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International Economic & Energy Weekly

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1 February 1985

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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Synopsis

1 **Perspective—*Brazil's Unfinished Economic Adjustments***

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In striking contrast to past predictions of doom, numerous observers now have renewed confidence in Brazil's economic future. Although there is much to cheer, we believe the economy remains vulnerable to adverse external shocks and major domestic imbalances.

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11 **Brazil: Economic Plans of the Civilians**

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Brazil's President-elect Tancredo Neves inherits an economy that remains seriously troubled. Neves's highest economic priorities for 1985 are to strengthen growth and employment, reduce inflation, obtain a multiyear rescheduling of foreign debt, and promote a more equitable distribution of income.

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15 **United Kingdom: Dealing With the Miners' Strike**

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Prime Minister Thatcher is well on the way toward winning her battle with the striking coal miners and their Marxist leader, Arthur Scargill.

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21 **No Quick Recovery for the Saudi Economy**

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We do not believe that Saudi Arabia can significantly boost oil revenues or cut spending sufficiently to avoid another year of large current account and budget deficits.

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27 **CEMA: Planning for Long-Term Cooperation**

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The Soviet Union has initiated discussions on a wide array of multilateral and bilateral economic agreements with other members of the Council on Mutual Economic Assistance (CEMA) designed to limit CEMA's dependence on the West and exert tighter control over the East Europeans. The commitments, however, appear too weak and nonspecific to assure that Soviet goals will be met.

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31 **World Trade Balances: Dramatic Shifts**

Worldwide trade balances have shifted dramatically since 1981. The factors precipitating these trade shifts probably will persist through 1985, heightening tensions among trading partners and fueling protectionist pressures.

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International Economic & Energy Weekly

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1 February 1985

Perspective

Brazil's Unfinished Economic Adjustments

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In striking contrast to past predictions of doom, numerous observers now have renewed confidence in Brazil's economic future. At home, the return of civilian rule has heightened popular expectations of restored prosperity. Abroad, Brazil has won high marks from foreign bank creditors for its remarkable balance-of-payments gains under the current IMF stabilization program. A record $13 billion trade surplus in 1984 exceeded ambitious IMF-supported targets by $4 billion, eliminated the need for further foreign borrowing, and even provided the impetus for a mild recovery after more than three years of recession. Although there is much to cheer, we believe the economy remains vulnerable to adverse external shock and major domestic imbalances.

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A closer examination of last year's payments performance is indicative. A 23-percent rise in export earnings fueled the trade surplus, although a moderate decline in imports—mainly reflecting rising domestic oil production—also contributed. Although the military government's aggressive devaluation policy partly explains the export surge, much of the credit goes to developed-country recovery and substantial price rises for key agricultural exports such as coffee and orange juice. Moreover, Brazil remains heavily dependent on the US market that absorbed about one-half of the 1984 increase in exports.

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Brazil's bank creditors are reportedly impressed with the country's balance-of-payments achievements and expect to agree soon to a multiyear debt restructuring package comparable to the one obtained by Mexico. Bankers also expect President-elect Tancredo Neves to follow up

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with public support for the package. During negotiations in New York last month, Brazil and its bank committee agreed to reschedule $45 billion of debt principal due between 1985 and 1991 but have not yet overcome differences on the spread over LIBOR.

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Progress in rescheduling debt, however, should not obscure the economic challenges ahead for the new administration. Brazil's domestic economic performance has fallen substantially short of original IMF program targets that have had to be continually revised. Inflation rocketed from just under 100 percent in 1982 to over 200 percent in 1983-84. Although some of the inflation

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has resulted from adjustment measures, such as rapid devaluation and the lifting of price controls, Brasilia also has failed to implement effectively fiscal and monetary reforms urged by the IMF:

- Little headway has yet been made on the public-sector deficit, because of the complex budgetary system that undercuts spending controls. Also, the indexation system continuously drives government financial obligations higher. As a result, public-sector borrowing requirements have held at 18 percent of GDP for the past two years—double the initial IMF target—contributing to high domestic interest rates that impede private-sector investment.

- The government permitted the monetary base to expand by nearly 250 percent last year against an IMF target of 95 percent. Although the trade surplus complicated efforts to contain monetary expansion, a particularly sharp jump in the monetary base in the final two months of 1984 indicates that political factors still override adjustment needs.

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Under these conditions, it is unlikely that improvements in Brazil's foreign payments and domestic growth can be maintained so long as the government remains unwilling to tackle economic reform. The Neves government will need to do a better job than the military regime in reversing Brazil's inflation psychology to encourage greater productive investment and domestic saving. Turning the tide on inflation, we believe, would require reform of public-sector banking to improve management of the money supply and long-term lending, tougher measures to cut the still-bloated public sector, and a gradual dismantling of the pervasive indexation system. Also, incentives are needed for the dynamic private sector to increase production and exports, as well as steps to attract direct foreign investment.

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Briefs

Energy

New OPEC Pricing System

A majority of OPEC's members agreed this week to cut the price differential between high- and low-quality oil from $4 to $2.40 per barrel. As part of the new pricing scheme, the organization's former benchmark crude price fell from $29 to $28 per barrel. Iran, Libya, and Algeria refused to accept the agreement, however, and Gabon abstained. The price cuts are largely symbolic because they merely authorize members to sell oil at previously discounted rates. Because the oil market has little faith in OPEC's ability to restrain output and adhere to its pricing guidelines, downward pressures on prices are not likely to abate. Without uncharacteristic discipline, the organization could face the necessity of another price cut as early as this spring.

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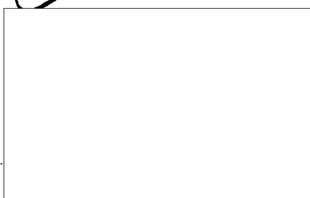
Egypt Moves Oil Production Steadily Higher



Despite public announcements that it would cut production to support OPEC, Egypt pushed its oil output to an alltime high of 870,000 b/d for the months of November and December, up more than 100,000 b/d from year earlier levels. The Gupco field led this surge with 600,000 b/d, supplemented by the new offshore production in Zeit Bay of around 20,000 b/d. Egyptian output will continue to increase in 1985 with the development of the Umbaraka and Meleika oilfields in the western desert, virtually assuring achievement of the goal of 1 million b/d by 1987, set more than a decade ago. Sharply increasing domestic demand—up nearly 15 percent annually in recent years—and weak oil prices, however, are likely to limit any increase in hard currency revenues.

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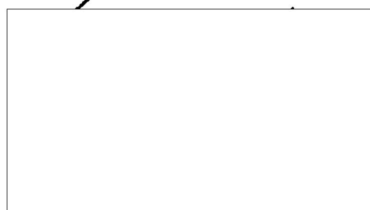
Turkey and Iran To Study Pipline Options



Turkey and Iran have agreed on a joint committee to oversee engineering and cost-benefit studies for two export pipelines from Iran through Turkey: one to transport crude oil to either the Mediterranean or Black Sea, the other to carry natural gas to West European markets. A memorandum of understanding signed during Iranian Prime Minister Musavi's visit to Turkey specifies that each country would finance and construct the portions in its own territory. Although Turkey has long been interested in joint pipeline projects, Iran's response is, in our view, mainly political maneuvering to improve trade relations. Despite Tehran's desire to develop alternative crude export outlets, the high cost of an Iran-Turkey pipeline—even longer than the oft-proposed line to the Strait of Hormuz or a recently proposed one to Lavan Island—makes this project unlikely. Moreover, the West European gas market is already saturated and Iran has long-range plans for increasing domestic gas use.

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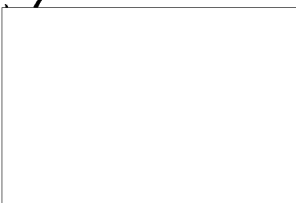
South African Energy Prices Soar



Pretoria has announced sharp increases in domestic fuel prices as a result of the declining value of the South African rand, which has fallen nearly 40 percent against the dollar in the past year. The price of gasoline, for example, has risen 40 percent. Although Pretoria claims these energy price increases will add only 2 points to the prevailing 13-percent inflation rate, some private economists are predicting rates as high as 18 percent for the year. Moreover, energy price increases probably will be passed along in higher utility charges for residents in black townships, increases that have triggered racial unrest in the past.

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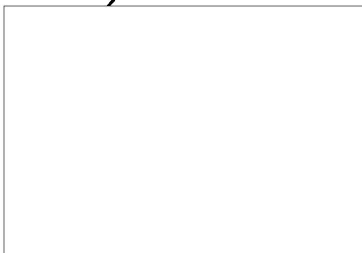
West European Gas Market Trends



West European gas consumption rose 9.3 percent above year-earlier levels in the first nine months of 1984, continuing the revival in gas demand begun in 1983. Demand in the United Kingdom—currently Western Europe's largest gas consumer—rose nearly 5 percent, while the Netherlands, France, and Belgium experienced increases of about 10 percent. Consumption in electric power stations accounted for nearly half of Italy's 24-percent demand increase. On the supply side, however, West European production was up less than 2 percent. As a result, West European imports of Algerian gas rose over 20 percent, largely as a result of deliveries to Italy through the trans-Mediterranean pipeline that entered its first full year of service. Gas imports from the Soviet Union rose by 8 percent.

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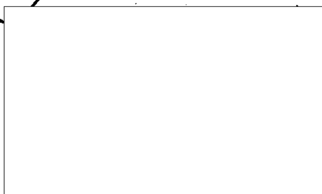
International Finance

Afghanistan Seeks Debt Relief



Kabul has asked several countries including West Germany, Japan, Iraq, Iran, Yugoslavia, Kuwait, and the United Arab Emirates to convert old loans to grants or at least extend the period of repayment. A UN representative was asked to convey a similar request to the IMF and the World Bank. All the responses have been negative. Kabul is seeking financial assistance because of its crumbling payments position and the reluctance of the Soviets to provide foreign exchange. Afghanistan paid about $25 million in FY 1984 on its roughly $500 million debt to non-Communist countries. Kabul's foreign reserves have declined to about $200 million, one-half the preinvasion level.

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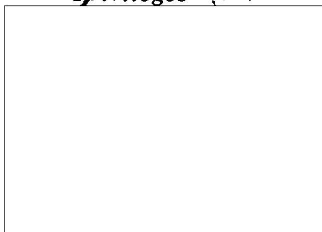
IMF Suspends Vietnam's Borrowing Privileges



The IMF last month suspended indefinitely Hanoi's access to Fund general resources—the first such action taken against a member. Vietnam had made only partial payment on its roughly $25 million in IMF arrears by the 15 January deadline and was apparently unable to convince the Fund that depleted foreign exchange reserves precluded full repayment. The suspension, however, is unlikely to have much impact on Vietnam's already bleak economic prospects. Hanoi has for two years been in de facto default on its $1.7 billion debt to non-Communist countries, accumulating approximately $350 million in arrears, and has had no success in arranging a multilateral rescheduling.

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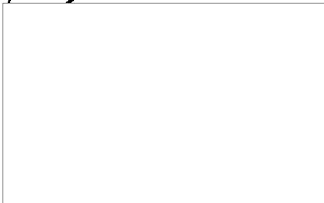
Moroccan Official Debt Problems



Morocco has suspended almost all payments to official creditors and has asked the Paris Club for a multiyear rescheduling of its official debt. The US Embassy in Rabat says that Moroccan finance officials believe this notification relieves Morocco's debt responsibility until a new rescheduling agreement is signed. The Moroccans may anticipate that the Paris Club will agree to forgo its usual policy and include unpaid obligations in any rescheduling package. Complicating Rabat's position with Club members is Morocco's foot-dragging on an IMF-supported stabilization program. Rabat's worsening financial problems, coupled with its recent failure to repay US-blended credits for agricultural goods, presage more difficulties in bilateral financial dealings with the United States. A major test will be the $655,000 due in March for military equipment purchases.

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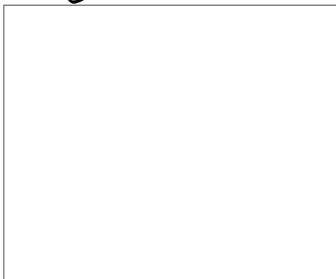
Dominican Republic Edges Closer to IMF Accord



After more than a year of contentious negotiations, President Jorge Blanco late last week announced new austerity measures aimed at securing a $65-70 million standby accord. A new standby could be signed as early as March, allowing Santo Domingo to reschedule its foreign debt and gain access to much-needed new lending. The measures include unification of the exchange rate and hefty export surcharges. The exchange rate adjustment caused price hikes for many basic commodities. Prices for gasoline and kerosene soared 34 percent and 87 percent, respectively, and electricity rates for residential users increased as much as 68 percent. Although there has been some backlash, the popular reaction so far has been less violent than last April when similar price hikes sparked riots that left over 60 dead. Quick actions by security forces, including the occupation of a major union headquarters, almost certainly dissuaded opposition groups from mounting violent protests. Nevertheless, to soften the impact of these new measures, the President announced plans to increase the minimum wage by 20 percent and pledged to continue subsidies for some food and medicine. He also promised improved housing and other services for the military and a new health plan for teachers.

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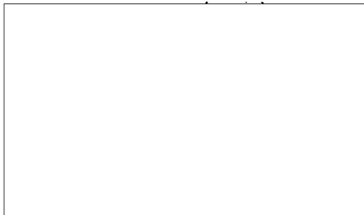
Portuguese Difficulties With the IMF and World Bank



Problems in recent talks with the IMF and World Bank probably will reduce the amount of money that Lisbon can obtain from those institutions in 1985. A sharp improvement in its current account deficit last year eased financing requirements, however, and barring a change in bankers' attitudes, we do not expect financing problems this year. The IMF refused Lisbon a waiver for overshooting its September ceiling on public-sector domestic credit because of an even larger overrun in December. Consequently, Portugal cannot draw further funds under the standby program that ends in February. According to the Embassy, the Soares government is also running out of time to tie down a $250 million structural adjustment loan from the World Bank this year. After more than a year of discussions, Lisbon remains deadlocked with the Bank over politically contentious institutional reforms. If the negotiations are not completed by March, the program probably will slip into 1986.

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Global and Regional Developments

Finnish-Soviet Industrial Cooperation

The Finnish-Soviet Economic Commission recently accepted Moscow's proposal for closer industrial cooperation as a means of expanding trade. Projects include joint production in Finland of machinery, equipment, and textiles, with the Soviets to provide the materials. Finland also is to construct several factories in the USSR, with Soviet repayment in the products of those facilities. The Finns have yet to work out financing for the projects and marketing of the products they would receive. The Soviets stand to gain technological and marketing advantages from these efforts. Helsinki is primarily interested in the arrangement because, under the balanced trade system between the two countries, the declining value of Soviet oil exports has, in turn, limited Finnish exports to the USSR.

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Progress on UNCTAD Reform

The yearlong US effort to reform UNCTAD, the principal UN forum for North-South discussions, is making headway. The acting Secretary General, Alister McIntyre, is willing to address US concerns about issues such as budget overruns and secretariat favoritism toward the Third World. Moreover, the developing countries recently agreed to enter into a dialogue on the subject. This momentum, however, could be halted or reversed if UN Secretary General Perez de Cuellar appoints someone unsympathetic to the US initiative to head UNCTAD. The post became vacant in January, and the African regional group is putting intense pressure on Perez to appoint an African since one has never held the position. Perez is unimpressed with the announced African candidates and postponed a decision by naming an interim secretary general.

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National Developments

Developed Countries

British Government Unveils Spending Plans

The Thatcher government's 1985/86 Public Expenditure White Paper continues to stress slower inflation and reduced public borrowing as the keys to sustained economic growth. It calls for a 1.3-percent decrease in real spending in the fiscal year beginning in April and zero real growth the following two years. London plans no increase in real defense spending next year, a 6.6-percent cut in capital spending, and only a 1-percent hike in social expenditures. We believe the government is unlikely to meet its ambitious targets because of the inflationary impact of the falling pound on defense outlays, the effect of the coal strike on government borrowing requirements, and continued pressures to combat unemployment.

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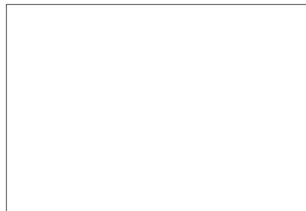
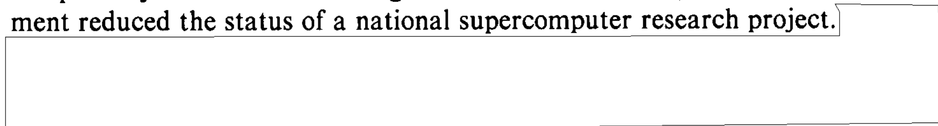
Cutback in French Supercomputer Project



A French computer manufacturer's joint marketing agreement with a US supercomputer supplier may be the cause of a cutback in French supercomputer research. CII–Honeywell Bull has agreed with the US firm to submit a joint bid when a prospective sale involves both supercomputer and conventional computer systems. Just as this agreement was concluded, the French Government reduced the status of a national supercomputer research project.



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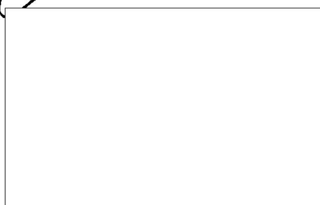
New Greek Labor Agreement



The new national collective labor agreement signed by the General Confederation of Greek Workers (GSEE) and representatives of three Greek employer organizations is likely to keep inflationary pressures strong in Greece in 1985. The agreement provides for automatic cost-of-living adjustments every four months and is consistent with Athens' 1985 incomes policy, which allows a 2-percent rise in real disposable income. The wage increases will fuel inflation that is currently about 18 percent. Despite Athens' generous wage policy, the new labor agreement drew heavy criticism from the Communist-affiliated trade unions that called a 24-hour general strike last week, although it was largely ineffective.

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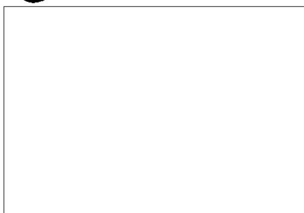
Australian Labor Protests



Prime Minister Hawke's wage and price accord with the Australian Council of Trade Unions is being seriously tested by a rash of strike activity in the wake of the Labor Party's slim victory in the December election. Flight attendants and engineers began the unrest by disrupting pre-Christmas domestic air travel. Railroad engineers hauling coal and wheat to New South Wales ports then staged a walkout jeopardizing export contract negotiations with Japan. More recently, civil servants have struck to protest a decision by the Federal Conciliation and Arbitration Commission to deny them a "catch-up" wage hike.

The Labor government is giving no quarter. New South Wales Premier Wran is threatening to fire railroad strikers. Civil servants face layoffs and suspensions, and the persistently troublesome Builders' Laborers' Federation has just been deregistered in New South Wales.

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Less Developed Countries

Philippine Banking Crisis

The country's largest savings bank, Banco Filipino, was forced into receivership last week after an unsuccessful six-month government rescue effort. A weak economy, combined with the stringent austerity measures under the IMF program, aggravated a liquidity crisis that began last July with a panic run on deposits. In a move designed to protect the 3 million depositors, savings accounts are being transferred to the government-owned Philippine National Bank (PNB)—the Philippines' largest commercial bank.

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These developments herald a new round of bank closings and consolidations—similar to the ones in mid-1984—and will further erode public confidence in the Philippines' shaky financial institutions.

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Record Palm Oil Production in Malaysia

Malaysian palm oil production rose 19 percent in 1984, and USDA is estimating a record crop of 4 million metric tons in 1985. With only slight increases in domestic consumption, successive large harvests have led to a 14-percent increase in processed palm oil exports for 1984—mainly to India, Singapore, Pakistan, and the USSR. Malaysia, the world's lowest cost producer of crude and refined palm oil, encourages exports of processed oil products through differential export duties and tax incentives for foreign and domestic investors. Malaysian processed palm oil products–which represent over 75 percent of the world's trade in palm oil—are currently priced well below competing US products and will make further inroads into traditional US markets.

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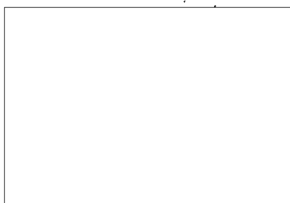
Mexico Says No to IBM



Mexico's recent rejection of a $10 million IBM microcomputer plant indicates growing domestic opposition to foreign investment. Approval of the 100-percent foreign-owned, export-oriented facility foundered on opposition from domestic assemblers of personal computers, who have been insulated from outside competition.

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The rejection will further chill Mexico's foreign investment climate because the IBM proposal was widely viewed as a test of President de la Madrid's pledge of flexibility, especially for export-oriented equity ventures.

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Mexico To Buy More Asian Rice

According to USDA estimates, Mexico will import 250,000 tons of rice in 1985, which, following imports of 170,000 tons last year, is a significant jump in the country's usual modest import requirements. For its $64 million purchase, the government food-purchasing agency is looking to Asian suppliers such as China, Vietnam, and Thailand, bypassing US rice, which would cost an additional $20 million. In spite of a government drive to boost production, Mexican rice harvests have declined in recent years. Production has stalled at about the level of a decade ago, and consumption has increased by 34 percent over the period.

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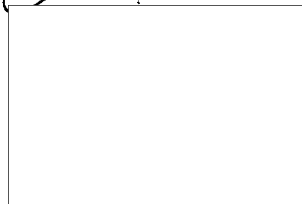
Record Chilean Copper Exports



We estimate that Chilean copper exports reached a record 1.3 million metric tons in 1984—a slight increase over 1983. Since 1980 mined output in Chile has grown more than 20 percent and, based on planned capacity increases, 1985's output should grow by about 5 percent. Despite record shipments, Santiago expects low world copper prices to cut export earnings by nearly $260 million—a 14-percent drop from the 1983 level. This loss of hard currency places increased strains on Chile's troubled economy, which depends on copper sales for roughly 40 percent of its export earnings.

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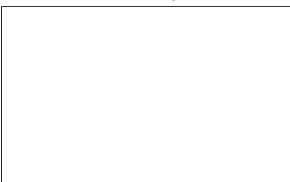
Communist

Large East German Trade Surplus With West Germany



Although its overall hard currency trade surplus probably declined in 1984, East Germany achieved a DM-1.3-billion (over $400 million) surplus in trade with West Germany. This is, by far, the largest trade imbalance between the two countries and contrasts with a DM-69-million deficit in 1983. We believe the sharp turnaround reflects East Berlin's desire to reduce its dependence on the Federal Republic. Moreover, the surplus probably enabled East Germany

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to reduce its debt to West Germany by one-fourth, to under DM 3 billion. As a result of East Berlin's continued export drive, good harvests, and controls on imports of capital goods, East Germany's exports rose 12 percent and its imports declined 8 percent. Export growth was concentrated in chemicals, nonferrous metals, and electronic products; and imports of agricultural products, machinery, iron and steel, and steel products fell sharply. [ ] 25X1

Soviet Ministries Impede Progress Under the Industrial Experiment

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A recent *Izvestiya* editorial blamed ministerial interference for shortcomings in the economic experiment begun last January in five industrial ministries. It said that most enterprises under the experiment have not experienced perceptible benefit from having their own source of finance for modernizing production and improving conditions for workers. Some ministries and departments have not relinquished planning functions and other authority to enterprises and arbitrarily changed plan goals. Furthermore, the ministries for heavy and transport machine building and for electrical equipment did not release bonus funds to enterprises last year for modernization and, in some cases, took funds enterprises were supposed to retain. The Soviet leadership last August announced intentions to improve the experiment and extended it to an additional 21 ministries in 1985. [ ] 25X1

China Buying US Polyester Again

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[ ] China will buy about 85,000 metric tons of polyester fiber from US firms in 1985, about half its expected import requirements. This amount would match the peak volume imported from the United States in 1981. China discontinued purchases of US fibers in 1982, ostensibly in reaction to US controls on textile trade, but largely because of massive fiber inventories. [ ] in spite of continuing differences over textile trade, China considers the political climate conducive to increased trade with US suppliers and wishes to avoid dependence on the Japanese. [ ] 25X1 25X1 25X1

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Brazil: Economic Plans of the Civilians

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Brazil's President-elect Tancredo Neves, whose inauguration on 15 March will end 21 years of military rule, inherits an economy that, despite some recent improvements, remains seriously troubled. Although GDP rose an estimated 3.5 percent in 1984 after three years of recession, growth has been narrowly based on exports while domestic incomes continue to languish. The record $13 billion trade surplus last year improved Brazil's foreign exchange position, but the new government is still burdened with a $100 billion debt and huge annual debt servicing obligations. Moreover, inflation has stubbornly remained above 200 percent for a second straight year under Brazil's IMF stabilization program, contributing to further erosion of living standards and critically needed investment. Neves's highest economic priorities for 1985 are to strengthen growth and employment, reduce inflation, obtain multiyear rescheduling of foreign debt, and promote a more equitable distribution of income.

Neves's Priorities

Although Neves indicates he will adhere to IMF-backed stabilization measures, we believe he wants some major economic policy initiatives to distinguish his administration from that of the military.

Neves has touted **resumption of growth** as the centerpiece of the new administration's economic program. The task will be made easier by last year's export-led recovery, which should, in the view of the IMF, pick up speed in 1985. Although Neves has said he intends to maintain an austerity program, he hopes to ease restrictive measures on domestic credit for private industry, subsidies to agriculture, and government investment in small-scale public works projects. He also wants to create more industrial jobs, raise real wages for lower income workers, and increase social spending to promote more **even income distribution.**

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Reducing inflation probably will be his most difficult challenge. Inflationary pressures will be especially intense at the outset because of the relaxation of monetary controls at the end of 1984. As a stopgap measure, he has proposed an emergency "social pact" between business and labor to limit wage and price increases and alter Brazilians' inflation psychology.

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Over the longer term, Neves believes that public-sector deficits must be restrained. He reportedly favors budget and tax reforms, divestiture of some nonessential state enterprises, and cutbacks in large-scale public projects. Neves also wants to reduce domestic interest rates—a principal cost of production.

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Coping With Interest Groups

We believe Neves's economic policies will be challenged. Labor, political parties, and small business— groups with little voice under the military— will now press for their widely diverging interests to shape economic policies. At the same time, those who have wielded significant influence over the past 20 years, such as the public-sector technocrats, the middle class, and the large industrialists, will attempt to protect their positions.

Neves, whose constituency spans all these groups, will probably attempt to accommodate their competing agendas without undermining his economic plans. According to the US Embassy, he is especially concerned that labor demands for higher wages, together with business calls for improved profits, could add to inflationary pressures early in his administration. Although the proposed "social pact" has achieved some support from business and labor, other contentious issues such as economic austerity to meet debt commitments may be nearly irreconcilable.

Influence of Advisers

According to the US Embassy, two major groups of advisers are competing for his attention—moderates willing to follow orthodox policies and expand Brazil's international economic ties and the leftists who are more unorthodox and nationalist in their approach. We believe Neves will offer government positions to both groups but will reserve key policy-making posts for moderates such as the highly respected banker, Olavo Setubal. Neves has indicated his preference for those businessmen and bankers with proven ability to manage financial affairs. To placate his leftist supporters, we believe he will find less influential posts for some of Brazil's leading leftwing economists, such as academic Celso Furtado.

Near-Term Outlook

We believe the civilian administration will make a determined effort in 1985 to continue Brazil's stabilization program under IMF auspices so long as economic recovery is not jeopardized. We believe Neves wants reasonably tough anti-inflationary measures this year to pave the way for a stronger recovery in 1986, when he hopes to reap considerable political gain in scheduled Congressional and gubernatorial elections. To help achieve stabilization objectives, we believe Neves's moderate economic policy team will seek greater fiscal discipline. Key advisers have endorsed budget reforms to enhance government control over spending. Also, they probably will take initiatives to reduce the pay and fringe benefit excesses that pervade the government bureaucracies and cut back nonessential large-scale public works projects.

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As a result, in our view, the odds are slightly better than even that the new government will succeed by the end of this year in slowing inflation. We judge that Neves and his economic team will be able to exploit their anticipated honeymoon, as well as popular concern about inflation, to maintain the cooperation of business and most of labor in restraining price and wage increases during 1985. If Neves fully carries out the military regime's financial reforms, in our view, he will also be in a better position to limit Brazil's monetary growth, which would further lessen inflationary pressures.

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Barring adverse international economic developments, Brazil's payments position this year should remain strong. Neves's economic team has asserted its intention of maintaining current sizable foreign reserves. Accordingly, we believe the new administration will continue to offer major incentives to exporters, especially those in industry. Neves probably will prefer to devalue the cruzeiro only gradually to soften the inflationary impact, but he is not likely to permit the currency to become overvalued. We believe that, with modest export growth, Brazil's trade surplus could approach last year's record $13 billion level keeping the current account deficit small.

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We expect no major shifts from the military government's foreign debt policy so long as Brazil's balance-of-payments performance remains favorable.

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Neves and his economic team probably will occasionally criticize the IMF and the banks about the terms they have imposed on Brazil, but we believe his administration is unlikely to break commitments made by the military regime.

Major Downside Risks

We remain concerned that efforts by Neves to accommodate the views of all his advisers could result in the adoption of inconsistent and misguided policies, such as highly expansionary measures to spur rapid, domestically driven growth. Under these conditions, Neves's plans to stabilize prices would be undone. Many Brazilians already are skeptical about the new administration's determination to fight inflation and will be alert to its first signs of wavering. A decision by Neves to shift to expansionary fiscal and monetary policies would likely lead to a rapid escalation of speculative price increases, perhaps resulting in annual inflation in the 300- to 500-percent range.

Sharply higher international interest rates and an unexpectedly severe drop in industrial-country economic activity probably could quickly swell Brazil's current account deficit some $3-4 billion. Even without new credit, Brasilia could accommodate such a deficit without great difficulty this year, mainly by drawing down its recently replenished foreign exchange reserves. At the same time, it would likely come under considerable domestic pressure to take a more antagonistic position in its relations with its foreign creditors. In that event, we believe the new government would press Washington and the international banks—individually or as part of a Cartagena debtors' movement—to pony up new funds or agree to a much more generous debt relief scheme.

If Neves's modest economic policies fail, the new President will likely find it increasingly difficult to maintain a centrist course. The ascendance of leftwing radical economists to positions of significant influence would portend major shifts to expansionary policies. The results could be heavier government controls over prices and economic activity with eventual harmful effects on the domestic economy and Brasilia's relations with its creditors.

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Implications for the United States

We believe that the Neves administration will continue the military government's efforts to maintain strong ties with Washington.

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Even in our most likely scenario, foreign investment and trade issues could become serious irritants.

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Neves probably will react quickly to perceived US protectionist actions and, in addition, will demand reciprocal concessions on Brazilian import liberalization measures sought by the United States.

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United Kingdom: Dealing With the Miners' Strike

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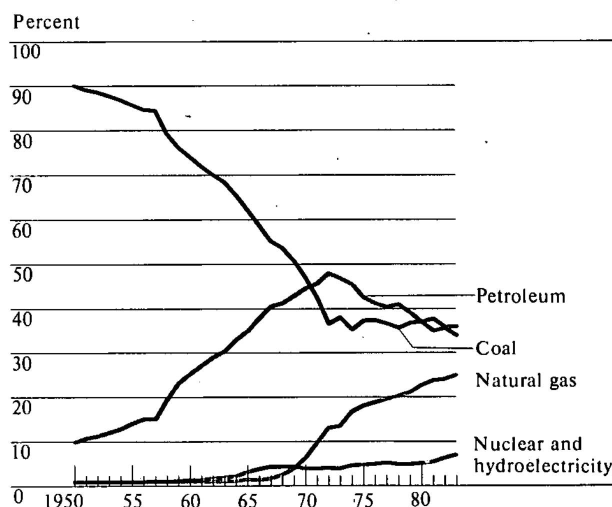
Prime Minister Thatcher is well on the way toward winning her battle with the striking coal miners and their Marxist leader, Arthur Scargill. The miners have failed to significantly disrupt the economy—in dramatic contrast to the 1973-74 strike—and have not persuaded other unions to join their walkout. Although the cost has been substantial—in terms of lost foreign exchange earnings and a higher budget deficit—there has been almost no impact on the average Briton. No energy shortage is in prospect primarily because London has maximized the use of oil-fired power stations. Miner solidarity is rapidly crumbling. Since the first of the year, more than 7,000 strikers have returned to work, and other unions are pressing the miners to settle before the strike simply peters out.

United Kingdom: Shares of Primary Energy Consumption, 1950-83



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Origins of the Miners' Strike

Elected on a pledge to boost industrial efficiency and end Britain's long economic slide, the Thatcher government tried to restructure the inefficient coal industry in 1981. London abandoned the attempt apparently believing that it lacked enough public support to tackle strenuous opposition by the National Union of Mineworkers (NUM). The coal industry's increasing financial deficits and production surpluses have made the need for restructuring even more clear. Over the past five years, losses by the National Coal Board (NCB) have totaled $3.5 billion, of which $3.3 billion was made up by grants from the government. Thatcher also has made some progress in her effort to reduce the power of labor unions. Several laws enacted since 1980 to make unions more "democratic" have reduced union leaders' power to call strikes, run closed shops, and raise money for the Labor Party without union members' approval.

In 1982 Thatcher made Ian MacGregor, who implemented a sweeping rationalization of British Steel Corporation (BSC) during 1979-82, Chairman of the NCB. Soon thereafter, MacGregor had laid out a plan to close 20 of the most unproductive coal pits and eliminate 20,000 jobs over 12 months. A relatively small number of mines account for the bulk of NCB losses. Some of MacGregor's critics, however, question his decision to announce all the pit closures at once. In fact, a South Wales Coal Board official told the Embassy that a much more tactful approach would have been to reveal and implement the plan in stages.

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Arthur Scargill, the fiery, power-hungry, Marxist leader of the NUM, took the position that no mine should be closed until exhausted of coal. One of the architects of the 1973-74 confrontation with the Heath government, Scargill had been looking for a chance to fight Thatcher since becoming NUM president in 1982. In response to MacGregor's plan, he first orchestrated an overtime ban in November 1983, and then called a nationwide strike on 12 March 1984. Scargill refused to hold a strike vote, however, probably because the miners had twice before voted against a walkout. Partly for this reason, about 25 percent of the miners ignored his call, saying the strike was illegal.

Whatever his motives in calling the strike, Scargill has demonstrated leadership by keeping it going. Although there has been a significant drift back to work, 60 percent of the workers—about 114,000—have stuck with him for more than 10 months with no strike pay and little hope of an early settlement. He has been aided, of course, by the NUM's tradition of militancy and by the feeling of many strikers that they have nothing to lose because their communities and lifestyles are threatened by MacGregor's plan. Moreover, there is fear of physical intimidation at the picket lines and ostracism in the close-knit mining communities.

Throughout the strike, the NUM has received only lukewarm support from other unions. The Trades Union Congress (TUC) has not authorized sympathy strikes, in part because its members fear a loss of jobs. Leaders of some unions may believe that a strike call would be ignored by workers who see no economic rationale for the strike and dislike Scargill's tactics. Moreover, Scargill is unpopular with the British public, and neither the TUC nor the leadership of Labor Party wants to be associated with him publicly.

The National Union of Mineworkers and Arthur Scargill

Although its membership has declined dramatically—there are now fewer than 190,000 coal miners, as compared with more than 1 million in the 1920s and 1930s—the NUM retains its reputation as one of the most militant unions in a country noted for the militancy of its labor movement. The NUM's reputation was earned by its aggressive participation in several major British strikes over more than half a century. It sparked the general strike of 1926 and continued to hold out for nine months after the other unions had settled. In 1973-74 the coal miners staged a strike that brought the entire economy to a standstill and precipitated the defeat of the Conservative government of Prime Minister Heath. The NUM's aggressive stance has frequently won wage increases far exceeding those of other unions.

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In Arthur Scargill the miners' union has found a leader more than worthy of its militant tradition. Scargill ascended through the ranks and became NUM president in 1982. A charismatic leader, he is perhaps best known for his radical political and economic views. Scargill is viscerally opposed to virtually every facet of Prime Minister Thatcher's free market economic policies.

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The Government's Response

The government moved quickly to reduce the economic impact of the strike by greatly increasing the use of oil-fired power stations and by boosting coal imports. Meanwhile, Thatcher took a backseat in MacGregor's negotiations with Scargill, probably in hopes of keeping the issue out of the political arena. The Coal Board, in turn, refrained from using the powerful new labor laws for fear of solidifying the miners' cause. The court-ordered freeze of the union's funds came about after its own members brought suit under the new laws against an illegal nationwide strike.

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The government is stepping up efforts to lure miners back to work. Several thousand strikers went back to their jobs before Christmas to receive special bonuses, and the Coal Board now is emphasizing income tax breaks to those who return to

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work before the end of the tax year this March. The government is also stressing that the strike will not bring about an energy crisis. Energy Minister Walker recently extended to the end of 1985 Thatcher's promise to avoid power cuts, while appealing to miners to end their walkout.

Economic Impact of the Strike

The strike has hurt the economy. We estimate that the foreign exchange cost alone—mostly in the form of foregone oil exports—is running at about $5 billion annually. This, in turn, likely has contributed to the fall of the pound over the past year that has raised the price of all imported goods. Lost tax revenue, police overtime, and the higher cost of burning oil in power stations, has added an estimated $2.8 billion to the budget deficit. We believe the strike has shaved GNP growth by about 1 percentage point, due almost entirely to the lost coal output and the substitution of higher cost oil.

Aside from some cut in steel production, the strike has had very little effect on other industries or on consumers. There has been no energy shortage, and taxes have not been raised to offset the increase in the budget deficit. Even electricity users have not been asked to pay for the higher cost of using oil—although Cabinet ministers are considering a one-time, 20-percent surcharge on electricity bills early this spring.

The economic impact of this strike is dramatically less than in 1973-74 when the miners' walkout put British industry on a three-day workweek:
- Nonstriking miners have maintained a substantial level of output—currently about 40 percent of normal, according to the Coal Board.
- As a result of the shift to coal-burning power stations over the last decade, the country had a large amount of idle oil-fired electricity generating capacity.
- Because of the surplus production of the previous four years, coal stocks at the beginning of the strike were exceptionally high.

United Kingdom: Energy Status

Million tons of coal or coal equivalent (except where noted)

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	Mar-Oct 1983	Mar-Oct 1984	Percent Change
Fuel used for electricity generation			
Total	63.0	63.0	0
Coal	49.0	29.0	−41
Oil	4.0	23.0	475
Other [a]	10.0	11.0	10
Coal balance			
Production	80.1	31.1	−61
Consumption	72.8	46.0	−37
Exports	4.4	0.8	−82
Imports	3.4	6.0	76
Coal stocks [b]	Nov 1983	Oct 1984	
Total	59.8	38.5	−36
At power stations [c]	33.3	15.5	−53
Other	26.5	23.0	−13

[a] Including the fuel equivalent of nuclear and hydroelectricity generation.
[b] The overtime ban began in November 1983; October 1984 is the latest month for which data are available.
[c] The "danger level" at power stations is 6 million tons. At that level the government would be forced to start making power cuts.

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Moreover, London has succeeded in bringing coal supply and demand back into balance, despite the strike:

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- The power industry had slashed its use of coal by more than half by the end of last summer. Although it probably cannot match this figure during the winter, when electricity demand is highest, an average reduction of close to 50 percent seems possible over a full year..

- Other coal users have reduced their consumption by about 30 percent.

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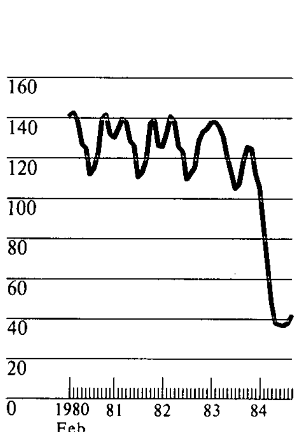
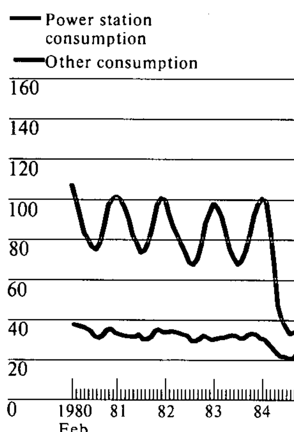
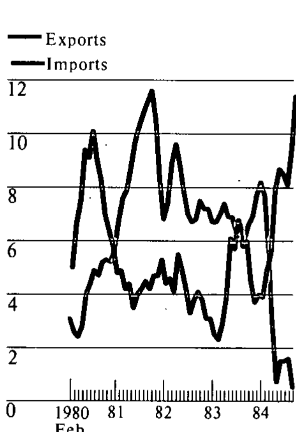
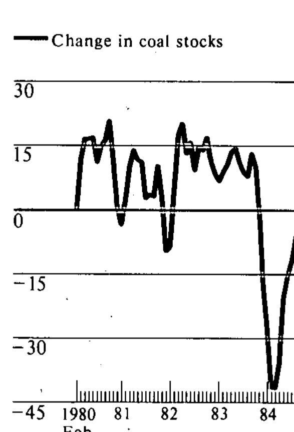
United Kingdom: Dealing With the Coal Strike, 1980-84

Million metric tons at an annual rate[a]









[a] Three-month moving average.

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- London also cut coal exports by 82 percent and boosted imports by 76 percent, bringing net imports up to almost 1 million tons a month by last fall.

After a rapid drawdown earlier in the year, coal stocks have been stabilized at a comfortable level.

Outlook

Although the public, opposition leaders, and most trade union representatives have expressed frustration at the impasse, neither side has budged. For Thatcher, the strike has become a key test of her credibility and her entire industrial restructuring policy, and its outcome could have a major impact on her political future. On the other side of the fence, Scargill remains even more unyielding. Only strong pressure from other unions fearful of a complete defeat for the miners or—more worrisome for Scargill—evidence that rank-and-file support is collapsing are likely to induce him to come to terms. Many of the miners still on strike probably believe they no longer have much to lose by staying out—although the government is arguing that deterioration of the closed pits is jeopardizing even more jobs.

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We believe that Thatcher is gradually gaining the upper hand, mainly because of her remarkable success in minimizing the strike's impact on the public. Although the budgetary and foreign exchange costs of the strike are high, we believe she will pay these costs indefinitely, rather than give in to Scargill. In this situation, the miners' primary hope of victory—even more than at the outset—rests on the unlikely chance of other major unions, such as the dockworkers or transport workers joining their strike.

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Pressure on the union to settle is mounting as more miners drift back to work—the pace has accelerated since the first of the year, with about 7,000 returning in less than three weeks. If the share of working miners reaches 50 percent by the strike's anniversary in March, Thatcher probably will declare victory. To avoid the ignominy of the strike simply petering out, the TUC is pressing the miners to compromise. In negotiations that resumed this week after being suspended last October, the Coal Board has the upper hand. We believe the most likely result will be a face-saving agreement—the union's acceptance of some mine closures with an arbitration body in which the Coal Board has the final say to offer advice on the scope and timing of closings. This arrangement apparently was part of the accord reached between the Coal Board and the foremen's union, but it has been rejected thus far by Scargill.

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No Quick Recovery for the Saudi Economy

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We do not believe that Saudi Arabia can significantly boost oil revenues or cut spending sufficiently to avoid another year of large current account and budget deficits. Oil revenues, in fact, will slide further as Riyadh backs away from its singlehanded effort to uphold the benchmark price. A policy of price cutting to boost oil revenues would entail high risks, however, because there is no guarantee that the Saudis can market substantially more oil even at a sharply lower price.

The poor outlook for oil earnings will force the government to consider cutting imports, but we doubt strong action will be taken soon. The Saudis also will promote nonoil exports—especially petrochemicals—in US and other markets. Indeed, during the upcoming visit of King Fahd, Saudi officials are likely to raise their concerns about access to the US market for their expanding petrochemical output. Because of the kingdom's economic setbacks, there is unprecedented criticism of the royal family's lavish spending and its failure to bear a fair share of the burden. This criticism is likely to grow in 1985.

Impact of the Oil Slump

Saudi Arabia's oil revenues have plunged from a peak of $112 billion in 1981 to $38.4 billion in 1984. The Saudis expected a recovery in 1984, but revenues fell by about $6 billion from their 1983 level. Crude oil output slid to only 3.8 million barrels per day (b/d) in the final quarter of 1984 compared with peak output of 10 million b/d in early 1981.

The impact of declining petroleum output has been widespread:

- Real GDP fell roughly 10 percent in Saudi fiscal year 1984 (ending in April). A further decline is expected in the current fiscal year.
- The Saudi budget shifted from a $30 billion surplus in FY 1982 to an officially announced deficit of $10 billion in FY 1984. We believe the actual deficit was close to $17 billion.
- Government spending, which serves to inject oil wealth into the economy, fell from $84 billion in FY 1982 to $64 billion in FY 1984.
- The current account turned from a nearly $50 billion surplus in 1981 to a $16 billion deficit in 1983 and an estimated $14 billion deficit in 1984. Usable official foreign assets—that is, excluding loans to Iraq—have been drawn down from a peak of $135 billion in 1982 to about $105 billion by yearend 1984.

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Although no group in Saudi society has been entirely immune, the government has sought to shield Saudi citizens, while letting foreigners bear the brunt of the recession:

- Budget cuts have hit the foreign-dominated construction industry hardest with projects put on hold or bills paid late.
- The government has refused to bail out two large, insolvent construction firms.
- A new law requires public bidding on all government contracts and has caused some existing contracts to be rebid. This effort has succeeded in securing lower prices on many projects.
- The Saudis reduced foreign aid programs in FY 1984 by nearly $2 billion, primarily involving non-Arab and non-Islamic nations. Riyadh con-

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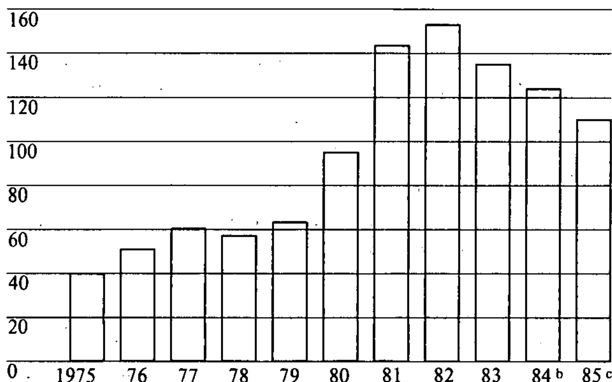
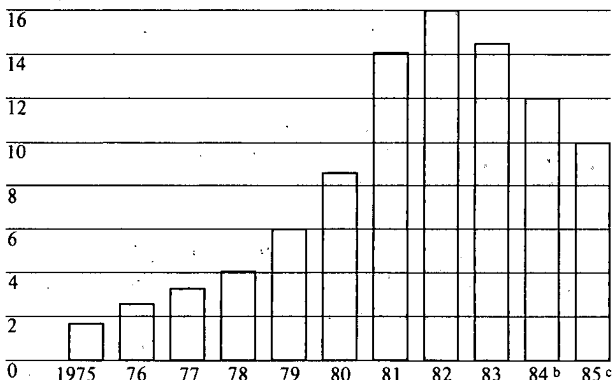
Saudi Arabia: Foreign Assets[a] and Investment Income, 1975-85

Billion US $





[a] These official assets include loans to Iraq.
[b] Estimated.
[c] Projected.

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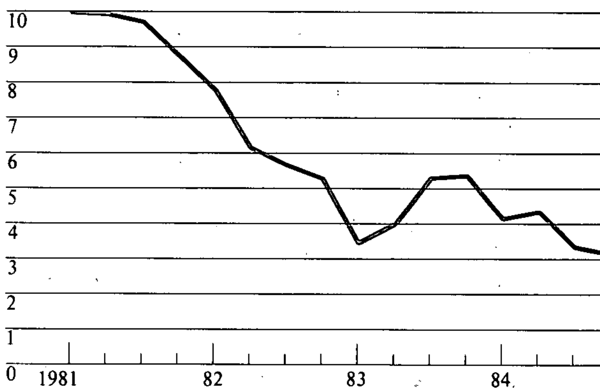
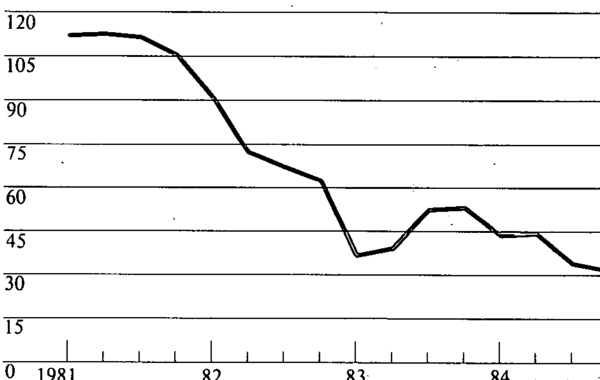
Saudi Arabia: Crude Oil Exports and Gross Oil Export Revenues, 1981-84

Note scale change





[a] Including Saudi exports from Neutral Zone.
[b] Quarterly data at an annual rate.

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tributed only about half of the $3 billion it pledged in emergency funding to the International Monetary Fund.

Only high-priority sectors have been relatively unscathed. Most military programs—especially air defense—remain intact. Petrochemical development—the main industrialization effort—has received full funding. This $15 billion investment will start to pay off in 1985 when petrochemical exports produce urgently needed net earnings instead of being a budget expenditure. Most subsidies—such as free health care and cheap electricity—have not been targeted for serious cuts because they are

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Saudi Arabia: Current Account

Billion US $

	1982	1983	1984 [a]	1985			
				Oil Scenario 1 [b]		Oil Scenario 2 [c]	
				High-Import Option [d]	Low-Import Option [e]	High-Import Option [d]	Low-Import Option [e]
Trade balance	33.8	7.2	4.3	−6.0	1.0	4.5	11.5
Exports, f.o.b.	72.8	45.2	39.3	29.0	29.0	39.5	39.5
Oil	72.6	44.8	38.4	26.5	26.5	37.0	37.0
Nonoil	0.2	0.4	0.9	2.5	2.5	2.5	2.5
Imports, f.o.b.	39.0	38.0	35.0	35.0	28.0	35.0	28.0
Services and private transfers	−21.0	−21.3	−16.7	−14.0	−11.5	−16.0	−12.5
Freight and insurance, net	−7.0	−6.8	−6.3	−6.0	−5.0	−7.0	−6.0
Investment income	16.0	14.5	12.9	12.5	12.5	12.5	12.5
Worker remittances	−5.0	−5.0	−4.7	−3.5	−3.0	−3.5	−3.0
Other service payments, net	−25.0	−24.0	−18.6	−17.0	−16.0	−18.0	−16.0
Grants	−5.3	−2.0	−2.0	−2.0	−2.0	−5.0	−5.0
Current account	**7.5**	**−16.2**	**−14.4**	**−22.0**	**−12.5**	**−16.5**	**−6.0**
Official foreign assets at yearend [f]	135.0	120.0	105.0	83.0	92.5	88.5	98.5

[a] Estimated.
[b] *Oil Scenario 1* assumes that 1985 oil prices stabilize at $27/barrel and that Saudi Arabia restricts production to an average of about 3 million b/d.
[c] *Oil Scenario 2* assumes a steep oil price decline to $20/barrel caused, in part, by increased Saudi Arabian oil production to an average of about 5.5 million b/d. Under this scenario, the Saudis also increase grant aid, primarily to Iraq, to offset Baghdad's lower oil earnings.
[d] *High-Import Option* assumes that Saudi Arabia seeks to maintain imports at 1984 levels.
[e] *Low-Import Option* assumes that Saudi Arabia cuts imports for consumption and development to reduce its current account deficit and foreign reserve drawdowns.
[f] Excludes loans to Iraq.

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considered politically sensitive.

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The 1985 Outlook—Tough Choices Ahead

We foresee no feasible combination of oil policy and domestic spending cuts that can rescue Saudi Arabia from significant current account and budget deficits this year. Current account deficits would reach $22 billion if the Saudis attempt to uphold OPEC oil prices by cutting production, while maintaining current imports. Even under a scenario where Saudi Arabia halts the steep slide in oil revenues and makes a 20-percent cut in imports, the kingdom still would face a current account deficit of around $6 billion.

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Oil Options. Saudi Arabia, unlike most other oil producers, has significant choices in its 1985 oil policies. If the Saudis continue to support OPEC unity through strict limits on output, 1985 oil

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earnings will plummet. For example, Saudi oil production of 3 million b/d at a stable price of $27 per barrel would cause oil earnings to fall by $12 billion, to $26.5 billion.

Alternatively, Saudi Arabia could raise output sharply in an effort to increase revenues. This would force prices down. Nevertheless, Riyadh would reverse the steep decline in earnings that occurred in the second half of 1984 by boosting production to 5.5 million b/d, even if such action caused prices to fall to $20 per barrel. There is no guarantee, however, that Saudi Arabia can quickly regain lost market shares even with aggressive price cutting.

Import Options. Saudi living standards and the pace of economic development remain critically dependent on imports—food, machinery, vehicles, building materials, and the entire array of modern consumer goods. Spending reductions caused a greater decline than was anticipated in 1984 imports. Nonetheless, further cuts in construction materials and other durable goods probably could be achieved.

The Saudis probably will attempt to maintain imports at their 1984 level of $35 billion. This import option represents a "muddling through" approach with the least amount of domestic disruptions, but it would produce large current account deficits. At the other extreme, import cuts of 20 percent would save about $7 billion, but reductions of this magnitude so far have been considered unacceptable by the government.

On balance, we believe the Saudis initially will attempt to uphold OPEC solidarity, while at the same time maintaining 1984 import levels. As the year progresses, however, a Saudi failure to shore up world oil prices, combined with large drawdowns in foreign assets, could cause the Saudis to abandon this approach. Should this occur, the Saudis then would seek higher oil revenues through increased output and would be forced to consider import reductions.

Within Saudi society, Islamic fundamentalists would welcome a further slowdown of the economy. They have long expressed concerns about the rapid pace of Westernization. The government, however, is likely to move cautiously. There is no widespread support for more austere policies that would limit subsidies or the economic opportunities of Saudi citizens.

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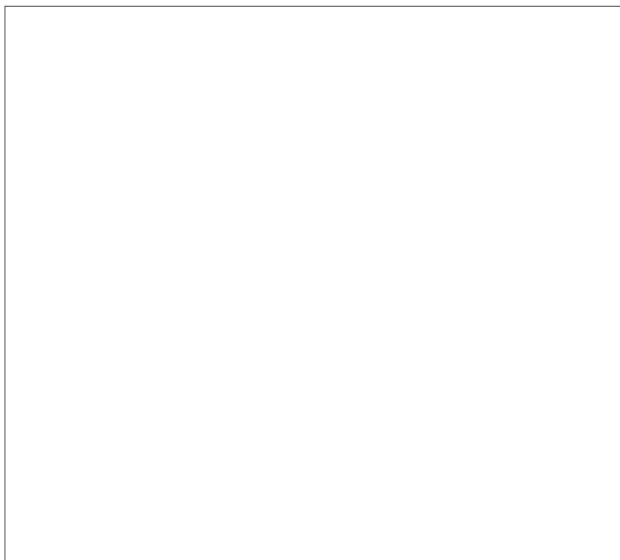

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Foreign Aid

Saudi foreign aid programs are used to placate potential regional threats, mold a moderate Arab consensus, reduce Soviet regional influence, and enhance Riyadh's international prestige. For these reasons, we judge that Riyadh will not substantially reduce aid in 1985. A steep oil price decline could even cause the Saudis to increase outlays, principally to Iraq. An oil price decline to $20 per barrel, for example, would reduce Baghdad's revenues by $3 billion, and Iraq would demand and probably receive compensating aid from Riyadh as well as from Kuwait.

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Implications for the United States

Saudi Arabia is the largest Middle East customer for US goods and services. Previous AWACS and F-15 sales make Riyadh one of the most important purchasers of US arms among the developing countries. Moreover, close to two-thirds of the Saudi investment portfolio is held in US dollars— and much of this is in the United States. While lower Saudi revenues would hurt US exports, this would be more than made up by the gains the US economy would receive from lower oil prices.

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Lower oil earnings, however, will stiffen Saudi Arabia's determination to penetrate world markets for its emerging petrochemicals industry. With about 5 percent of non-Communist basic petrochemicals capacity—in plants partly owned by US firms—free access to global markets has become a vital Saudi concern. We expect Saudi officials will raise the issue of access to the US market when King Fahd visits Washington later this month. Saudi Arabia has warned the United States publicly that it will retaliate—as it did to the EC with tariffs on electric cable imports last summer—if Washington adopts protectionist measures.

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We believe Saudi Arabia will be less willing to respond to US requests for financial assistance to other countries while it faces large current account deficits. Moreover, continued tight revenues probably will make Riyadh less receptive to US requests to provide Saudi oil on concessional terms to selected LDCs.

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CEMA: Planning for Long-Term Cooperation

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The Soviet Union has initiated discussions on a wide array of multilateral and bilateral economic agreements with other members of the Council on Mutual Economic Assistance (CEMA) [1] designed to limit CEMA's dependence on the West and exert tighter control over the East Europeans. These will be long-term arrangements to guide economic relations within CEMA for the rest of the century. Although Moscow can cite these framework agreements as guidelines for cooperation and trade, the commitments appear too weak and nonspecific to assure that Soviet goals will be met.

Multilateral Programs

Science and Technology. Perhaps the most important result of last June's CEMA summit was the "Long-Term Comprehensive Program for Cooperation in Science and Technology for the Next 15 to 20 Years." Still incomplete, the program has been billed as equal in significance to CEMA's highly touted 1971 Comprehensive Program for Economic Cooperation and Integration.

The program appears to be a Soviet effort to make technology CEMA's primary concern, and aims to coordinate development of high-technology industries. Although it does not rule out a role for Western imports, a major reason is to defend CEMA against Western controls on exports of technology. The program emphasizes cooperation in five key areas—electronics, flexible manufacturing systems, nuclear energy, advanced materials technology, and biotechnology. A basic goal is to avoid duplication of effort and make CEMA's high-tech products compatible by sharing data and research. Although CEMA technology is largely unsophisticated by Western standards, pooling resources could provide badly needed gains in productivity. A more ambitious—and contentious—goal would be to assign certain tasks and responsibilities to individual countries. Most East European countries continue to resist Soviet or CEMA measures that would dictate which industries must be located in which country.

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The program appears to be going slowly, and the goal of completing it by the end of this year may not be met. In an unusually blunt public criticism, Czechoslovak Premier Strougal—a proponent of the program—recently noted that "there are instances of serious delay in this work." He recommended that CEMA's Executive Committee review the drafting of the program and urged the Committee to assure that it be accompanied by measures linking it to cooperation in production.

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Other CEMA-Wide Agreements. The major accomplishment announced at the October 1984 Havana gathering of CEMA premiers was agreement on "Long-Term Comprehensive Measures for Cooperation in the Sphere of Energy, Fuel, and Raw Materials for the Period Through 1990 and Beyond." the USSR will continue to supply fuel and other raw materials at present levels in return for more and better quality East European goods, greater conservation efforts, and increased investments in joint projects. In addition, members agreed to work out plans for building nuclear power plants through the year 2000. Finally, in January, the CEMA Executive Committee discussed a program for joint electric power development up to the year 2000, and a complex program of cooperation in transport for 1991-2000.

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[1] CEMA members include Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, the USSR, Cuba, Vietnam, and Mongolia.

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Bilateral Cooperation Through 2000

The USSR is also negotiating long-term bilateral agreements with each East European country in science, technology, and economics. Bilateral accords can be tailored to fit the Soviet relationship with each country, and they reflect the reality that CEMA has little real authority as a multilateral organization. Agreements already signed with Poland and East Germany repeat many of the provisions of planned multilateral programs. [ ]

Poland. On 4 May 1984, General Jaruzelski and party leader Chernenko signed the "Long-Term Program for the Development of Economic, Scientific, and Technical Cooperation Between the USSR and Poland for the Period Up to the Year 2000." A harbinger of subsequent accords, the agreement covers cooperation in all major areas of the economic relationship. [ ]

In machinery, both sides are to modernize existing industries, as well as devote special attention to emerging industries—microelectronics, robotics, and flexible manufacturing systems. Although the agreement specifies some 15 sectors in which each country will specialize, the list does not represent any change from the status quo. [ ]

The fuel and energy section guarantees Soviet deliveries of energy. In return, Poland will help with the construction of natural gas pipelines in the USSR and, according to a Polish official, produce machinery to manufacture large-diameter pipe. [ ]

The key innovation is the encouragement of expanded relations between planning organizations, enterprises, and institutes (including the Polish and Soviet Academies of Science). The Polish press has cited several efforts to implement the commitment:

- Jaruzelski met last September with about 60 Polish enterprises to discuss ways to stimulate further cooperation with Soviet counterparts.
- Beginning in 1985, annual trade protocols will allow some Polish and Soviet enterprises to bypass foreign trade organizations in both countries. [ ]

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East Germany. After two and a half years of negotiations, a program for long-term bilateral cooperation was signed on 6 October 1984 by Soviet Minister of Foreign Affairs Gromyko and East German party leader Honecker. Agreement was reached at a time of political strains in the relationship with Moscow, one month after the postponement of the Honecker visit to West Germany. Unlike the Polish-Soviet program, the text of the "Program for the Development of Cooperation Between the USSR and the GDR in Science, Technology, and Production for the Period Until the Year 2000" was not published, but the press carried several details of it. [ ]

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The program is similar to the Soviet-Polish pact:

- The industries specified for cooperation are roughly the same.
- It calls for modernizing manufacturing plants in both countries.
- Energy supplies from the Soviet Union are to be secured in part through East German construction of capacity to produce equipment for the Soviet oil and gas industry. [ ]

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Differences vis-a-vis the Soviet-Polish agreement appear to be mainly ones of emphasis. In particular, the East German program puts greater stress on cooperation in science and technology, in recognition of East Germany's strength in these fields. It emphasizes all aspects of microelectronics—manufacturing, developing new technologies and applications, and exchanging equipment and material inputs. [ ]

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More To Come. In recent months, communiques from bilateral meetings between Soviet officials and those in Bulgaria, Hungary, Czechoslovakia, and Romania have announced negotiations on programs for cooperation through 2000. We have few details on the status of these preparations, but the

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Soviets probably would like to ink pacts modeled on the Polish and East German programs by the end of 1985.[2]

Obstacles to Integration

Rhetoric aside, there are several reasons to be skeptical that a breakthrough to achieve genuine economic integration in CEMA is in the offing. Remarkably similar programs launched in the 1970s with great fanfare were billed as blueprints for CEMA for 15 to 20 years, but they were quickly overtaken by events. The Comprehensive Program for Integration of 1971 failed to offer an attractive alternative to opportunities then opening up for CEMA members to trade with the West. The Long-Term Target Programs of a few years later were designed to inject new life into the Comprehensive Program and to guide cooperation through 1990, but the Polish crisis and Eastern Europe's financial difficulties consumed the economic efforts of the region in the early 1980s and disrupted plans for cooperation.

The present drive for increased integration, like past efforts, relies heavily on jawboning. It leaves virtually untouched the chronic obstacles to cooperation: deficient financial mechanisms; the East Europeans' continued desire for a measure of political and economic autonomy; bureaucratic and inefficient management; and discrepancies between the types and quality of goods being offered and demanded.

The only significant exception is the seemingly genuine encouragement for improved links among lower level economic units in different countries,

[2] Soviet programs for bilateral cooperation through 2000 are not limited to the East European CEMA members. Vietnam in October 1983 and Cuba in October 1984 signed similar "year 2000" programs. The Mongolians and the Soviets announced in November that preparatory work is under way. The East European countries are also negotiating bilateral programs through 2000 with each other. Poland's Deputy Premier Messner, for example, announced last October that Warsaw had concluded agreements with Bulgaria, Hungary, and Romania and was involved in talks with Czechoslovakia and East Germany.

Predecessor Programs: False Starts of the 1970s

The current drive to wrap up agreements that will guarantee and direct cooperation for the long term resembles two major CEMA programs launched in the 1970s with the same purpose. Although they are nominally still in effect, both fizzled after only a few years.

The Comprehensive Program. *Two years after it was proposed at the 1969 Summit, CEMA adopted "The Comprehensive Program for Further Expansion and Improvement of Cooperation and Development of Socialist Economic Integration Among CEMA Member Countries." The Comprehensive Program, considered one of the most important tracts in CEMA's 35-year history, was designed to stimulate and guide economic integration for the following 15 to 20 years. It called for extensive plan coordination, joint investment projects, and increased multilateral financial relations, including covertibility of the transferable ruble. Progress in achieving these goals has been largely disappointing.*

Long-Term Target Programs. *In the late 1970s, CEMA initiated long-term programs to single out five areas for special emphasis in applying the provisions of the Comprehensive Program. Programs for energy and raw materials, agriculture and food industry, and machine building were approved in 1978; those for industrial consumer goods and transportation were approved the next year. The Target Programs were accompanied by Soviet bilateral agreements with each East European country. Signed in 1979 and 1980, the bilateral accords also were to cover economic relations through 1990, but these too have shown few concrete results.*

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particularly the USSR. Previous programs have stalled in part because lower levels ignored the directives of the political and planning authorities. Even this is new only in degree, and there is still sure to be substantial resistance from foreign trade ministries and other entrenched bureaucracies.

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Despite the record of false starts and failed efforts, it is too early to write off the present drive as yet another doomed Soviet attempt to exert economic control over Eastern Europe. Lessons from past failures may even offer experience that will improve future cooperation. With some of the countries feeling abused or disillusioned by the results of their turn to the West in the 1970s, there is now a stronger consensus for making cooperation work. The programs probably will be important guides in setting the directions and patterns of economic ties, but, in their present form, they are statements of intention whose ultimate impact will only be determined by more concrete and binding agreements.

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World Trade Balances: Dramatic Shifts

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Worldwide trade balances have shifted dramatically since 1981. For the United States, the strong dollar, and for the Middle Eastern OPEC countries, the weak oil market have been principal factors in their deteriorating trade positions. Japan and Western Europe have been major beneficiaries of the surge in US import demand, and a group of 10 key troubled debtors [1] have markedly improved their trade balances through import austerity. The factors precipitating these trade shifts probably will persist through 1985 heightening tension among trading partners, fueling protectionist pressures, and complicating the launch of a new GATT trade round.

Bilateral Shifts

Although US public attention has focused on the role in the US trade deficit of the growing Japanese surplus with the United States—a record $35 billion last year—there have been large trade shifts worldwide driven by differential growth rates, exchange rate movements, and shifts in international competitiveness:

- The US trade balance with Western Europe, for instance, shifted from an $11 billion surplus in 1981 to an estimated $14 billion deficit in 1984, a larger shift than occurred in US-Japanese trade. This stemmed from a $17 billion increase in US imports and $8 billion decrease in US exports, a result of the strong US recovery, the generally sluggish West European economies, and the appreciation of the US dollar against the West European currencies.

- In contrast to the $17 billion improvement in its trade balance with the United States, Japan experienced worsened balances with the key debt troubled LDCs and Western Europe, chiefly because of sluggish or declining exports to these countries. Japan, however, boosted its surplus with the East Asian NICs through continued export gains.

- In addition to the improvement in its US and Japanese trade positions, Western Europe narrowed its deficit with the East Asian NICs and substantially improved its balance with the Middle Eastern OPEC nations through a marked cutback in its oil imports from these countries, particularly Saudi Arabia. Its deficit with the troubled debtors, however, widened by $15 billion, over the three-year period.

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- The troubled debtors dramatically improved their trade positions, largely through massive import reductions. Their trade surplus with the United States, for instance, grew nearly sixfold as the result of a $14 billion cut in imports and a $3 billion increase in exports.

- Despite generally rapid economic growth and rising imports, the East Asian NICs greatly improved their trade positions, chiefly because their trade surplus with the United States grew by $11 billion on the strength of a $13 billion surge in their exports. Continued growth in sales of textiles, electrical machinery, consumer electronics, and other manufactures accounted for much of the gain. In contrast, their trade position with Western Europe and Japan worsened somewhat as they achieved only minimal expansion in sales to these markets.

- The trade position of most of the Middle Eastern OPEC countries worsened. The global economic recession, austerity measures by many oil importers, and falling oil prices all contributed to the

[1] The troubled debtors include Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Nigeria, Peru, the Philippines, and Venezuela.

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Bilateral Export and Import Shifts, 1982-84 [a]

Billion US $

	United States	Japan	Canada	Western Europe	Troubled Debtors [b]	Asian NICs [b]	Middle Eastern OPEC [b]
United States							
Exports to		1.3	7.1	−8.3	−13.8	2.2	−2.9
Imports from		18.5	17.8	16.6	2.8	13.3	−10.4
Japan							
Exports to	18.5		0.9	0.2	−6.2	3.2	−1.4
Imports from	1.3		0.5	1.5	NEGL	1.4	−9.0
Canada							
Exports to	17.8	0.5		−1.7	−1.3	0.3	NEGL
Imports from	7.1	0.9		1.0	−0.4	0.8	−2.0
Western Europe							
Exports to	16.6	1.5	1.0		−14.7	1.5	−3.0
Imports from	−8.3	0.2	−1.7		0.7	0.4	−40.0
Troubled debtors							
Exports to	2.8	NEGL	−0.4	0.7		NEGL	**0.7**
Imports from	−13.8	−6.2	−1.3	−14.7		**−1.4**	**−28.3**
Asian NICs							
Exports to	13.3	1.4	0.8	0.4	**−1.4**		**0.9**
Imports from	2.2	3.2	0.3	1.5	NEGL		**−4.6**

[a] Most 1984 figures are annualized from partial-year data.
[b] Boldfaced data show trade shifts from 1981 to 1983.

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sharp reversal in the fortunes of this group. Although the $37 billion deterioration in their trade balance with Western Europe was the most striking, problems also occurred in their trade with the United States, Japan, and to a lesser extent the troubled debtors and Asian NICs.

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Outlook

In our judgment, many of the factors that precipitated the trade shifts in 1981-84 will continue to influence trade patterns in 1985. The US dollar remains strong, and the oil market will probably soften further in the near term. According to the OECD, US economic growth is forecast to remain more rapid than in Western Europe, and Japan is

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Bilateral Trade Balance Shifts, 1982-84 [a]

Billion US $

	Overall	United States	Japan	Canada	Western Europe [b]	Troubled Debtors [c]	Asian NICs [d]	Middle Eastern OPEC [e]
Trade balances of:								
United States	−74		−17	−11	−25	−17	−11	8
Japan	21	17		NEGL	−1	−6	2	8
Canada	8	11	NEGL		−3	−1	−1	2
Western Europe	30	25	1	3		−15	1	37
Troubled debtors	50	17	6	1	15		**1** [f]	**4** [f]
Asian NICs	12	11	−2	1	−1	**−1** [f]		**6** [f]

[a] Most 1984 figures are based on annualized partial-year data. All countries are not included.
[b] Western Europe excludes Portugal, Iceland, and Turkey.
[c] Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Nigeria, Peru, the Philippines, and Venezuela.
[d] Hong Kong, Singapore, South Korea, and Taiwan.
[e] Iran, Iraq, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates.
[f] Boldfaced data show trade shifts from 1982 to 1983.

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expected to boost export volume by over 8 percent—again outstripping the growth in imports. The NICs will continue to push for a greater share of industrial country markets and may, in turn, further widen their trade surplus with the United States. The bilateral trade surpluses of the troubled debtors, however, may narrow this year if these countries increase their purchases as OECD import demand slows. Continuing large trade imbalances could heighten trade tensions and increase protectionist pressures.

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