over the improved economic performance of the last two years, his suggestions for improvement were conservative and did not call for major changes in the existing system of organization and management.

25X1

25X1

Cuban Housing Law

To improve what President Castro recently acknowledged as a severe housing shortage, the Cuban Government has passed a new housing law that will become effective this July. Those currently renting from the State will become owners of their homes, paying the cost in installments. This measure also permits property owners to rent rooms for a limited period, and to sell their property at freely established prices. In addition, the Cuban Savings Bank has been authorized to make low-rate loans for new construction and home improvement. While making no immediate additions to the housing stock, Havana apparently hopes that the liberal ownership provisions and low-cost financing will provide sufficient incentives for private construction. Stringent payment terms, however, which will raise costs for households that have paid only token amounts for rent, as well as the shortage of construction materials, may dampen public enthusiasm for the law. Castro's public support and the unprecedented publicity campaign that accompanied the new law probably were intended to soothe opposition by hardline officials to the return of landlords and a free housing market.

25X1

25X1

International Trade in Services: An Emerging Policy Issue [redacted] 25X1

The United States has told its trading partners that it attaches great importance to including international trade in services in a new round of multilateral trade negotiations (MTN). The GATT, which currently is focused almost exclusively on trade in physical goods, does not include provisions to protect and foster growth in services trade. Moreover, many nations are suspicious of US motives, and attempts to block US initiatives on services are likely. Nonetheless, a preliminary examination of services trade data indicates that many other countries have an important stake in establishing rules for these transactions. [redacted]

Outlook for Negotiations

Foreign reactions to the US initiative on services have largely been skeptical or negative:

- The positions of the other industrialized countries suggest lukewarm support for the US initiative, combined with wariness that the United States may be embarking on an ill-conceived "crusade" that has minimal chance of success.

- Many developing countries oppose what they perceive as a US scheme to dominate their emerging service sectors.

Moreover, services trade involves politically sensitive national sovereignty issues, such as the right to regulate investment, because many service transactions must be carried out through overseas subsidiaries or branches. [redacted]

The issue of negotiations on services has implications for US economic security and international competitiveness over the longer term. Transactions such as banking and financial services play a major role in the US balance of payments, while other services such as telecommunications and transborder data flows contribute to the US comparative advantage in technology-intensive industries. Moreover, service transactions are often closely linked to exports of manufactured goods, and so can be important as a competitive factor for other sectors of the economy. [redacted] 25X1

A major obstacle to negotiations on services trade is the absence of adequate data on the transactions involved. Unlike merchandise trade in physical goods moving across borders, international service transactions are by nature intangible. They are sometimes measured differently by different countries, are often undercounted or recorded as foreign investment, and are rarely disaggregated to the level of detail provided for merchandise trade. Lack of basic data and analysis on international services trade has provided an excuse for some countries not to move beyond their initial, negative positions. [redacted]

25X1

25X1

Shifting World Services Markets

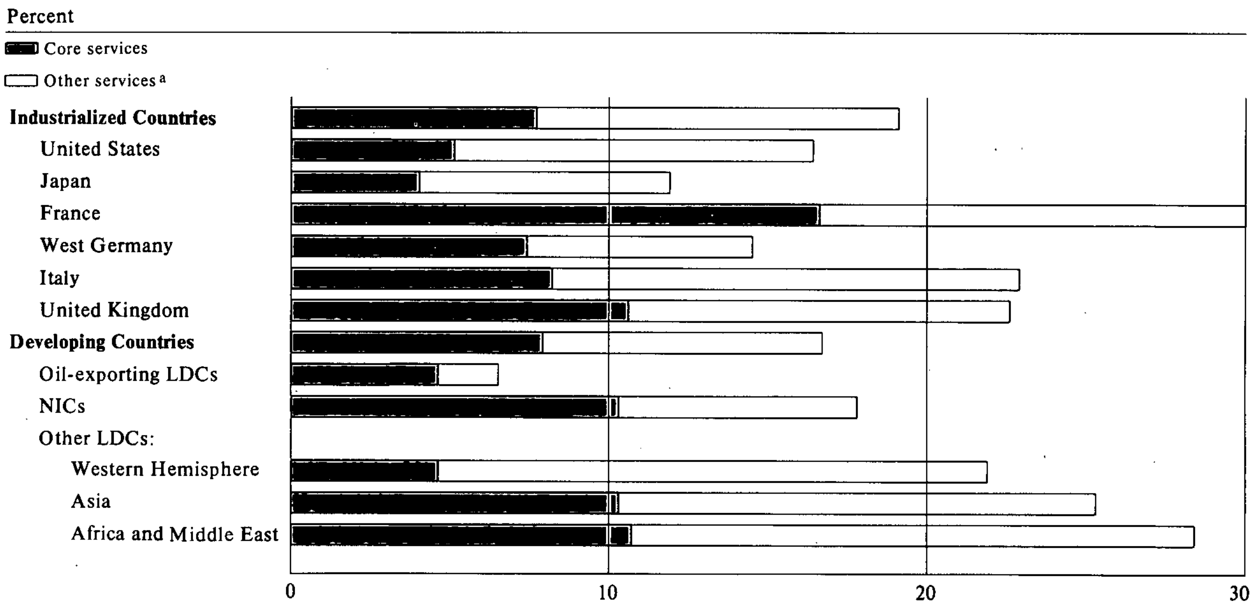
IMF and US Commerce Department data show some surprising trends in services trade:

- While the United States does appear to be a world leader in services trade, its share of the world market has been significantly eroded in recent years.

- France and the newly industrialized countries (NICs)—major sources of opposition to the US initiative in the GATT—appear to have gained market share while the US share was declining.

25X1

Service Receipts as a Share of Goods and Services, 1983



[a] Other services include shipping, transportation, and travel/tourism.

25X1

304526 (C00817) 1-85

- US exports of services over the past decade have been fairly buoyant for Asia and Africa, Western Europe, and Latin America—but remained at low levels for Japan and Canada.

- Perhaps most striking in terms of what other countries have at stake from liberalization of services trade, US imports of services from Asia, Africa, and especially Latin America in the past 10 years have expanded at a faster pace than US service exports to those areas.

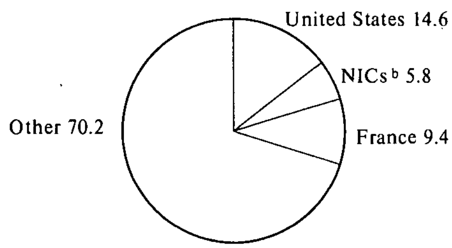
Only a decade ago, the United States dominated the international market for services, holding a larger market share than any other country in core services,[1] as well as in services as a whole, which also includes the low-tech but high-volume categories of shipping, transportation, and travel receipts. During the 10 years since 1973, the US share of the global market for core services was slashed nearly in half. The principal beneficiaries of this shift in market share appear to have been France and the NICs—although some of the apparent expansion in French service exports was due to changes in the way France reported its figures to the IMF. In addition to the United States, Britain and Italy also 25X1

[1] Core services include banking, insurance, communications, business services, advertising, accounting, legal services, brokerage, management, repair, and construction/engineering. 25X1

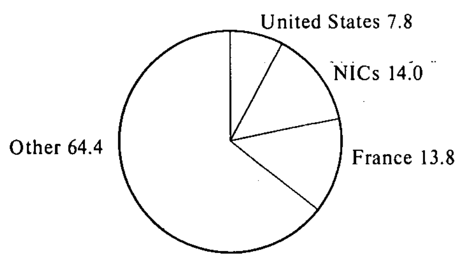
Global Market Shares in Core Services[a], 1973 and 1983

Percent

1973



1983



[a] Core services include fees, royalties, and rental payments for use of intangible assets and for provision of management, professional, and technical services, and payments for other private services including banking, insurance, communications, business service, advertising, accounting, legal services, brokerage, management, repair, construction, and engineering. Receipts for services measured in special drawing rights (SDRs).

[b] NICs (newly industrializing countries) are Brazil, Mexico, South Korea, Taiwan, Hong Kong, and Singapore.

[redacted]

304525 (C00819) 1-85

Changing Global Market Shares in Core Services *Percent*

	1973	1983
United States	14.6	7.8
Japan	3.9	4.3
France	9.4	13.8
West Germany	9.0	9.1
Italy	9.1	4.9
United Kingdom	10.1	8.2
Other EC-10	14.5	8.8
Other industrialized	15.6	11.5
NICs	5.8	14.0
Oil-exporting LDCs	1.3	5.6
Other LDCs	6.7	12.0

[redacted] 25X1

lost market share, while gains were registered by the developing countries other than the NICs. [redacted]

Much of the dynamism of the core services can be linked directly to the strong US position in high-technology and knowledge-intensive industries, particularly in the communications and information-services fields, but also in finance, construction, and engineering. In addition, many overseas services transactions in areas such as banking, insurance, accounting, and advertising serve to facilitate US exports of manufactured goods, and thus can be a significant competitive factor for US industries. Increased protectionism in international services trade, or even perpetuation of the status quo, could worsen the US balance of payments and have a negative impact for US exports of high-technology products. [redacted] 25X1

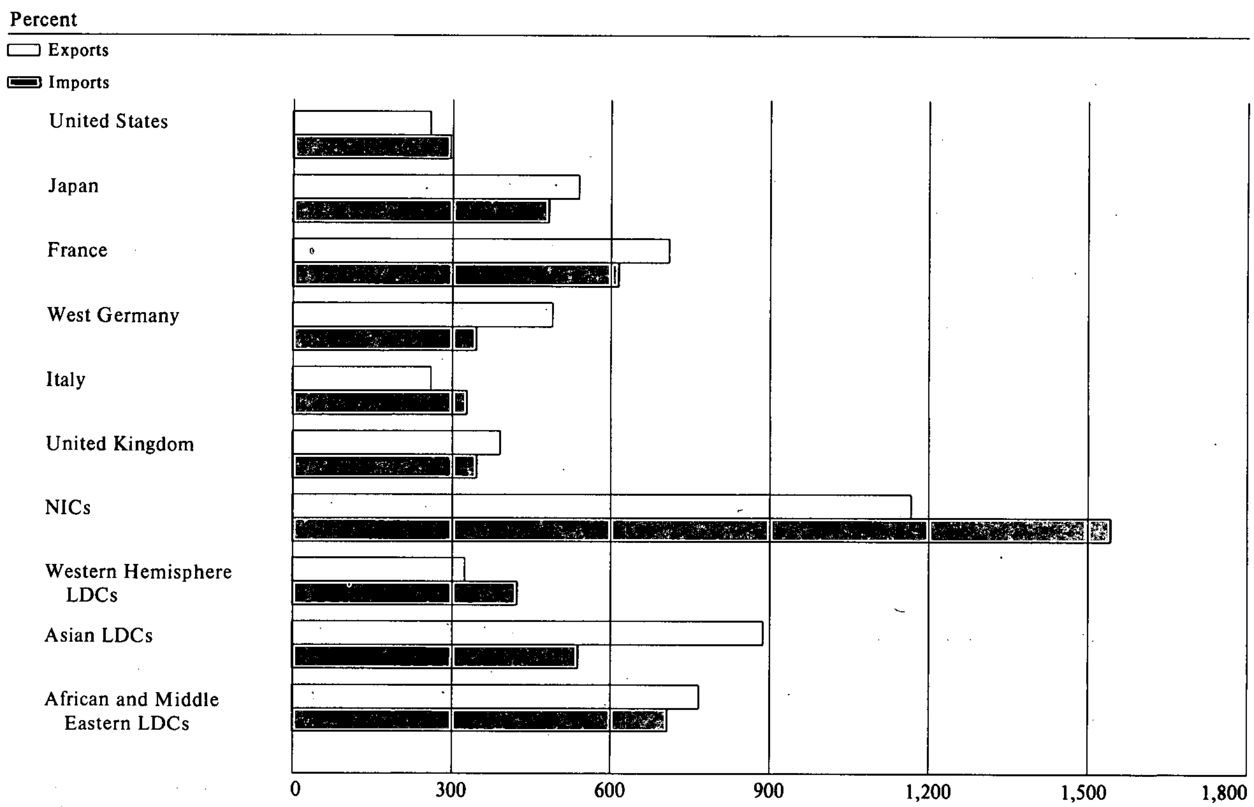
At the same time as the US economy is becoming increasingly service oriented (49 percent of GNP was attributable to the services sector in 1982, compared with 33 percent in 1952), the US international market share in core services is being rapidly eroded. While US efforts to engage the world trading community in addressing these issues have been resisted by many LDCs in the GATT, it is precisely the fastest growing among the developing countries (the NICs) that have benefited the most from the US loss of market share. [redacted] 25X1

25X1

National Interests in Services Trade

The importance that different countries might attach to negotiations on services should be related to their dependence on services earnings reflected in

Growth in Exports and Imports of Core Services, 1974-83



25X1

304527 (C00818) 1-85

their ratios of service receipts to total exports of goods and services. Contrary to what might be expected, the industrialized countries and the LDCs appear nearly equal in their relative dependence on core services receipts. 25X1

By this measure the United States is less dependent on its services exports than the NICs, the non-oil-exporting LDCs, or any other industrialized countries except West Germany or Japan. Notwithstanding the imprecision of the data, the prevailing view of services negotiations—as an exclusively US concern—is evidently unfounded. If anything, several other countries may have more at stake than the United States in liberalizing international services trade. To what extent these patterns of apparent commercial interest can be translated into negotiating opportunities remains very much an open question, however, in light of experience in the last round of MTNs. 25X1

Receipts as a Share of Payments for Core Services, 1983 *Percent*

Unites States	299
Japan	48
France	139
West Germany	81
Italy	113
United Kingdom	235
NICs	119
South Korea	188
Singapore	259
Brazil	39
Mexico	50
Taiwan and Hong Kong	118
Oil-exporting LDCs	40
Other LDCs	89

[redacted]

United States: Trade in Core Services, 1973-83

	Million US $		Average Annual Growth
	1973	1983	(*percent*)
Exports to			
Western Europe	395	1,270	12.4
Canada	251	644	9.9
Japan	84	246	11.3
Latin America	359	1,172	12.6
Asia and Africa	314	1,767	18.9
Imports from			
Western Europe	396	886	8.4
Canada	247	352	3.6
Japan	40	114	11.0
Latin America	263	1,690	20.4
Asia and Africa	59	420	21.7

25X1

[redacted] 25X1

Global Patterns of Competition in Services

The United States appears for the moment to be in a stronger position in international trade in core services—measured by its trade surplus in this area—than any other industrialized country. The United Kingdom, France, and Italy also have surpluses in this segment of services trade, while West Germany and Japan registered deficits. [redacted]

Among LDCs, the oil-exporting countries register deficits in international services transactions, as would be expected, while the non-oil-exporting LDCs as a group are nearly breaking even in international services trade. This seems to refute the common supposition that all LDCs are bound to be substantially in deficit in this sector and that only the United States (and possibly a few other industrialized countries) stands to gain from negotiations to apply GATT rules to trade in services. [redacted]

The most striking conclusion to emerge from the data is the apparent competitiveness of the NICs in international services trade. Recorded surpluses in services trade, however, might also be due to protection of domestic service markets rather than to any inherent strength of service exports. [redacted] 25X1

25X1

To assess competitiveness in international services trade, more detailed data will need to be developed on such key indicators as import penetration and relative prices. As a proxy for these measures, the relative growth of countries' exports and imports of core services suggest that Japan, France, West Germany, and some of the LDCs are experiencing more favorable trends than the United States, with growth in their service exports exceeding that of service imports. Moreover, core services receipts of these countries and the NICs have grown at a faster pace than their merchandise exports. [redacted] 25X1

25X1

In terms of negotiating dynamics within the GATT, the wide differences in apparent competitiveness among the NICs raise serious problems. South Korea and Singapore, both strong performers in this comparison, have not been active participants in multilateral discussions within GATT, preferring to focus on bilateral trade discussions. Taiwan, Mexico, and Hong Kong are not members of the GATT. Brazil, which has actively opposed the US initiative on services negotiations in the GATT, appears to be conspicuously noncompetitive among the NICs in core services. The opposition of Brazil and other noncompetitive LDC activists such as India could perpetuate a north-south stalemate over the issue of international services negotiations—even though such an outcome would apparently be contrary to the interests of many LDC members of the GATT. [redacted] 25X1

[redacted] 25X1

West Germany: Taking a Lead on the Acid Rain Issue [redacted]

25X1

Chancellor Kohl, host this May for the annual Big Seven economic summit, intends to make environmental protection one of his main themes. Rapidly worsening damage to West German forests from acid rain [1] has pushed Bonn into an unusual leadership role in Western Europe on an international issue. West German actions on this issue could affect Bonn's relations with West and East European neighbors—major sources of pollution—and with the European Community. Domestically, the acid rain issue has united the nation on the need for urgent action, although controversy has flared over the exact content of legislation. The issue also has been a key factor boosting the fortunes of the environmentalist Green Party, putting it into position possibly to replace the Free Democrats as the nation's third-largest party. [redacted]

Extent of the Problem

One-half of West Germany's forests are damaged, primarily because of air pollution, according to the Ministry of Agriculture's 1984 report. By contrast, the 1983 report found 34 percent damaged and the 1982 report only 8 percent—although part of the increase probably is due to improved survey techniques. The devastation is most acute in the Black Forest area in the southwestern state of Baden-Wuerttemberg, where 66 percent of the forested land is affected. Bavaria—the southernmost state—is almost as badly hit. These two states contain just over half of West Germany's forests. [redacted]

The damage to trees, soil, fish, and buildings attributed to acid rain is estimated by West German scientists to approach $1.5 billion per year. The forestry industry, in particular, estimates that its annual costs, including both smaller harvests and higher management expenses, total approximately $350 million. The cost is likely to rise considerably in the coming years as much higher percentages of damaged trees, whose wood is unusable or of a lower grade, are felled commercially. The tourism industry expects to be hurt as well. [redacted] 25X1

The increase in this damage is staggering to the West Germans, who have a strong emotional attachment to their forests. While the official figures may exaggerate the growth of the problem somewhat, the latest Ministry report has produced public outrage and a sense of urgency that cuts across all political lines. Chancellor Kohl, who calls the problem one of inestimable importance, faces almost no domestic disagreement in laying the lion's share of the blame on acid rain. [redacted] 25X1

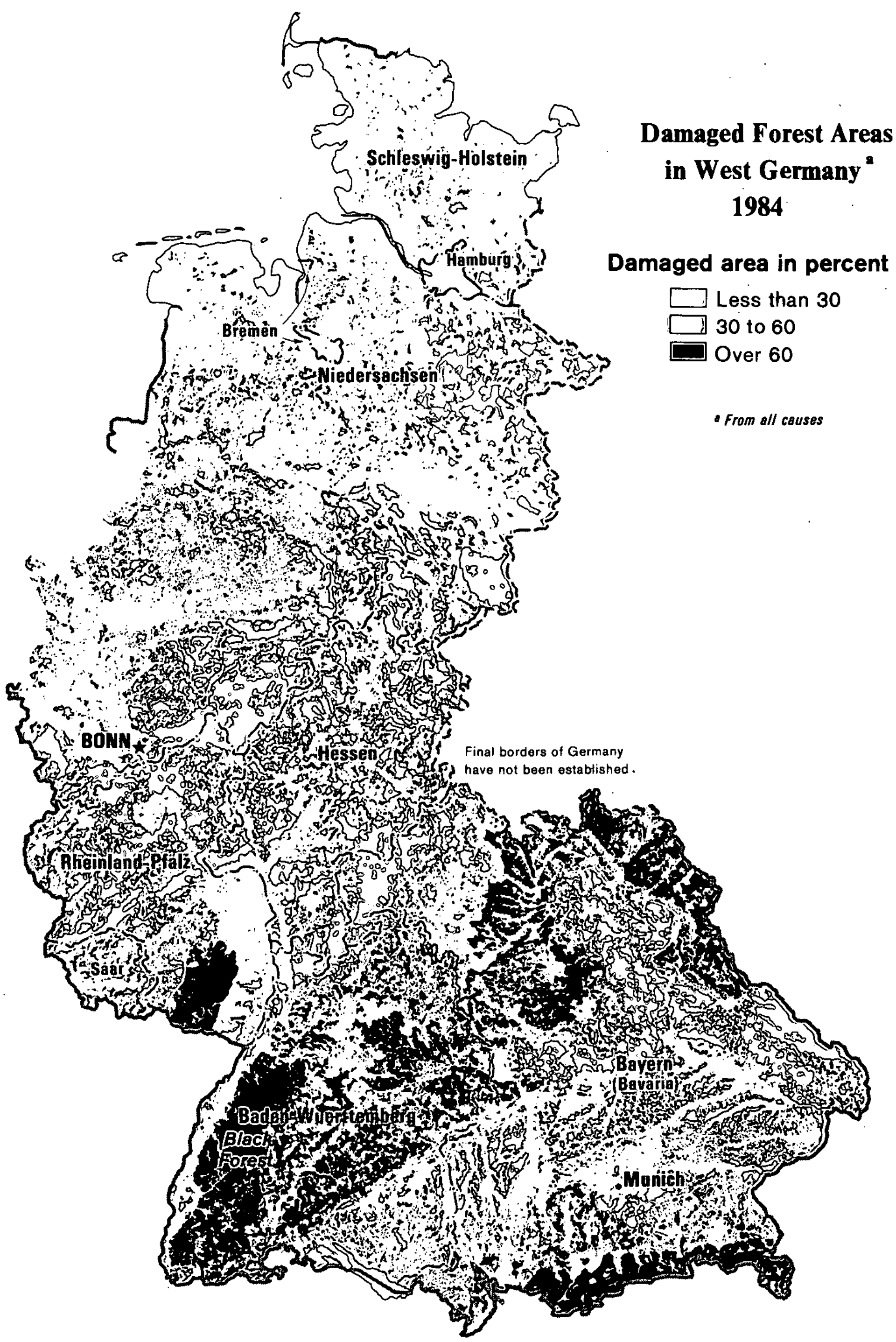
25X1

Government Action

Bonn, under pressure from a growing environmentalist movement, is attacking acid rain with strict antipollution regulations, stepped-up R&D, and an ongoing effort to promote international environmental cooperation. In 1983, the government mandated emission standards for large power plants and factories that will require installation of "scrubbers" at an industrywide cost of well over $3 billion; plants and factories unable to meet the standards will have to shut down. Legislation regulating smaller plants is also being drafted. The goal is to reduce sulfur dioxide emissions one-third by 1988 and one-half by 1990. Meanwhile, strict

25X1

[1] Acid rain forms when sulfur dioxide and nitrogen oxides from smokestacks and vehicle exhaust combine with atmospheric moisture. [redacted] 25X1



704027 1-85

25X1

limits for more than 40 other pollutants are already in force.

After months of squabbling, the Cabinet last September ruled that larger cars must meet emission standards virtually identical to those in effect in the United States by 1988; all new cars must be in compliance a year later. To achieve the reduction in emissions, catalytic converters and lead-free gasoline will be needed. Beginning this July, drivers who voluntarily change to low-emission vehicles will be eligible for tax breaks ranging from $350 to $1,000. A further financial inducement as of July is a 2-pfennig-per-liter (less than 1 US cent) reduction of the tax on lead-free gas and a 2-pfennig-per-liter increase on leaded gas. The tax change will represent 1 to 2 percent of the pump price.

Forests Versus Fast Cars

Despite the far-reaching domestic impact and international implications of the acid rain legislation—West Germany is well ahead of other West European countries on the issue—little serious dissent has emerged. In sharp contrast, the idea of imposing speed limits on West Germany's autobahns has set off a powder keg of controversy. The famous autobahns are a last frontier of unlimited high-speed driving, and tales are legendary of Porsches, Mercedes, and BMWs with flashing headlights bearing down on unwary foreigners in the passing lanes. Many West Germans regard driving fast as a right, which they fervently defend. A government-recommended limit of 120 kilometers (75 miles) per hour has had little impact. Secondary roads do have speed limits, but past attempts to introduce them on the autobahns—chiefly on safety grounds—have fallen flat.

The fuse of the stormy political debate was lit when the Federal Environment Office found that a 100-kilometer-per-hour (62-mile) speed limit would substantially reduce nitrogen oxide auto emissions, a key factor in acid rain. Chancellor Kohl and Economics Minister Bangemann both quickly came out against speed limits, the latter warning that cutting speeds could mean cutting jobs, since West Germany's automobile industry is geared to turn out high- 25X1
performance cars. Just as quickly, however, Agriculture Minister Kiechle, who is from Bavaria, broke ranks and spoke out in favor of speed limits. Most West German politicians shun the sensitive topic, and the government's vacillation reflects popular uncertainty. A poll by a major polling institute disclosed that 55 percent of West Germans would accept speed limits if it would help save the forests, but a later poll by West Germany's most popular newspaper found a majority against speed limits. 25X1

West Germany's powerful automobile industry has mounted a major lobbying effort against speed limits. Vehicles account for 17 percent of total 25X1
West German exports, and Volkswagen and Daimler Benz are, respectively, the nation's second- and third-largest employers. The industry accepted catalytic converters after the government agreed to postpone their introduction from the originally proposed 1986 date, but automobile manufacturers argue that the best way to control pollution is for people to buy new cars that pollute less than older models. Moreover, industry officials claim that the reputation of West German cars for speed and power is exemplified by the fact that Germans drive as fast as they want. The auto industry complains about a fall in new orders due to uncertainty about the effect of the various new measures, and company officials point out that the cleaner cars will cost more, use 5 to 10 percent more gasoline, and lose as much as 15 percent in power and performance. Environmentalists counter that the best foreign customers, like those in the United States, have not lost their taste for German cars, despite rigorous speed limits. 25X1
25X1

Bonn's official line now is that the evidence on the benefits of speed limits is not conclusive and requires more study. The state of Hesse, however, where the environmentalist Green Party has played an influential role, is proceeding with the introduction of speed limits on three autobahn stretches on a test basis. 25X1

The "Greening" of West Germany

The decline of West Germany's forests has been matched by the equally dramatic rise of the Green Party—an uncompromising defender of the environment. Founded just over four years ago, Green support has grown to as much as 10 percent of the electorate. The party won over 5 percent of the seats in the Bundestag in the last federal election, and it is also represented in six of 11 state parliaments. In some local governments, the Greens are the second-largest party. With three state elections this spring, the Greens stand an excellent chance of expanding their influence even further. If present trends continue, they could overtake the Free Democrats and emerge from the 1987 national election as West Germany's third-largest party. [redacted]

Along with the opposition Social Democrats, the Greens brand Bonn's environmental actions as "too little, too late." The Greens demand speed limits now, and both parties fought the three-year delay in the introduction of catalytic converters. The Social Democrats also are pushing a tax on electricity, with the proceeds to be used for pollution control. [redacted]

Clearing the Air Internationally

Fifty percent of the 7 million metric tons of acidic materials falling in West Germany annually comes from foreign sources, particularly France, Britain, and East Germany, according to government statistics. International cooperation on acid rain, therefore, is a priority for Bonn, and the Kohl government has found itself in the unusual position of leading Western Europe on an international issue. Kohl, host this May for the annual Big Seven economic summit, intends to make environmental protection one of his main themes. He has also repeatedly stressed he wishes to discuss environmental issues with East German leader Honecker when the two eventually meet. [redacted] 25X1

Bonn views the United States as the leader on domestic environmental policy, but Kohl may urge the United States to be more forthcoming at future international environmental conferences. On the other hand, the Soviets and East Europeans, [redacted] 25X1, are 25X1 among the world's major polluters and are doing virtually nothing about it. Foreign Minister Genscher last month in Prague did win some cooperation on cross-border air pollution with an agreement that West German aid would be used to clean up a Czechoslovak power station. [redacted] 25X1

Bonn's action on auto emission standards, well ahead of its West European neighbors, has been a source of consternation within the EC. Last month, however, the EC finally agreed to compulsory introduction of lead-free gasoline no later than 1989, although the Community's target date for auto emission controls remains 1995. West German Interior Minister Zimmermann, whose responsibil- 25X1 ities include the environment, believes that Bonn has now achieved momentum in Brussels and that the EC soon will adopt Bonn's 1989 date for emission controls as well. If the EC fails to do so, Bonn will go it alone, invoking the article in the Treaty of Rome that allows for individual regulations in case of danger to health or environment. The EC also is considering stricter German-style emission standards for large factories, but agree- 25X1 ment any time soon is highly improbable. [redacted] 25X1

[redacted] 25X1

Sanitized Copy Approved for Release 2011/03/07 : CIA-RDP97-00771R000707350001-0

Argentina's Grain Outlook: Challenges for Alfonsin [1] [redacted]

25X1

The year-old government of President Raul Alfonsin is counting on a major expansion in Argentina's grain exports to help service its $46 billion debt. Buenos Aires's new grain program is designed to generate an additional $2-3 billion in annual earnings by the early 1990s. The success will depend to a large extent on Argentina's relationship with the Soviet Union, its largest grain buyer and a key bidder on a necessary grain port expansion project. [redacted]

From a US perspective, Argentine success in nearly doubling its current grain exports would be a two-edged sword. Attainment of this goal is necessary for setting the Argentine economy back on a long-term growth path, but it would also mean keener competition for US grain in markets likely to be glutted for the remainder of the decade. If Buenos Aires undercuts US prices—as it has promised—the United States will lose sales, particularly in traditional Latin American markets. [redacted]

Government Policies

We believe that the goal of the program—production of 60 million metric tons by the early 1990s—is technically feasible. Consistent annual production of between 50 and 55 million tons appears more realistic, however, given domestic infrastructure constraints and world market demand prospects. Even this outcome would mean a significant advance from current production and export levels. [redacted]

To increase grain exports, Buenos Aires will have to implement policies to expand planted area and improve yields, and make sizable investments to modernize and expand grain storage, transportation, and port facilities. The Alfonsin government is already pursuing measures to meet these objectives:

- According to Embassy reporting, the new government has reactivated a World Bank loan for $87 million to finance basic infrastructure improvements, including grain storage facilities.

25X1

[redacted]

25X1

- Several port improvement projects also have been under consideration. The focus has been on an integrated modernization scheme for the port of Bahia Blanca—the primary export terminal for wheat. [redacted]

25X1

Moscow would very much like to win the multi-million-dollar Bahia Blanca contract but has lost ground recently to Western firms also bidding on the project. Buenos Aires probably will seriously consider Moscow's bid, however, because Soviet grain purchases from Argentina have generated $1.9 billion annually during 1980-83, about half of Argentina's total grain exports in that period. Recent slowdowns in Soviet grain purchases may be an attempt by Moscow to exert leverage regarding the Bahia Blanca contract and to pressure the regime to improve its balance of trade with the Soviet Union. The USSR-Argentina Long-Term Grain Agreement—guaranteeing annual grain sales of 4.5 million tons to the Soviet Union—comes up for renewal this year, and we expect Moscow to be a hard bargainer. Argentina can ill

25X1

25X1

[1] This article summarizes a forthcoming research paper. [redacted]

25X1

Argentina: A Major Force in World Grain Trade

Argentina is a major factor in world grain trade in spite of its relatively low grain yields and significant infrastructure problems. According to the most recent USDA estimates for the current season, Argentine wheat, corn, and sorghum exports accounted for 6 percent, 10 percent, and 35 percent of global trade in these commodities. Argentina's presence in the world soybean market has risen from virtually nothing in the early 1970s to its current share of about 8 percent of global soybean exports.

In the 1983/84 marketing year, (July/June) Argentina exported a record 9.6 million tons of wheat—up 28 percent from the previous year. The Soviet Union, China, and Iran were the dominant markets, taking 80 percent of the total, but sales to smaller markets in Latin America, the Middle East, North Africa, and Asia also showed considerable growth. Corn exports for 1983/84; (Oct/Sep) totaled 5.9 million tons, with Argentina ranking as the world's second-largest supplier after the United States. Major buyers were the USSR, Iran, and several countries in Western Europe and Latin America. In sorghum, Argentina rivals the United States as the leading supplier to the world market. Of the 4.8 million tons exported by Argentina in 1983/84 (Oct/Sep), Japan and the Soviet Union were the major markets, taking about 80 percent of total exports. Likewise, Argentina's soybean exports are second only to the United States, with major sales going to Western Europe, the USSR, and Asian markets. 25X1

According to a former president of the National Grain Board, Argentina's main market goal in the 1980s is to recover and increase its share of the Latin American grain market. Argentina has largely ignored this area in recent years while trying to build premium-priced sales to the Soviet Union—in the wake of the US grain embargo. Another goal is to develop markets for its grains in the Pacific region, which Argentine officials see as the main food growth market in the 1990s. Aside from established markets in Japan for sorghum, and the recently expired long-term grain agreement with China, the Alfonsin regime has yet to make major inroads in this market—especially among the newly industrializing countries. In addition to recapturing Latin American grain trade and developing new nontraditional markets, the Alfonsin regime has often stated its goal of reducing the high level of dependence on Soviet grain purchases. 25X1

25X1

afford to lose steady grain sales to the USSR if it is to meet its ambitious new grain export goals.

The Payoff—Growth and Earnings

If Buenos Aires's grain program is successful, it will improve Argentina's prospects for economic recovery and payment of its foreign debt obligations. This would improve the financial situation of US banks with large exposure in Argentina and provide an opportunity for expansion in US-manufactured exports to Argentina. On the other hand, increased grain exports by Argentina would add pressure to a world grain market already marked by fierce competition, soft prices, and declining US sales. US-Argentine competition would be particularly intense in the 20-million-ton-per-year Latin American grain market, a major US market already being targeted by other exporters such as Australia and Canada. 25X1

25X1

We believe Argentina has no good alternative to grains for increasing export earnings by as much as $2-3 billion. Failure on the grain front might provide the United States some benefit through reduced competition in Latin American grain mar-

Argentina: Grain and Oilseed Exports

	Billion US $				*Percent*	
	Total	Agricultural	Grain	Oilseed and Products	Grain and Oilseed Exports As a Share of:	
					Total Exports	Agricultural Exports
1980	8.0	6.0	1.6	1.4	38	51
1981	9.1	6.8	2.8	1.3	45	60
1982	7.6	5.4	1.8	1.2	40	56
1983	7.8	6.0	2.8	1.3	52	67
1984 [a]	8.2	6.3	2.3	1.4	45	58

[a] Estimated.

[redacted] 25X1

kets. The resulting economic and political uncertainty, however, would undermine the progress Alfonsin has made toward establishing a democratic system. [redacted] 25X1

[redacted] 25X1

Israel: Facing Revenue Shortfalls [redacted] 25X1

Since Israel's unity government assumed power in September, a continuous decline in revenue has undercut efforts to trim the growing budget deficit.[1] Because the Bank of Israel is legally required to finance budget deficits—by running the printing press if necessary—the result has been a sharp increase in the money supply and greater inflationary pressures. Budget cuts announced to date have not been widely implemented, but reduced spending will eventually slow economic growth and further erode government income. Pressures then will probably intensify for the government to address its deep-seated revenue problems. [redacted] 25X1

Recent Developments

Israel's budget deficit has grown sharply over the past year. Incomplete data suggest the deficit may have reached its highest level in several years during the latter half of 1984. [redacted] 25X1

Excessive government spending remains the core of the problem. In addition to political concerns to maintain living standards and low unemployment, recent governments have found their ability to cut spending eroded by mounting debt service obligations, which now account for nearly 40 percent of the budget. Expenditures, however, are not the sole cause of the recent growth in the deficit. In real terms, government outlays during the first half of 1984 dropped 9 percent below the levels recorded a year earlier, but government income over the same period fell by 19 percent. [redacted] 25X1

[1] The domestic deficit is not clearly defined in Israeli statistics. In this article, the deficit refers to the difference between revenues (taxes and other government earnings) and ordinary government expenditures. [redacted] 25X1

Tax Revenues To Blame

The heart of the recent slump in revenues is a drop in tax collections. Tax revenues—which account for about 90 percent of total government income—were down 15 percent in real terms during the first three quarters of 1984, compared to the same period in 1983:

- Some of the reduction resulted from the expiration of the "compulsory loan" tax imposed in mid-1982 to help finance the invasion of Lebanon. This nine-month levy was equivalent to about 4 percent of personal income.
- Direct taxes—which consist of taxes on all types of income—have been running well below 1982 levels since the last quarter of 1983. These taxes generate about 55 percent of total tax income.
- Customs revenues from civilian imports also are down, and they usually amount to about one-fifth of tax revenues. Tax collection rose briefly during the third quarter of 1984 as consumers rushed to import items in anticipation of restrictive measures likely to be imposed by the new government. These revenues are estimated to have tailed off again in the last quarter, largely because of a ban of some luxury imports.
- Revenues from indirect levies on property and consumer purchases, as well as value-added tax revenues, also have fallen over the past year.

[redacted] 25X1

Israel: Government Expenditures and Revenues [a]

Million 1982 Israeli shekels

	1982				1983				1984	
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter
Balance	**3,985**	**−6,412**	**−2,545**	**−424**	**−236**	**−1,528**	**−5,883**	**−6,171**	**−3,587**	**−5,439**
Expenditures	30,840	34,541	33,213	32,245	39,339	34,685	39,296	36,273	33,868	33,740
Revenues	34,825	28,129	30,668	31,821	39,103	33,157	33,413	30,102	30,281	28,301

[a] Monthly averages.

25X1

These declines stem in part from the economic slowdown. GNP growth was a modest 1.5 percent in 1983 and stagnated last year. Consumers finally bore some of the burden, with real wages falling 4 percent in 1984, consumption dropping roughly 5 percent, and unemployment climbing to nearly 6 percent. Imports of consumer goods and services fell, with noticeable declines for some highly taxed durables.

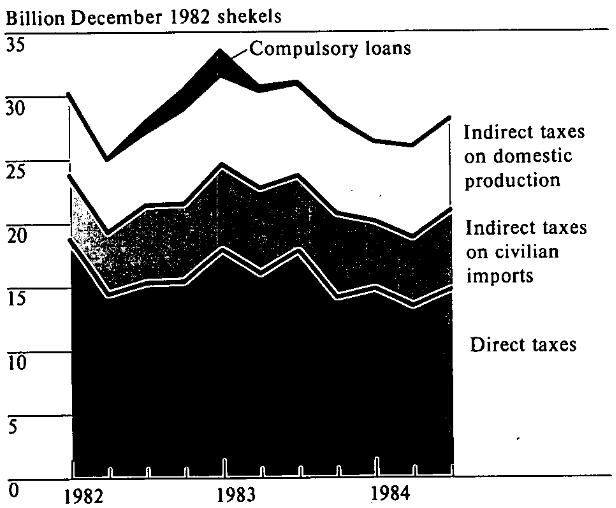
Israeli attempts to offset the revenue shortfalls with various revenue-enhancing measures proved ineffective. In March 1984, Prime Minister Shamir's Likud government doubled the travel tax, imposed new taxes on some child allowances, and boosted the marginal tax rate limit to 66 percent. In September 1984, the government removed some tax exemptions on pensions and allowances, and levied a one-time fee on cars, boats, machinery, and buildings. Efforts to implement an 8- to 10-percent surtax on October incomes and to reintroduce compulsory loans foundered because of opposition from the Histadrut, the large labor organization.

Cumbersome Tax System

The current tax system is extremely complex, with rates ranking among the highest in the world. Taxes as a share of GNP rose from 46 percent in 1981 to 51 percent in 1983. On the administrative side, tax workers are overburdened and mismanaged and admit doing a less-than-adequate job. Their work has been further complicated by the "Tax Law Under Conditions of High Inflation" introduced in 1983 to regulate payments from companies and self-employed workers. This legislation is extremely complex and has been constantly amended, contributing to declining productivity within the tax bureaucracy. Tax workers are as strike prone as other government workers, adding to delays in tax collection. 25X1 25X1

The cumbersome and onerous tax system encourages tax evasion. The high marginal rates are a tremendous disincentive to additional work hours. Tax accountants have had a field day in searching for loopholes contained in the "Tax Law Under Conditions of High Inflation." Not only did this law allow for numerous justifiable tax reductions, but its complexity also resulted in delayed payments. According to one estimate, 40 percent of recent revenue shortfalls were the consequence of this one piece of legislation. Outright cheating also is acknowledged to be rampant, with taxpayers arguing that they simply cannot afford to pay all that is required by law. 25X1 25X1

Israel: Tax Revenues, 1982-84[a]



[a] Monthly averages.

304481 (C00811) 1-85

The government is attempting to beef up revenues by tightening up tax collection. A two-week "tax raid" in October, for example, resulted in additional assessments of $4.5 million on 981 audited returns.

Other Sources of Revenue

The Israeli Government has little recourse to other sources of income. Incomes from government property and services annually average less than 10 percent of total earnings, and these, too, have fallen as a result of austerity. For the first half of 1984, monthly earnings from this source were down nearly 30 percent in real terms from the same period in 1983.

The Israelis have sought to finance the domestic deficit through bond sales. In recent years, such sales have covered roughly two-thirds of the gap. Yet the government found this traditional revenue source more difficult to tap in 1984. Bond redemptions increased markedly because a large number of 10-year-old issues came due. In addition, public confidence in the economy and the government has been waning, causing new sales to lag and rollovers to drop. For several months last spring, bond redemptions outpaced new issues, fueled by rumors that after the July national election the government would tamper with the linkage system that protects bonds from inflation. Israeli officials have expressed concern that the pace of redemptions could pick up again if consumers choose to "buy now" in anticipation of the end of the price freeze. 25X1

By law and practice, the Bank of Israel is required to cover the remaining gap. In November alone, the Bank of Israel reportedly pumped 130 billion shekels (about $225 million) into the economy—primarily to help cover rising subsidies resulting from the price freeze—compared to a 30-billion-shekel injection the previous month. The injection of money slowed to just over 100 billion shekels in December—in part because of government efforts to delay some payments and credits—but is expected to pick up again in January. 25X1 25X1

Outlook

The Israeli Government has yet to offer an economic program to replace the current wage-price freeze, which is slated to expire on 5 February. 25X1 Finance Minister Modai came under attack by some other ministries at a late December Cabinet meeting for failing to come up with a new package. Modai argued that little new could be expected if old programs, particularly budget cuts already approved, could not be enforced. 25X1

There are some signs that the government is considering remedies for the revenue side of the deficit problem. Modai has stated publicly that in the next package the government will collect the taxes required to balance the budget. 25X1 Moreover, a special committee appointed by former Finance Minister

Cohen-Orgad to study the tax law is scheduled to issue its report by the end of February. Some of the preliminary recommendations of the committee include abolishing the "Tax Law Under Conditions of High Inflation," linking tax payments to a stable benchmark rather than the depreciating shekel, and broadening the tax base to reduce the burden on individuals. Political realities will make such changes hard to implement, however, and major changes are unlikely in the near term.

25X1

25X1

India: Bhopal's Limited Backlash [redacted]

25X1

The unprecedented chemical plant disaster in Bhopal, India, which claimed over 2,500 lives and injured well over 70,000, is not likely to slow India's industrial modernization or its efforts to obtain foreign technology. Although the state and federal governments controlled by Rajiv Gandhi's Congress (I) Party share the blame for the catastrophe, it had no effect on the election. Soviet attempts to blame US policies are not likely to be well received in New Delhi, which is trying to attract US technology. [redacted]

Black Eye for India

Although flaws in plant design cannot be ruled out, press and US Embassy reports suggest that poor supervision and training by Indian management as well as lax—even nonexistent—inspection by local officials were largely responsible. The US Consulate in Bombay reports that both the Indian business community and expatriate supervisors believe that Bhopal was the result of an endemic aversion to maintenance and safety procedures by Indian management. The Consulate notes, however, that multinational corporations often take only a cursory interest in the management of their Indian subsidiaries and often oppose added expenditure on safety equipment or needed inspections. [redacted]

Foreign perceptions of India's improving business climate have probably suffered a temporary setback in the wake of Bhopal. In our view, the extensive international press coverage, the fear of an extended legal battle, and the bizarre arrest and release of the Union Carbide corporate chairman are likely to revive stereotypes of Indian bureaucratic bungling and antimultinational attitudes. [redacted]

Impact on Foreign Commercial Ties

According to US Embassy reports, New Delhi continues to indicate a strong interest in US technology and selected multinational participation in the economy. The absence of government public comment, other than Rajiv Gandhi's promise to tighten safety regulations and support for suitable compensation, suggests an effort to minimize controversy and reassure current or potential foreign collaborators. [redacted] 25X1 25X1

In our view, New Delhi will impose tighter safety and environmental controls on both Indian and foreign companies as a result of Bhopal. If rigorously enforced, these controls would raise production costs and make some industrial operations less profitable. Given the lack of a deep-rooted safety consciousness in India, however, we doubt that new rules alone will be effective. We expect foreign firms involved with highly toxic substances will be reluctant to make new investments or transfers of technology unless they are guaranteed limited liability and more control of safety or production processes. [redacted] 25X1

Because most US technology desired by India is in the "clean" fields of computers and electronics, we do not expect US technology transfer in India to suffer. Unlike Union Carbide, which has a majority interest in the agrochemical plant, most new US tieups are joint ventures with Indian firms, requiring only the transfer of technology and little or no equity investment. A Union Carbide decision to leave India probably would be viewed by the international business community as an isolated

25X1 25X1

case and not the result of Indian Government policies.

In our view, India's recent agricultural success, which, in part, is due to the increased use of pesticides, is not in jeopardy. With over 40 major agrochemical firms in India, Union Carbide accounted for only 14 percent of the large and growing pesticide market. Moreover, press accounts claim that the Union Carbide plant was losing money and was in production for only part of the year. Supplies currently are plentiful, and the permanent closure of the plant will have little effect on agricultural production.

Domestic and International Political Fallout

Despite opposition efforts to blame the ruling party for negligence, indifference, and cowardice, Gandhi's candidates swept to a landslide. Even in Madhya Pradesh state—where Bhopal is the capital—the Congress (I) Party won nearly all parliamentary seats despite reports that the state's Chief Minister and a Nehru family friend fled in panic at the height of the disaster.

We expect India will attempt to resolve the legal tangle quickly and quietly to avoid further damage to its image and speed up compensation to the victims. The US Embassy reports that, when the Union Carbide president and Foreign Secretary Rasgotra met in December, alternate compensation packages, administered by state and federal agencies, were discussed. Press reports indicate that one of the first moves of the new Gandhi administration will be to organize a legal committee to help represent the victims and pave the way for a possible out-of-court settlement.

According to US officials in India, anti-US protests have been small, orderly, and confined mainly to requests for adequate compensation. Indian media criticism has focused on the activities of US lawyers and on state government officials whose oversight and cozy relationship with the US multinational, the media claims, helped lead to the tragedy. In our view, public debate is likely to continue on the relationship between the government, multinationals, and domestic industry even after the furor over Bhopal dies down. 25X1 25X1

Seeing Bhopal as a propaganda windfall, Moscow was quick to blame Washington and US multinationals for elevating profits over people. The USSR has also claimed that Western powers have exploited the disaster as a chemical warfare study at the expense of needed medical care. We believe the heavyhanded Soviet attempts have not been well received in New Delhi, which shares the blame and hopes to attract new US and foreign technology. 25X1

Implications for Multinationals and Developing Countries

Bhopal will instill a keener awareness of the environmental dangers of rapid industrialization, which were often neglected by India and other countries in the name of development. We expect developing countries will institute increased safety and environmental controls. Although these changes will probably lead to higher short-run costs for chemical industries, we do not foresee a major reduction in the transfer of needed technology or expertise, because both the multinationals and developing countries require these processes to sustain their economic growth. To minimize risk, however, some firms are likely to process hazardous chemicals in the United States or other Western countries and then export less dangerous products to subsidiaries in the developing countries. 25X1

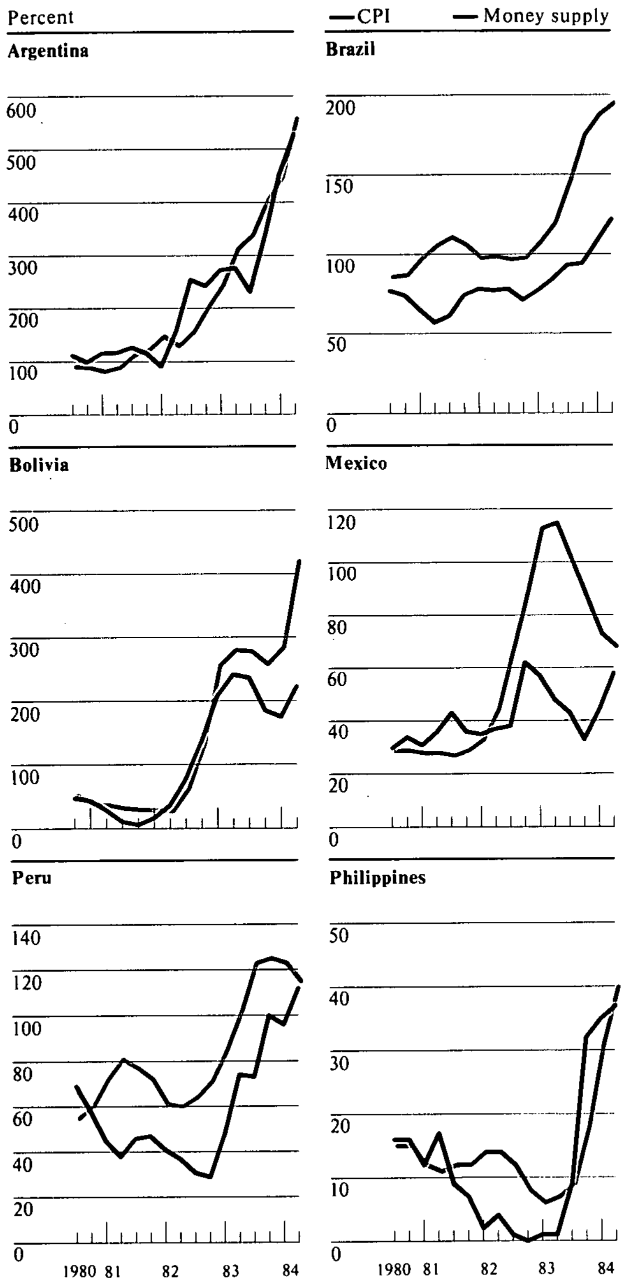
25X1

25X1

Page Denied

Next 1 Page(s) In Document Denied

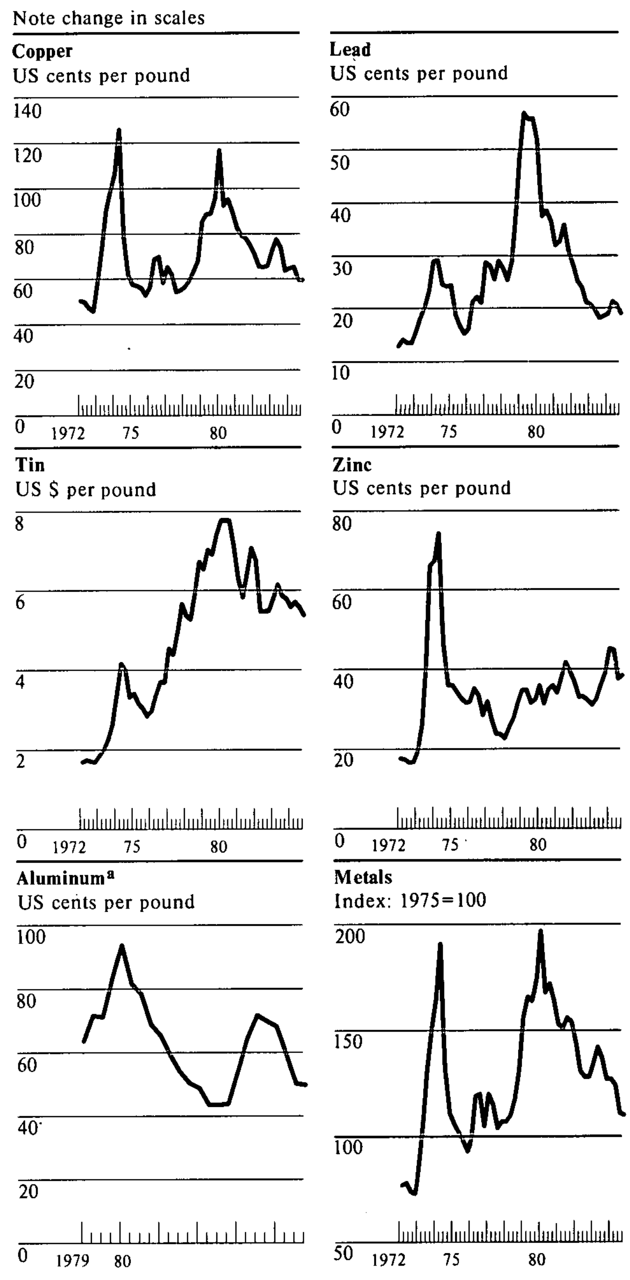
Troubled LDC Debtors: Consumer Price and Money Supply Growth[a]



[a] Quarterly data; change over corresponding period of the previous year.

304438 (C00778) 1-85

World Metal Prices: Still a Damper on LDC Earnings, 1972-84



[a] Average quarterly price on the London Metals Exchange.

25X1

25X1

304459 (C00775) 1-85

Secret

Secret