



Directorate of
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**International
Economic & Energy
Weekly** 

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29 March 1985

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**International
Economic & Energy
Weekly** [Redacted]

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

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**International
Economic & Energy
Weekly**

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Synopsis

1	Perspective—Foreign Effects of US Economic Trends	25X1
	The international economic position of the United States has shifted dramatically. These shifts have created both pluses and minuses in the rest of the world, but, on balance, we believe the impact has been positive.	25X1
3	Summit Issues: Impact of the US Recovery on the OECD	25X1
	Strong US import demand accounted for almost one-half of the 3.4-percent GNP growth in the other OECD countries last year.	25X1
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11	Caribbean Oil Boom Goes Bust	25X1
	The Caribbean oil-based economies—Trinidad and Tobago, the Netherlands Antilles, and The Bahamas—have been hit by the slack world oil market. The result almost certainly will be more urgent calls for increased US aid to the region and even larger flows of illegal entrants into the United States.	25X1
15	Colombia: Oil Export Prospects	25X1
	Despite recent oil finds, Colombia's goal of becoming a significant net oil exporter remains elusive.	25X1
21	Rice Production: The Asian Success Story	25X1
	Asian rice production has increased by 75 percent over the past 20 years as a result of government policies designed to encourage production, and burgeoning export surpluses have had a significant impact on foreign exchange earnings across the region.	25X1

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**International
Economic & Energy
Weekly** [Redacted]

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Perspective

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Foreign Effects of US Economic Trends [Redacted]

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The international economic position of the United States has shifted dramatically. The current account deficit has topped \$100 billion; the capital account surplus has approached \$100 billion; even with the recent decline, the dollar is at heights unmatched since the 1960s; and the United States will this year become a net debtor for the first time since 1914. These shifts have created both pluses and minuses in the rest of the world, but, on balance, we believe the effect has been positive. [Redacted]

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The chief favorable impact has been through trade flows. Using IMF data, we estimate the \$90 billion jump in US imports between 1982 and 1984 equaled the entire rise in the rest of the world's export sales over the same period. This surge of sales to the United States was a major factor in what little growth has occurred in Western Europe and in the dramatic improvements in several Latin debtors' external positions. The high dollar also allowed foreign competitors to make inroads, even in markets where the United States presumably has a competitive edge, such as computers, semiconductors, and telecommunications equipment. [Redacted]

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On the other hand, we believe the huge shift toward net US capital inflows probably has had some detrimental impact on the rest of the world. The increased desirability of the United States for investment—most notably of US funds that formerly went abroad—has reduced the availability of investable funds abroad and helped to raise domestic interest rates in other countries. [Redacted]

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The positive effects abroad on jobs, profits, and external balances of the surge in US imports of goods and services has far offset the negative impact on investment. Moreover, some of the negative impact of US capital inflows should perhaps be discounted, given the probability that foreign financial and structural problems may have retarded investment in any case. [Redacted]

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How long these trends will continue is problematical, but we believe the determining factor will be perceptions of the investment climate in the United States compared with that elsewhere. So long as US demand for credit remain strong and global investors continue to view the United States as the place to invest, the current situation will continue: foreign investors will acquire additional net claims on the US economy; the dollar's value will not change markedly; the US current account deficit will persist; and foreign firms will achieve further competitive inroads. [Redacted]

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Expected changes in underlying relative investment returns or expectations of a dollar decline could alter investor perceptions. Because most shifts in US capital flows have been in short-term funds, we believe that a reversal in investor perceptions could be quickly felt in financial markets. Indeed, in the last week, the foreign exchange markets reacted sharply to reports of slower US growth and the Ohio savings and loans closures. [redacted]

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Given the large US current account deficits and the growing US net foreign debt position, a reversal in investor perceptions could set off rather large adjustments, including a sharp decline in the dollar and the trade deficit. The reversal in US trade trends, however, would remove one of the main impetuses to foreign growth. Although the greater availability of investment capital abroad would help somewhat, we do not believe it would be enough to offset the lesser trade stimulus. [redacted]

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In such a circumstance, we would expect West European expressions of concern about the depreciating dollar, and possibly more strident stances by Latin debtors. Debtors would be more vocal if US interest rates also rose, as would be likely if the reversal stemmed from a loss in confidence in the dollar, as opposed to lower US credit demand. Although these reactions themselves would not pose major difficulties, they could complicate a number of areas, including continuing debt negotiations and the beginning of a new GATT trade round. [redacted]

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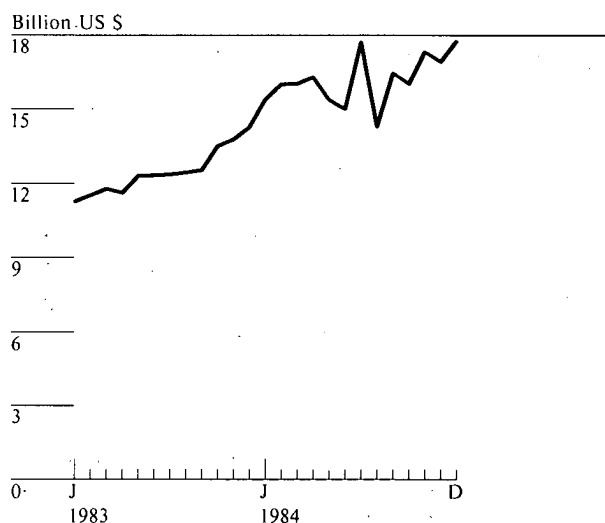
Summit Issues: Impact of the US Recovery on the OECD



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Strong US import demand accounted for almost one-half of the 3.4-percent GNP growth in the other OECD countries last year. The increase in US imports came primarily in manufactures, a trend that especially favored the Big Six economies, the major suppliers of these goods. Canada and Japan gained the most from US trade; the United Kingdom and France benefited the least.

United States: Imports From the OECD, Seasonally Adjusted, 1983-84



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Impact of the US Recovery

The United States last year was the fastest growing major export market for the other OECD countries, accounting for about two-thirds of their export growth. The robust US economic expansion and the rising dollar helped boost OECD exports in 1984 to the United States by 29 percent over the previous year—a sharp rebound from 1982 when these exports fell by almost 2 percent. In contrast, most other markets for OECD goods posted only moderate gains over 1983.

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United States accounts for 7 to 14 percent of their total exports.

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According to simulations of our Linked Policy Impact Model (LPIM), the full impact of export sales to the US market alone boosted OECD GNP growth by 1.6 percentage points in 1984. As a result, we estimate that employment remained 1.5 million higher than otherwise would have been the case.

Trade Trends

The impact of the expansion in US import demand on the individual OECD countries varied primarily according to the relative importance of the US export market for each economy. The Canadian and Japanese economies received the largest stimulus because the United States accounts for 70 percent and 35 percent, respectively, of each country's sales abroad. The four major West European countries received a smaller boost because the

Manufactures accounted for almost 90 percent of the increase in OECD exports to the United States. The biggest increases came in machinery and transport equipment where motor vehicles and electrical machinery accounted for almost 60 percent of the total increase for the two categories. Semi-finished goods, the third-largest category under

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**United States: Imports
From the OECD**

Billion US \$

	1982	1983	1984
Total	139.2	149.7	193.0
Big Six	120.1	129.9	167.2
Japan	37.7	41.2	55.9
West Germany	12.0	12.7	16.5
France	5.5	6.0	7.9
United Kingdom	13.1	12.5	14.1
Italy	5.3	5.5	7.5
Canada	46.5	52.1	65.3
Small Seventeen	19.1	19.8	25.8

manufactures, got its major boost from a \$3.6 billion gain in metal sales. Consumer electronics, chemicals, and fuel were other areas where US import growth was strong. [redacted]

Canada, which supplies one-third of US imports from the OECD, would have suffered a decline in GNP (according to the LPIM) without the \$13 billion rise in its sales to the United States. In particular, the Canadians boosted vehicle exports by \$5 billion last year, one-half the OECD total. Japan, the second-largest exporter to the United States, posted \$56 billion in sales in 1984 for a 36-percent gain. Japanese producers accounted for most of the OECD increase in sales of electrical machinery, business machines, and consumer electronics. Although the four major West European countries averaged a 25-percent increase in exports to a total of \$46 billion last year, total British sales rose by only 13 percent because of a \$728 million plunge in raw material exports, mostly unwrought silver. British manufacturers, however, matched the performance of the other West European economies, boosting exports by almost one-third. The West Germans made their gains in such traditional

**Estimating the Impact of
US Import Demand**

We used our Linked Policy Impact Model to estimate the impact of the expansion in US import demand on OECD exports and economic growth. To estimate this impact, we determined the difference between actual trade, employment, and GNP growth for 1983 and 1984 and the simulated results for the same variables assuming no growth in US imports. Because the model links all OECD economies, the results capture not only the direct impact of increased exports to the United States, but also the indirect effects on domestic consumption and investment as well as increased exports to each other and the rest of the world. [redacted]

products as vehicles, heavy industrial machinery, and metals, and the Italians did well in textiles and apparel. French increases were moderate. [redacted]

Implications

Although US import demand is helping all the OECD economies, it cannot solve their fundamental economic problems over the medium term. The benefits flowing to these countries, nevertheless, do provide an economic cushion as they restructure their industries and grapple with increasing unemployment. [redacted]

West European leaders are aware of the beneficial impact of the US expansion, but the recent strengthening of the US dollar is rekindling criticism of US economic policies. Policymakers in most industrial countries are worried that the trade

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OECD: Export Gains to the United States, 1984

Change from previous year

	OECD	Big Six	Japan	West Germany	France	United Kingdom	Italy	Canada
Total								
(million US \$)	43,280	37,237	14,747	3,788	1,828	1,678	2,014	13,183
(percent)	28.9	28.7	35.8	29.8	30.4	13.5	36.9	25.3
Foodstuffs								
(million US \$)	959	698	73	73	112	4	61	374
(percent)	11.0	13.4	19.8	17.5	15.6	0.6	12.0	15.0
Raw materials								
(million US \$)	670	332	-12	80	24	-728	9	961
(percent)	6.4	3.8	-8.3	39.4	15.3	-67.8	12.0	13.4
Fuels								
(million US \$)	2,644	1,461	44	-24	52	229	268	893
(percent)	17.8	11.5	266.7	-25.5	92.9	5.5	125.8	10.9
Manufactures								
(million US \$)	38,345	34,344	14,700	3,724	1,708	1,917	1,656	10,639
(percent)	35.2	34.9	36.6	32.1	35.4	32.2	36.2	34.0
Chemicals								
(million US \$)	2,111	1,740	164	293	281	238	111	654
(percent)	24.1	24.9	15.0	23.9	32.0	23.3	36.9	26.3
Semifinished								
(million US \$)	6,951	5,355	1,734	817	314	245	472	1,773
(percent)	37.5	33.4	34.2	52.2	31.3	31.1	48.7	26.6
Machinery								
(million US \$)	13,753	12,582	7,005	1,076	656	863	387	2,595
(percent)	48.0	48.9	58.2	27.3	54.3	38.9	38.8	49.0
Transport								
(million US \$)	11,098	10,753	3,120	1,414	306	464	190	5,257
(percent)	29.1	29.5	20.9	34.1	28.1	46.8	49.4	35.1
Consumer products								
(million US \$)	4,433	3,914	2,675	124	150	108	496	360
(percent)	29.5	29.9	38.1	16.7	23.1	11.5	25.8	19.6
Other								
(million US \$)	661	403	-57	-65	-69	257	22	315
(percent)	9.9	8.4	-11.0	-18.1	-26.1	45.9	26.8	10.4

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United States: Contribution to OECD Economic Growth ^a *Percentage points*

	1983		1984	
	GNP Growth	US Imports	GNP Growth	US Imports
Non-US OECD	1.8	0.5	3.4	1.6
Big Six	2.0	0.6	3.7	2.4
Japan	3.0	0.8	5.8	3.2
West Germany	1.3	0.4	2.5	1.7
France	0.7	0.3	1.8	1.1
United Kingdom	3.2	0.4	2.0	1.3
Italy	-1.2	0.5	3.0	2.0
Canada	3.3	2.1	4.7	5.0

^a Based on Linked Policy Impact Model.

[Redacted]

gains—which forecasters predict will continue in 1985—will provoke Washington to impose such protectionist measures as an import tariff surcharge, which could abort their own tentative economic recoveries. On the other side of the coin, West Europeans are also concerned about the potential disruption to trade and monetary relations the dollar were to slide rapidly.

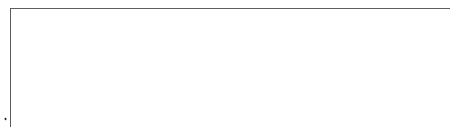
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Summit Issues: Big Six Attitudes on Mixed Credits

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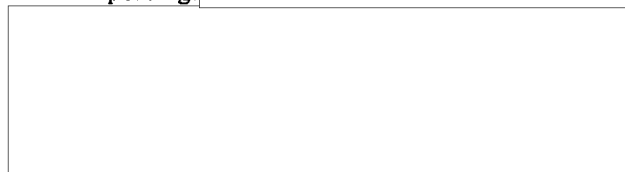
Some Big Six governments are sympathetic to US initiatives to curb mixed credits, but the French are likely to block progress on this issue if it is raised at the Summit. Mixed credits—concessionary, foreign aid loans, or grants blended with standard commercial or official export credits—typically are used for LDC development projects that include tied purchases from the donor country. The ability of US firms to compete on such projects has been limited because they lack access to similar financing, and, as a result, US businessmen are becoming increasingly vocal over the role of mixed credits in distorting international trade. Although the amount of mixed credits has apparently declined in recent years, a resumption of LDC growth would probably revive their use.

also reflected cutbacks in the development programs of key LDCs.

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The yearly commitments for mixed credits remain small in relation to annual OECD capital goods exports of \$75-85 billion to the LDCs, but the total value is larger than official reporting indicates. Estimates on mixed credits depend on country submissions to the OECD, and these are subject to underreporting.

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Recent Trends

The use of mixed credits grew rapidly in 1982 when a number of OECD governments apparently began to use such credits to circumvent the strengthened 1981 OECD consensus agreement on export credits—an arrangement that set minimum interest rates on official export credits to limit government interest rate subsidies on such loans. According to the OECD, the value of mixed credit commitments rose from \$3.5 billion in 1981 to \$5.2 billion in 1982.

Outlook

Once LDCs adjust sufficiently to resume development plans and projects, pressures for new mixed credits may intensify. China, for example, is actively soliciting mixed credits to finance its development program. Some LDCs, such as India, have become adept at augmenting multilateral lending, such as World Bank loans, with mixed credits. Mixed credit competition will remain especially strong in the telecommunications sector.

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Attitudes Toward Reform

Alarmed by this growth, OECD governments agreed to screen mixed credit proposals more tightly after July 1983 and to ban mixed credits containing a grant element below 20 percent. Mixed credit commitments fell to \$2 billion in 1983 and \$1.5 billion last year. OECD aid devoted to mixed credit programs dropped from 6 percent of total bilateral aid commitments in 1981-82 to 3 percent in 1983-84. Countries seem to be honoring the 20-percent aid requirement. Tighter discipline contributed to the drop in mixed credits, but the decline

The United States has proposed that the minimum grant element of mixed credits be raised from 20 to 50 percent. Such a requirement would increase the budgetary costs of mixed credit programs and discourage their use for commercial competition. The US proposal would apply to all foreign aid loans tied to donor nation procurement.

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Country Programs

All of the Big Six governments have on occasion issued mixed credits. Some consider mixed credits an integral part of their export strategies; others employ mixed credits chiefly on an ad hoc basis to match competitors. Unlike humanitarian aid, mixed credits are directed toward relatively affluent LDCs and are concentrated in capital-intensive sectors—principally power generation, steel, telecommunications, and transport. [redacted]

France accounts for slightly less than one-half of all mixed credits issued by OECD governments, and Paris does not hesitate to use foreign aid as a tool to promote exports. Mixed credits are generally the only type of project aid Paris is willing to make available for LDCs outside the francophone area. French mixed credits typically have a minimal aid component, highlighting their commercial character. [redacted]

The United Kingdom accounts for about one-fourth of all mixed credits, despite the Thatcher government's stated aim of ultimately banning such financing methods. A new trade/aid facility was established in 1977 to match competitors' efforts, but the government began in 1981 to negotiate mixed credit lines directly with LDCs. [redacted]

Italy has patterned its program after the French: a high proportion of foreign development projects involve mixed credit, which, in turn, contain a relatively low aid component. Although the Italians try to

use mixed credits aggressively, they are constrained by low aid resources, which prevent Italian companies from participating in many such deals. Italy accounts for slightly more than 9 percent of all mixed credits. [redacted]

Japan is the fourth-largest issuer of mixed credits, accounting for slightly less than 9 percent of the world total. Tokyo uses mixed credits to match competitors and to augment its extensive yen-loan program. Yen loans, which are highly concessionary, can often underwrite LDC projects without any other type of finance. [redacted]

[redacted] Mixed credit transactions presently need approval by an inter-ministerial committee. [redacted]

Canada has been a minor player in the mixed credit game—on average only 5 percent of bilateral aid has been allocated to such finance. The more interventionist government of former Prime Minister Trudeau had proposed a new trade/aid fund that could have multiplied mixed credit usage. The Mulroney government has put this facility on hold, however, pending an overall review of Ottawa's foreign aid policies. [redacted]

West Germany is opposed in principle to mixed credits and is not a significant practitioner. [redacted]

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Big Six reactions to the US proposal vary widely. The French reject the US proposal and are adamant in defense of their mixed credit program. Paris contends that mixed credits increase the overall volume of developmental aid and are therefore beneficial to LDCs. Moreover, the French point out that mixed credit use has declined, and deny, in any case, that mixed credits distort trade. The French likely perceive the United States as the sole hardliner on this issue and, given the divisions in the United States over subsidized export financing, probably consider US retaliation with its own mixed credit scheme an empty threat. Japan is pushing a compromise—raising the minimum grant element to only 25 percent. The Italians back the French in opposition to a major boost in the minimum grant element but would probably agree to the lower Japanese proposal. [redacted]

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The West Germans, on the other hand, support the United States on the need to phase out mixed credits, but Bonn seems reluctant to push hard on this issue. The British Treasury agrees with the United States on the need for tougher rules on mixed credits, although British trade officials are more ambivalent and publicly advocate the use of foreign aid to promote exports. The new Canadian Government appears to be leaning toward a tougher line against mixed credits and supports in principle the US proposal. Some Big Six governments feel that mixed credits are not a priority issue, but almost all are willing at least to compromise on tighter rules on disclosure and on prior notification of mixed credit offers. [redacted]

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Caribbean Oil Boom Goes Bust



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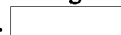
The Caribbean oil-based economies—Trinidad and Tobago, the Netherlands Antilles, and The Bahamas—have been hard hit by the slack world oil market. Primarily geared to produce heating oil for the US market, Caribbean refineries are operating at half capacity or less because of excess refining capacity in the United States and the switch to cheaper energy sources by US consumers. Moreover, the Netherlands Antilles and Trinidad have been hurt by sluggish growth in tourism—their second-largest foreign exchange earner—and depressed island-based shipping. The result has been an overall economic stagnation in the past four years for all three countries compared with the 5-percent average annual growth during the 1976-80 period. In addition, the economic decline of these wealthier islands is already having a negative impact on the other Caribbean nations. The result almost certainly will be more urgent calls for increased US aid to the region and even larger flows of illegal entrants into the United States.



Unaccustomed Economic Woes

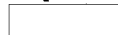
Despite the economic doldrums that afflicted much of the Caribbean region during the past decade, the oil windfall in Trinidad, the Netherlands Antilles, and The Bahamas until recently helped to cushion the region's problems. As a result, these islands became havens for migrants from other Caribbean countries seeking job opportunities. Moreover, Trinidad became both the largest regional aid donor and market for Caribbean-made goods. These countries also used their rapidly rising oil earnings to begin diversifying their economies. Trinidad ventured into costly, energy-intensive industries such as steel and petrochemicals. Petroleum receipts allowed the Netherlands Antilles and The Bahamas to bolster tourism and offshore banking by providing the extra revenue necessary to

offer generous investment and tax breaks. With the worldwide recession of the early 1980s, however, virtually all of these islands' foreign exchange earners—including oil—began to flag.



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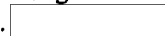
Economic activity in Trinidad fell about 3 percent in 1984, following a 2.6-percent decline in 1983. Lagging crude and refined product output, which contributes nearly 50 percent of GDP and 75 percent of export earnings, was largely responsible. Other important sectors also performed poorly—agriculture continued to suffer from prolonged neglect, construction sagged, steel sales fell because of quality and marketing problems, and petrochemical exports declined. As a result of two consecutive \$1 billion balance-of-payments deficits, foreign reserves at yearend 1984 stood at less than \$1 billion. The government belatedly tightened controls on imports and withdrew some consumer subsidies.



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Most workers, including the salaried middle class, have been hurt badly by even limited belt-tightening and have shown signs of restiveness. The unemployment rate tops 20 percent. Formerly generous wage increases now are held well below the 20-percent rate of inflation. As a result, labor unrest increased in the past year, with strike actions hitting most major industrial installations. In addition, a work slowdown by most of the country's 65,000 public-sector workers—demonstrating rejection of the government's wage contract proposals—temporarily brought the country to a near standstill last fall.



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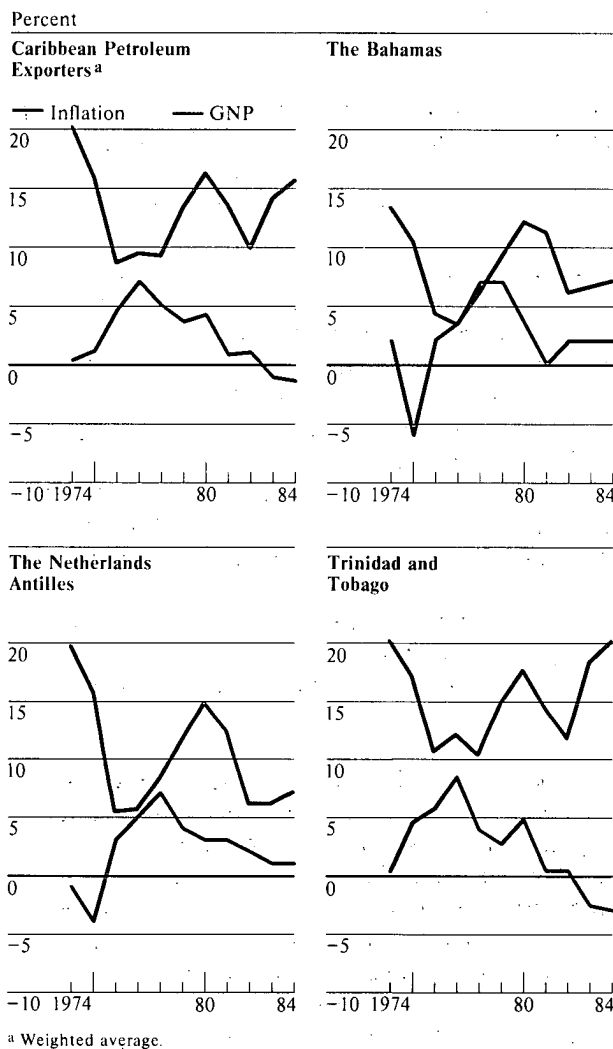
Only generous Dutch aid allowed economic activity in the Netherlands Antilles' six-island federation to grow at even a snail's pace during 1983 and 1984.

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Caribbean Petroleum Exporters: Economic Growth and Inflation, 1974-84



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The oil sector's poor performance—output of petroleum products contributes about 30 percent of the country's GDP and 97 percent of export earnings—was to blame. Other important sectors also languished. New US legislation removed the withholding tax exemption for US investment in that country's financial sector, hurting Antillean offshore

banking activities. The strong US dollar has increased the attractiveness of Western Europe and other vacation spots contributing to the steep drop in tourist receipts. Unemployment continued to rise, topping 25 percent. Meanwhile, the government—hoping to ride out the world oil slump—avoided belt-tightening. As a result, foreign reserves fell to \$100 million by yearend 1984, half of the peak 1982 level. [redacted]

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During 1983-84 real economic growth in The Bahamas averaged only 2 percent because the performance of nonoil sectors was not strong enough to fully offset growing problems in that country's petroleum industry. Only tourism—buoyed by the US economic recovery, an aggressive advertising campaign, and close proximity to the United States—and banking—probably helped by drug-related money laundering—showed any real improvement. In these circumstances, the jobless rate rose to about 25 percent by yearend 1984. The crime rate—partly drug related, according to press reports—jumped alarmingly as well, especially among unemployed youths. As a result, the government initiated negotiations in early 1985 with Haiti to return illegal immigrants—who, according to the US Embassy, may number over 50,000. [redacted]

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Looking Ahead

The principal concern in Trinidad is the expected shutdown of Texaco's unprofitable refinery at Point a Pierre and of on-island producing fields. Texaco, according to press reports, will close the refinery if a buyer is not found, idling 3,400 workers and eliminating 40 percent of Trinidad's export earnings. [redacted]

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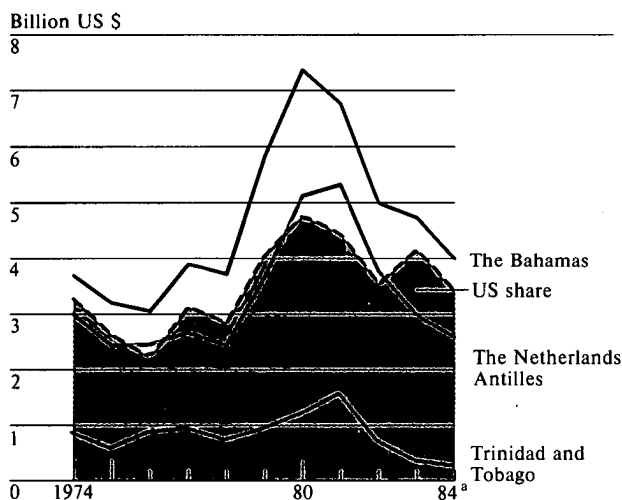
Although the government recently held preliminary talks with the IMF on financial assistance, national

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Caribbean Area: Petroleum Exports and US Share, 1974-84



^a Estimated.

[Redacted]

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elections, scheduled for late 1985, will make it especially hard to come to terms with the Fund any time soon. [Redacted]

Exxon's closure this month of its refinery in the Netherlands Antilles will severely compound that country's economic troubles. Royal Dutch Shell also has announced plans to pull out unless costs can be cut. A shutdown of both refineries virtually would bankrupt the economy and directly add about 2,000 workers to the jobless ranks, pushing the country's unemployment rate to nearly 30 percent. According to the US Embassy, the government expects other traditional foreign exchange earners to decline further—government revenues from offshore banking alone are forecast to drop 30 percent over the next few years as effects of new US legislation take hold. Moreover, growing economic troubles are likely to generate sporadic unrest, particularly as Aruba prepares to leave the Federation in early 1986. Police on that island used

tear gas this month to disperse 200 to 500 demonstrators protesting a 10-percent cut in public-sector wages, a result of the Exxon closure. [Redacted]

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In The Bahamas, should the BORCO refinery close—one of its owners, Charter Oil Company, reportedly has filed for bankruptcy—or related petroleum transshipment activities be curtailed, the impact would be much less severe than in the other countries but still could cost several hundred jobs and a sizable loss in export earnings. Overall performance in other key sectors is unlikely to improve much over the near term. Tourism probably will not grow much until the value of the US dollar moderates against other currencies. Although the country could initially attract some business from the Antillean banking industry, any financial gains would be short lived; Washington and Nassau are finalizing negotiations on a 15-month agreement to allow limited US access to Bahamian banking records. [Redacted]

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US Interests

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Worsening difficulties in three of the Caribbean area's larger economies can be expected to contribute to more urgent pleas for stepped-up US aid to the region. We believe these islands also will exert stronger pressure on Washington to provide preferential treatment under the Caribbean Basin Initiative (CBI) and to try to deter or compensate for any substantial US private disinvestment. For its part, the Netherlands Antilles lobbied the US Government to stop the Exxon closure. Moreover, worsening economic conditions and the efforts to expel illegal immigrants from other Caribbean islands will increase illegal immigration to the United States from the region. [Redacted]

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Growing economic hardship also is likely to open the door to further Communist penetration efforts. [Redacted]

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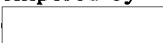
Colombia: Oil Export Prospects 

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Despite recent oil finds, Colombia's goal of becoming a significant net oil exporter remains elusive. Potential oil exports could provide Bogota \$1-2 billion in foreign exchange annually. The Betancur administration needs to raise \$700-800 million in investment capital to fund infrastructure and field development costs, but international lenders are reluctant to provide credit. In addition to improving Colombia's financial outlook, these oil earnings may aid Bogota's efforts to bring the drug industry under control and combat a persistent terrorist and insurgent threat. 

Oil-Sector Trends

Oil production, which peaked in 1970 at 220,000 b/d, began a steady downward course shortly thereafter prompting the government to initiate policies aimed at rejuvenating domestic oil supplies. Prices paid to producers were raised to world levels, investments in oil recovery projects were increased, and contract terms were adjusted to attract foreign investors. Since 1979, according to the Ministry of Mines, production began to increase gradually—at an average annual rate of about 6 percent—from a low of 125,000 b/d. According to Embassy reporting, production last year averaged 168,000 b/d and—for the first time since 1975—surpassed domestic oil consumption. 

We believe oil consumption will rise slightly through 1990, perhaps to as much as 200,000 b/d. Slow economic growth and the completion of nonoil energy projects will help keep oil demand in check. Bogota will also continue to promote oil conservation—through its policy of maintaining prices at near world market levels—with the goal of minimizing imports and increasing oil revenues. The success of this approach may be tempered by declining international oil prices. 

Colombia: Oil Production, 1984^a


	Barrels Per Day	Percent of Total
Total	167,810	100
Magdalena basins	122,499	73
Llanos basin	17,873	11
Putumayo basin	18,803	11
Southwest Maracaibo basin	8,635	5

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^a Based on first six months of 1984.



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In the mid-1970s, Colombia began offering oil companies "association contracts," which—according to industry analysts—includes contract terms among the most attractive in the international oil market.¹ Colombian officials state that foreign investment under association contracts increased steadily from \$127 million in 1979 to \$267 million in 1982. Investment dropped last year to \$186 million in the wake of worldwide recession and weak oil demand. Despite the continued oil market softness, investment is expected to rise again as new finds and favorable contract terms encourage additional exploration efforts. 

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¹ Under association contracts, foreign oil companies are responsible for all exploration costs, but once a discovery is declared commercial, Ecopetrol—the national oil company—will pay 50 percent of development costs. The operator is required to pay a royalty equal to 20 percent of the volume of oil and gas produced, and the rest is shared equally with the government. Companies are paid the world price for their oil and allowed to export after domestic requirements are met. 

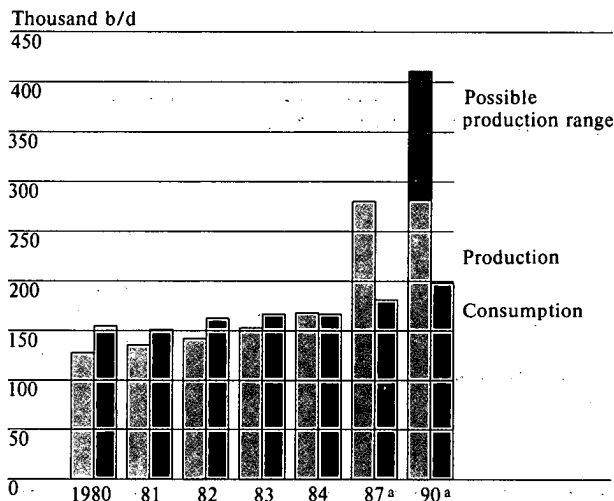
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Colombia: Oil Production and Consumption



^a Estimated.

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Production Potential

We believe Colombia has the potential to surpass its 1970 production record of 220,000 b/d and once again become a sizable net oil exporter. Upon completion of the Rio Zulia pipeline, total domestic output should increase to about 280,000 b/d and exports could rise to about 100,000 b/d. If more optimistic production levels are achieved, Colombia could be producing more than 400,000 b/d by the end of the decade and exporting close to 200,000 b/d.

Exploration has been concentrated in the Llanos basin where production has increased from 3,500 b/d in 1982 to the current 18,000 b/d. The most significant discovery of late has been the joint Occidental/Ecopetrol finds in the Cravo Norte concession. According to Embassy reporting, preliminary evaluations indicate proved reserves of at least 400 million barrels that will allow an initial production rate of 90,000 to 100,000 b/d. Company officials estimate the Cravo Norte concession

could contain 760 million barrels and produce as much as 220,000 b/d. Other industry personnel in Colombia, however, believe these figures to be overly optimistic.

Construction of a 300-kilometer pipeline is required to link the finds with an existing pipeline at Rio Zulia. Crude will be transported from Rio Zulia to either the Tibu refinery or to Colombia's main pipeline network at Ayacucho. Initial capacity of the new line will be 90,000 b/d that can be expanded to 250,000 b/d with construction of additional pumping stations. Last August a \$171 million contract was awarded to a West German and British consortium with a scheduled completion date of January 1986. A second pipeline system is planned to connect the fields of Apiay and Casanare in the southern part of the Llanos to an existing pipeline that traverses the center of the country. A contract award is expected shortly. These fields are estimated to have sufficient reserves to provide an additional 20,000 b/d through 1990.

In addition to new finds, secondary recovery projects are scheduled to stem the decline in output from fields in the major oil-producing region, the Magdalena Valley. A major water injection project is planned for the Casabe and Cocorna fields. Industry experts expect production from these two fields to more than double to about 40,000 b/d by 1988.

The southwest Maracaibo and Putumayo basins supply the remaining oil—approximately 27,400 b/d. A majority of the fields within these basins started producing in the early 1960s and are now nearing their full potential. Recent successful drilling tests and enhanced oil recovery techniques, however, are expected to boost production slightly.

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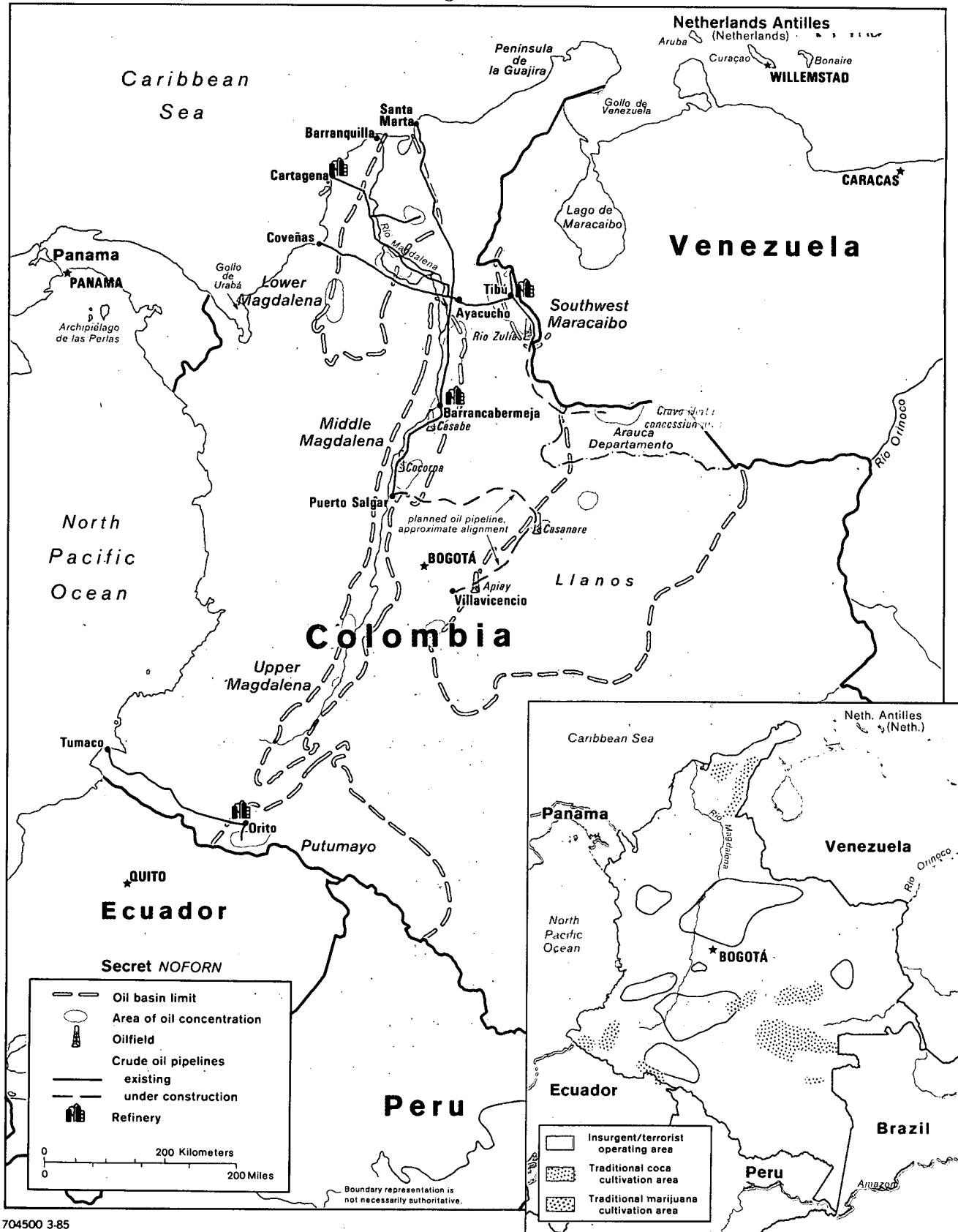
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**Petroleum Development,
Insurgent Operating Areas, and Narcotics Growing Areas**



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Constraints on Development

Although Colombia has the potential geologically to become a significant net oil exporter, it is likely that it will suffer setbacks in its production timetable because of financial and security concerns. We estimate Colombia's share of the roughly \$1 billion in development costs of the Llanos basin and the Casabe and Cocorna fields to be \$700-800 million. Although Bogota, through Ecopetrol, will generate a portion of the needed capital, most will have to be raised on the international market. Bogota received a financial boost in November 1984, when the World Bank approved a loan of \$130 million for field development. Colombian officials are hoping that the World Bank loan will encourage additional credit from private as well as international lending sources. International lenders, however, remain reluctant to lend to Colombia in light of its worsening economic conditions, balance-of-payments difficulties, a \$12 billion foreign debt, and the absence of a formal debt repayment plan. We believe capital inflows would be more forthcoming, however, if Bogota undertakes austerity measures under an IMF program. [redacted]

The Rio Zulia pipeline is the linchpin to Colombia's quest for continued oil development. In recent months, however, there have been sporadic incidents of sabotage to pipeline facilities and kidnappings by the National Liberation Army (ELN). Construction ceased with the abduction of a high-level West German official; his release was granted in exchange for a substantial ransom. After Bogota agreed to provide additional security measures, construction resumed in early January. The first 130 to 160 kilometers of the pipeline must be laid before the rainy season begins to avoid further delay. [redacted]

[redacted] the scheduled completion date of January 1986 remains attainable. If terrorist attacks continue, however, despite improved security measures, we believe completion could be pushed back by up to a year. [redacted]

In addition to problems with terrorists, the pipeline will extend into regions where cocaine smuggling is common. Drug traffickers, however, do not pose as

Columbia: Petroleum Sector Investment Program, 1984-88

Million US \$

	Ecopetrol ^a	Private Sector	Total
Total	2,124	952	3,076
Exploration	203	450	653
Development	990	379	1,369
Pipelines	323	123	446
Refineries	358	0	358
Miscellaneous	250	0	250

^a Includes export credits and international loans. Includes \$700 million earmarked for development of the Llanos basin and completion of enhanced oil recovery projects.

[redacted] serious an impediment to pipeline construction and personnel security as do guerrilla groups—only 5 to 10 percent of all cocaine trafficking in Colombia takes place along the pipeline route. Moreover, narcotics traders, may use the pipeline support infrastructure and personnel to facilitate smuggling activities. Although the construction phase will increase government and corporate presence in the vicinity and may temporarily interrupt trafficking activities, we believe traffickers will adjust by relocating operations. If government activities and military personnel begin to affect profits of these organizations, however, violence may occur and possibly disrupt oil production. [redacted]

Implications

Since 1980 Colombia has progressively improved its oil trade balance. A lower volume of imports coupled with low world oil prices reduced Colombia's oil import bill from \$700 million in 1980 to about \$445 million in 1984. At the same time, steadily rising production has generated additional export earnings. Last year, according to Ecopetrol,

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Colombia generated a small oil trade surplus, and we believe this surplus will grow. Upon completion of the pipeline, net oil export earnings could average about \$1 billion annually and double that amount if more optimistic production levels are achieved. This additional foreign exchange would ease debt service pressures, enable Bogota to focus on economic recovery, and possibly permit greater drug enforcement efforts.



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Rice Production: The Asian Success Story

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Asian rice production has increased by 75 percent over the last 20 years as a result of government policies designed to encourage production, and burgeoning export surpluses have had a significant impact on foreign exchange earnings across the region. The growing political leverage of Asian farm lobbies will work in most countries to ensure continued production gains, import cuts, and export growth. As a result of these trends, the United States, a major rice exporter, will face continued Asian competition in African, Middle Eastern, and European markets, as well as the permanent loss of such lucrative Asian customers as South Korea and Indonesia.

Powerful farm lobbies intent on protecting farm interests against the demands of competing sectors have evolved in most Asian rice-producing countries. Across the political spectrum Asian governments have had to accede to the demands of rice farmers for price increases, increased input subsidies, and liberalized credit terms, as well as greater tolerance of free market forces.

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The Payoff—Sufficient Food and Current Account Dividends

Responsive Government Rice Policies

Asian governments have long recognized the political importance of ensuring sufficient rice supplies, particularly in the cities, while at the same time providing for the welfare of rice farmers, who account for about half of the region's population. To reach these goals, these governments have followed widely different policies. Although most set quotas on amounts that must be sold to the government, a wide range of free market entrepreneurship on the part of farmers and traders is permitted. For example, the Government of North Korea has a monopoly on trade, and all production above subsistence levels goes to the state. At the other end of the spectrum, less than 13 percent of Thai rice is procured by the government.

Careful orchestration of rice policy over the past 20 years has spurred a 75-percent increase in Asian rice production from an already large base; the region now produces 92 percent of total global supplies. With 45 percent of the crop still dependent on monsoon-driven rains, production gains have not been even, however. Some countries—Vietnam and the Philippines—for example, temporarily emerged as net exporters, only to fall behind again as a result of combinations of bad weather, misguided farm policy, or political disruption. Most countries, however, have been able to sustain production gains over the longer term.

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The rapid gains in total production have contributed to a significant improvement in the trade balances in the region. Despite population growth rates of about 2 percent, the Asian share of world rice imports dropped from nearly 65 percent in 1965 to 30 percent this year, and the Asian share of exports held steady at about 66 percent:

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- Pakistani exports increased by 850 percent, although consumption doubled.

India's successful Green Revolution has spread across Asia. Success has been facilitated by large amounts of private and public investment in irrigation, subsidized farm inputs, and hybrid seeds adapted to local conditions. In turn, better yields in combination with effective price stabilization and government procurement policies have stimulated Asian rice farmers to expand production.

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World Rice Production *Million metric tons, milled*

	1965	1975	1985 ^a
World production	180.9	226.4	313.8
Asia	165.0	206.0	288.1
China	85.1	86.7	123.2
India	39.3	39.6	58.5
Indonesia	9.6	15.3	25.0
Bangladesh	10.5	11.3	14.3
Thailand	7.5	8.8	12.2
Japan	11.5	11.2	10.8
Burma	5.3	5.4	9.0
Vietnam	6.3	7.2	9.0
South Korea	4.0	4.4	5.7
Philippines	2.6	3.7	5.1
Pakistan	1.4	2.3	3.5
North Korea	1.4	2.4	3.5
Taiwan	2.1	2.3	2.0
Nepal	1.5	1.6	1.8
Sri Lanka	0.7	1.1	1.5
Cambodia	1.8	0.4	0.9
Malaysia	0.7	1.4	1.1
Laos	0.5	0.6	0.7
Afghanistan	0.2	0.3	0.3
Brunei	NEGL	NEGL	NEGL
Other	15.9	20.4	25.7
United States	2.4	3.7	4.4
Brazil	5.2	4.8	6.1
EC Ten	0.6	0.8	0.8

^a Estimated.

Source: USDA

[Redacted]

- India, self-sufficient in most years, was a substantial net exporter from 1978 to 1982, and now imports only to replenish stocks during periods of low world prices.
- Both Burma, where rice exports account for 40 percent of export earnings, and Thailand, where rice earns 15 percent of the total, have tripled exports in the last decade.

- Indonesia and South Korea, which each imported 2 million metric tons of rice annually during the 1970s, are expected to import little or no rice in 1985. [Redacted]

Problems on the Horizon

Effective management of rice policy in the face of the growing political influence of farm lobbies will challenge Asian planners for the remainder of the decade. Embassy reports indicate that the need to reduce burdensome farm subsidies poses a dilemma for countries such as South Korea, where consumption is declining, as well as for those for which continued increases in production are essential—India and the Philippines, for example. Steps are under way in South Korea to reduce the government deficit by cutting rice and fertilizer subsidies, but Seoul may face strident opposition from farmers. In India, both the federal and state governments are being squeezed by rising farm subsidies and growing political influence of farm lobbies. Filipino farmers predict a shortfall of 300,000 tons in the fall harvest unless demands for a rollback in production costs are met. [Redacted]

Complicating the task of government rice planners is the instability of the world rice market, both as to availability and price. Only about 5 percent of the world rice crop enters international trade, and about half of total production is dependent on the vagaries of the Asian monsoonal rains. World prices are currently at a 10-year low and demand is weak, causing problems for major exporters such as Thailand and Burma. The market could shift rapidly this year, however, because global stocks—currently at a 10-year low—are inadequate to compensate for crop losses if the weather turns bad. [Redacted]

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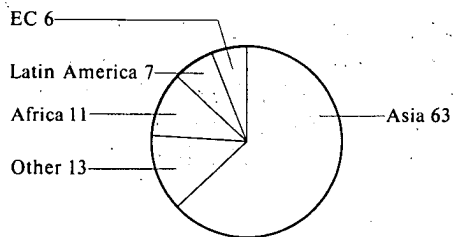
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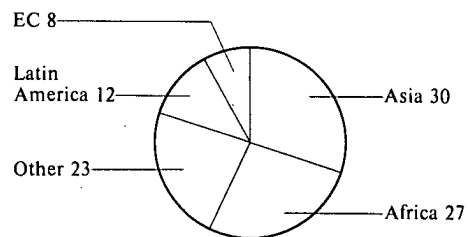
World Rice Trade, 1965 and 1985

Percent

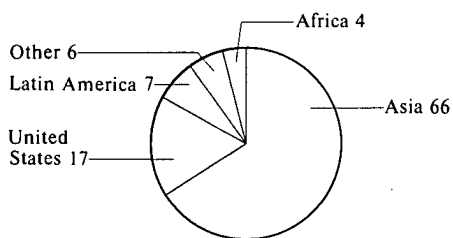
Share of Imports-1965



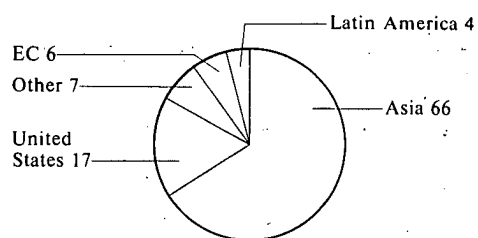
Share of Imports-1985



Share of Exports-1965



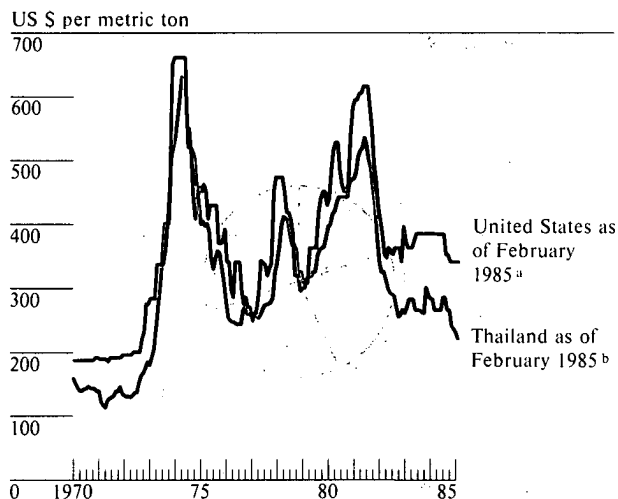
Share of Exports-1985



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World Rice Prices, 1970-85



^a Milled, Zenith No. 2, medium grain miller to distributor, f.o.b. New Orleans.
^b White milled 5 percent broken, f.o.b. Bangkok.

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Implications for the United States

A growing ability to supply the high-quality rice preferred by consumers in the Middle East and Western Europe is enabling some Asian exporters to capture shares of these traditional US markets. Thai producers have developed varieties of rice designed to appeal to these stable markets and have installed improved milling and sorting machines. As a result, in combination with low Thai prices, Thai rice exports to the EC doubled in 1984. In addition, [redacted] economic reforms providing incentives to export rice have resulted in a larger availability of good quality Chinese rice on the international market. [redacted]

The Asian competitive advantages, in climate, cheap labor, low energy usage, and strong government support suggest continued formidable competition for the United States, [redacted]

[redacted] Large Asian purchases from the United States in deficit years—such as the 1-million-ton Korean purchase in 1981—are becoming rarer. At the same time, US prices—currently about 50 percent higher than Asian prices for comparable quality—are particularly unattractive to the poorer African countries and have led to growing US rice stocks. Pressure likely will build for concessional US sales and credits from these African countries and probably the Philippines. [redacted]

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Briefs

Energy

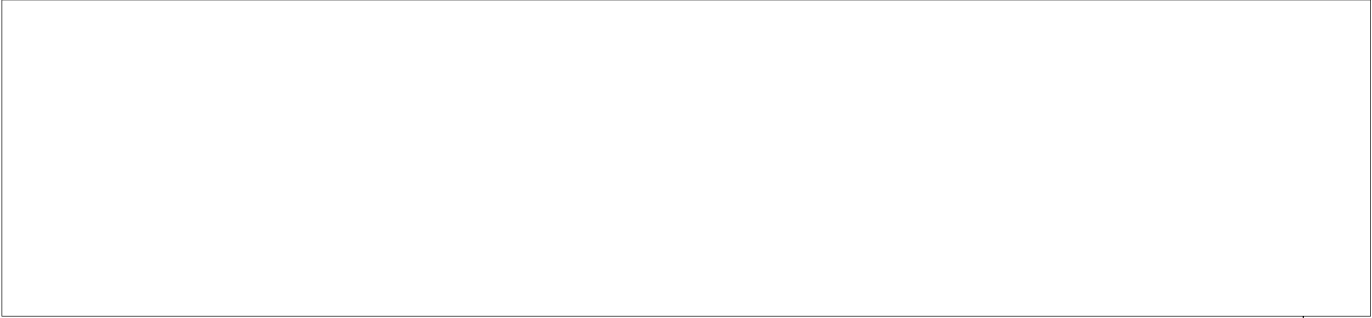
Nigeria Expanding Countertrade in Oil



Nigeria has reversed policy and is negotiating countertrade deals in an effort to raise import levels in the face of high debt service and falling foreign exchange earnings. Brazil is discussing a second barter deal worth about \$1 billion over the next year, and Canada, Yugoslavia, France, Italy, Austria, and West Germany have indicated interest. Although conserving on hard currency import costs, such deals do not add to foreign exchange available for debt repayment and diminish the government's ability to respond to changes in world oil prices. Furthermore, cuts in oil revenues that are shared with Nigeria's 19 states risk heightened regional discontent, particularly in the south where opposition to the northern-dominated government is already festering. 

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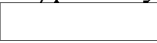
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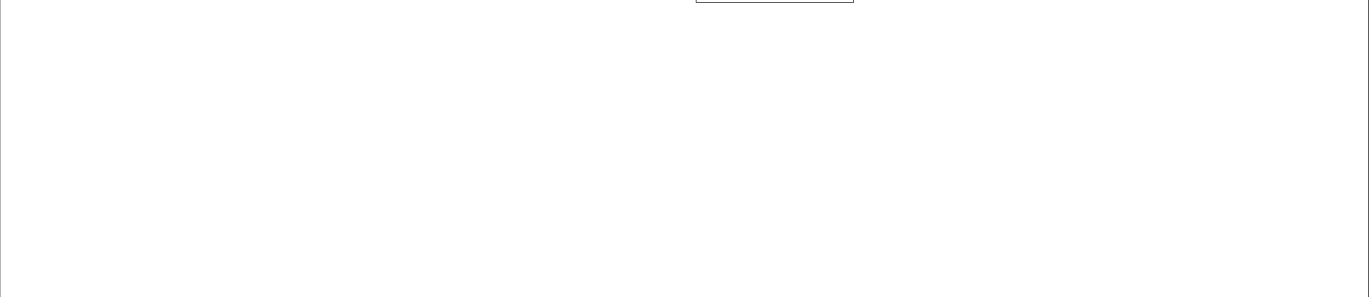
New Libyan Refinery Online



Production at Libya's new Ra's al Unuf refinery continues to average about 20,000 b/d since testing began earlier this year. Output is being sold on the spot market with negotiations under way for term contracts with several West European countries. Plans call for 120,000-b/d production by midyear—half of designed capacity. A substantial portion will go to the domestic market because existing refinery capacity of about 130,000 b/d barely meets domestic demand. Construction of phase two of Ra's al Unuf—including petrochemical units—is moving ahead. Weak world demand for petroleum products and petrochemicals, however, probably will keep production and revenues well below planned levels. 

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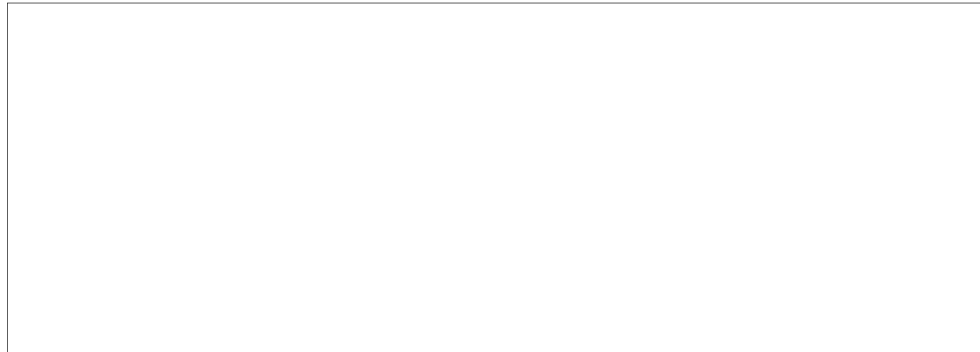
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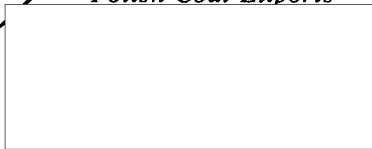
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Shortfalls in Polish Coal Exports



Harsh winter weather has contributed to a 15-percent drop in hard currency exports—mainly coal—in the first two months of this year, as compared with the same period of 1984. The decline in coal exports may reflect in part a decision to give priority to increased consumer demand during the cold weather. The Poles exported a record amount of coal in 1984 in hopes of a second mild winter and successful conservation. Warsaw has spent the past two years trying to regain its reputation as a reliable supplier after labor unrest reduced coal exports by more than 60 percent in 1981. The recent shortfalls are likely to cause an overall decline this year in coal sales—which earned about 20 percent of hard currency revenues in 1984—and thus add to Warsaw's difficulties in meeting its financial commitments. 25X1

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International Finance

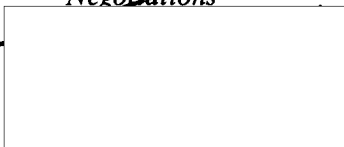
Sudan's IMF Agreement



The IMF's qualified endorsement of Khartoum's recent economic package improved Sudan's near-term financial outlook, but entails several politically explosive reforms. The memorandum of understanding is not a formal agreement but should permit disbursement of foreign bilateral and multilateral assistance largely suspended since Sudan fell into arrears on its IMF standby arrangement in mid-1984. Resumption of this funding, worth over \$400 million annually, would allow at least partial repayment of IMF arrears and substantially ease the critical foreign exchange shortage. Khartoum's reform program includes a 48-percent official devaluation, a 66-percent increase in gasoline prices, and a 30-percent increase in the price of bread. The bread price increase has sparked violent rioting throughout the Khartoum area that could lead the Nimeiri regime to backpedal on some price increases, thereby jeopardizing the IMF accord. 25X1

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Mauritanian Debt Negotiations



Mauritania has signed a letter of intent with the IMF for a standby loan for 1985. Conclusion of the agreement, however, requires that Nouakchott close the \$160 million foreign payments gap expected this year; the government is marshaling support from Arab and Western donors. In addition, Mauritania has requested a Paris Club rescheduling of its estimated \$1.6 billion foreign debt. Over \$210 million is due this year—85 percent to Arab creditors! Drought and weak markets for Mauritania's primary exports—fish and iron ore—however, sharply limit Nouakchott's ability to improve its finances. 25X1

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Global and Regional Developments

Record South American Soybean Crops



Brazil, Argentina, and Paraguay will have record-breaking 1985 soybean harvests totaling 23-24 million tons, [redacted] Record crops this year are the result of expanded plantings, high-yield seed, and opportune late season rains. With favorable export tax incentives and aggressive marketing, large quantities of South American soybeans will be competing with US soybeans in export markets, especially in the EC and Eastern Europe. The strong dollar will make foreign producers even more competitive. US soybean exports are down 22 percent from 1983 levels, and South American exports have jumped 60 percent. [redacted]

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Rubber Producers' Negotiating Position



Members of the Association of Natural Rubber Producing Countries (ANRPC)—Malaysia, Thailand, Indonesia, Sri Lanka, India, and Singapore—met last week to discuss their negotiating position on the International Natural Rubber Agreement (INRA), which expires in October. Producer-consumer meetings are scheduled to begin next week. Although higher prices will be the key issue for producers, a senior Thai delegate reported that members will also agree to the US request for discussions about supplies at the April meetings. Malaysia—which accounts for about half of world natural rubber production—had been an outspoken opponent of the US position on supply guarantees. ANRPC members also agreed to seek a two-year renewal of the current agreement—the maximum permitted. [redacted]

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West German-Soviet Rail Ferry



Chancellor Kohl said last week that he is "favorably disposed" toward a proposal to establish a Baltic rail ferry between either Kiel or Luebeck in West Germany and Klaipeda in the Soviet Union. A decision could come as early as next week. Officials of the coastal states of Hamburg, Bremen, and Schleswig-Holstein see economic benefits from the project and are the main supporters of the idea. [redacted]

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[redacted] The Soviets have been pressing for such a link for several years, probably as an alternative to costly rail transport through Eastern Europe. Bonn expects a guarantee of at least 51-percent West German ownership. [redacted]

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National Developments

Developed Countries

Belgium Continues Austerity Program



Prime Minister Martens has proposed new spending cuts for 1985 to allow the government to meet its original target of reducing the budget deficit to 10.4 percent of GNP. The \$420 million decrease will come mainly in social expenditures, including unemployment-related early pensions, and sick pay for public servants. The government also is hoping for a smaller increase in its contribution to the EC. Despite those deficit reduction targets, Martens

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announced a four-year tax cut to begin in the 1986 budget—welcome news to supporters facing election later this year. More difficult bargaining between Social Christian and Liberal coalition partners will be required on next year's budget, which will be presented in June.

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Greek Foreign Payments Deteriorated Further in 1984

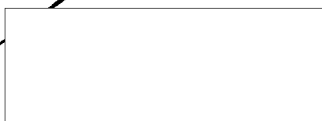


The deterioration in Greece's foreign payments position last year increases the possibility that Athens will need to seek official assistance in 1986 if present economic policies are continued. The current account deficit grew 16 percent to \$2.2 billion, or 6.7 percent of GNP, up from \$1.9 billion or 5.3 percent of GNP in 1983. The trade deficit declined slightly, but invisibles fell for the fourth consecutive year—mainly because of a sharp fall in shipping receipts, interest payments on a growing foreign debt, and a drop in net EC subsidies. The poor external performance necessitated official borrowing of \$2.2 billion, up from \$1.9 billion in 1983. Foreign debt, including military debt, now totals \$14 billion and debt service likely will reach 25 percent of current account earnings this year. The Bank of Greece, however, was still able to negotiate a \$450 million syndicated loan on favorable terms probably because the participating banks wanted to protect their heavy exposure in Greece.

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South African Budget



To fight persistent double-digit inflation and restore credibility, Pretoria has announced another austere budget for the fiscal year beginning 1 April 1985. South Africa's fiscal management has suffered in recent years from serious overspending, particularly for defense, and overly optimistic revenue projections. Spending is set to rise by 13.9 percent—compared with current 16-percent inflation. Revenues are projected to increase by 18.8 percent—about one-third from higher taxes, including a 2-percentage-point increase in both sales taxes and the income tax surcharge. The anticipated \$1.3 billion deficit before borrowing represents 2.2 percent of GDP, well below the 3-percent IMF guideline under the standby agreement.

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Australian Strike Laws Strengthened



Last Friday the state of Queensland passed unprecedented legislation outlawing industrial disputes in the electrical industry, requiring workers to sign no-strike contracts and subjecting strikers to suspensions and heavy fines. A February strike by the Electrical Trades Union caused 15 days of statewide power outages, closed Queensland ports, and cost businesses approximately \$420 million, according to the US Consulate in Brisbane. Although public opinion is solidly behind the government, union officials have threatened sporadic strikes to cut state revenues. The umbrella Australian Council of Trade Unions has given Queensland unions the go-ahead in their campaign against the state's National Party government undoubtedly because it fears the spread of strike-limiting legislation.

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Less Developed Countries

Explosion at Iraqi Bank Headquarters

An explosion heavily damaged central bank headquarters on 14 March, producing temporary confusion throughout the Iraqi banking system. The US Embassy reports foreign businessmen are having trouble obtaining foreign exchange transfers, and several embassies have encountered difficulties making deposits or withdrawals. Key records may have been destroyed, but no workers were harmed in the afterhours blast, and bank activity is slowly returning to normal. Additional restrictions on issuing letters of credit will continue for at least a short time, and foreign worker remittances will be snarled.

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Aluminum Smelter in Saudi Arabia?

According to Embassy reporting, the Aluminum Company of America is considering building a smelter in Saudi Arabia as a joint venture with Saudi industry and government. This would continue the trend of locating aluminum smelting near low-cost energy sources; since 1980 aluminum smelting capacity in the Persian Gulf region has increased more than 40 percent. Although these countries account for a small share of total world aluminum capacity at present, low-cost energy supplies assure their growing importance, putting increased pressure on high-cost Western producers. US primary aluminum capacity has, for example, remained at the 5-million-ton level since 1980 and nearly one-fifth of this capacity is idle.

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Algerian Land Reform

The Algerian Government has offered free state land to small farmers around Algiers probably as a trial balloon to help raise production through conversion of collective farms to private ownership. The US Embassy says that response has been mixed because the government will retain control over crop choice and marketing. The 1985-89 plan stresses development of agriculture and water resources and, especially the land reform program, is a major break with past emphasis on industry and reflects Bendjedid's growing ability to guide the economy over the opposition of remaining socialist hardliners.

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Algerian Price Increases

Prices for bread and other subsidized goods have been raised 12 to 17 percent by Algiers—the sharpest increase in recent years and probably the beginning of a broader campaign to contain foreign borrowing needs and stimulate domestic agricultural production. The rising subsidy burden consumed almost \$400 million—5 percent—of budget revenues in 1984. The new price adjustments will trim \$50 million from the subsidy bill this year. Algeria's pervasive security forces and the limited expectations of most Algerians have helped control discontent so far, but tighter austerity increases the likelihood of unrest especially in urban areas.

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Nicaraguan Coffee Harvest Falls Short of Goal

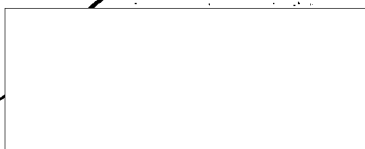


Despite President Ortega's claims to the contrary, Nicaraguan coffee export revenues will be \$50-100 million below Managua's target according to the US Embassy. Private-sector growers estimate that the December-March harvest will fall about 400,000 quintals short of the 1.2-million-quintal goal. They have told US officials that, despite a bumper crop, the harvest was down because of the use of inexperienced workers, Contra activities, and the threat to pickers of military impressment. Moreover, at least 20 percent of the crop is below export quality because of the overextended harvest period. Managua will likely be forced to purchase coffee on world markets to satisfy contracts let last fall based on the government's optimistic production estimate.

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Uruguay's New Economic Team



President Sanguinetti's reliance on market-oriented officials probably signifies pursuit of coherent stabilization policies rather than quick economic fixes. Foreign Affairs Minister Enrique Iglesias is entrusted with international economic policy and will likely play the major role in debt negotiations with the IMF and commercial banks. Although he is a vocal supporter of political dialogue with creditors, US Embassy officials indicate he opposes a debtors' cartel. Finance and Economy Minister Ricardo Zerbino, a free market economist, will probably support exchange rate adjustments to stimulate export-led growth, cuts in government spending, and improved tax collection. We judge this will allow the new Central Bank President, Ricardo Pascale, to pursue a tight monetary policy to fight inflation and maintain export competitiveness. With these policies, Uruguay will probably be able to reconcile with the IMF and reach agreement with its creditors to ease external constraints on growth.

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Cabinet Changes Rumored in Jakarta



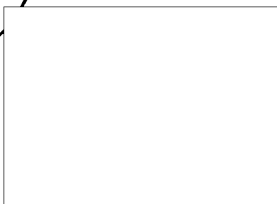
The US Embassy reports an upsurge in rumors of leadership shifts as the Soeharto government begins a new fiscal year next Monday. Local bankers are criticizing Finance Minister Prawiro for his weak leadership and ineptness in introducing a new value-added tax. They are also watching Prawiro's moves to clean up the notoriously corrupt Customs Service, a task not helped by his reputation for dishonesty. One Embassy source said that longtime Soeharto aide, Sudharmono, will head a newly created structure overseeing domestic politics. Sudharmono's son-in-law, Ginandjar Kartasasmita, who was recently named to head the Capital Investment Coordinating Board, would combine oversight of foreign and domestic investment with his other duties involving the promotion of domestic products. Such moves would continue the economic housecleaning by President Soeharto who, in the past several months, has replaced the leadership of the state oil company, the national airline, the investment coordinating board, and the Customs Service.

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Sharp Drop in Soviet Orders for Western Machinery and Equipment



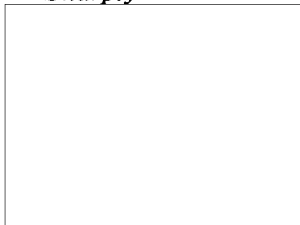
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Soviet orders of Western machinery and equipment totaled only \$1.1 billion in 1984—the lowest in more than a decade and one-half the 1983 level. Leading the decline was a precipitous drop (from \$1.6 billion in 1983 to about \$295 million last year) in new orders for the oil and gas, chemical, and metallurgy industries. Only partially offsetting this decline was a near doubling of orders for the transportation sector (from \$213 million in 1983 to \$387 million in 1984) and a slight rise in new contract commitments for the consumer goods sector. As in recent years, the lion's share went to Western Europe (\$731 million) and Japan (\$251 million). US firms, in contrast, took only about 6 percent (\$70 million) of the total, reflecting Soviet efforts since the imposition of Western sanctions to become less dependent on US machinery and equipment. Despite last year's poor showing, we expect the pace of contracts placed in the West to pick up somewhat as the Soviets embark on their 12th Five-Year Plan.

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Lao Trade Through Thailand Drops Sharply



Vietnam is apparently succeeding in its attempt to divert Laos from its dependence on Thailand as a conduit and market for foreign trade. According to a World Bank economist, the share of Lao import tonnage transiting Vietnam increased from one-fifth in 1982 to two-thirds in 1985, and Lao commodities are increasingly exported through Vietnam including all Lao gypsum and tin ore for smelting in the Soviet Union. Wood—Vientiane's primary export—is now exported chiefly as logs to Vietnam because Lao sawmills have failed to meet standards for the Hong Kong and Japanese markets. Although unofficial border trade with Thailand will probably continue, we expect the upgrading of road links and the construction of an additional oil pipeline connecting Laos and Vietnam to further reduce dependence on transshipment through Thailand.

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