



Directorate of
Intelligence

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**International
Economic & Energy
Weekly**

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14 June 1985

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DI IEEW 85-024
14 June 1985

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**International
Economic & Energy Weekly**

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14 June 1985

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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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Synopsis

1	Perspective—West European Gas Prospects: Limiting Soviet Opportunities <input type="text"/>	25X1
	The current gas surplus in Western Europe, together with the increased availability of low-cost Soviet gas, could prevent or delay the development of Western Europe's substantial reserves needed to meet domestic demand requirements beyond 1990. <input type="text"/>	25X1
3	Nicaragua: Steps To Counter the US Embargo <input type="text"/>	25X1
	Managua is adopting a broad strategy to deal with the US trade embargo announced in May. While Soviet Bloc benefactors have offered some new aid, most other donors have given little more than moral support. <input type="text"/>	25X1
7	Mexico: Shortsighted Oil Policies Under de la Madrid <input type="text"/>	25X1
	Mexico is encountering problems meeting its oil development goals because of financing and marketing constraints. Meanwhile, the country faces a continuing decline in world oil prices that would further erode petroleum revenues. <input type="text"/>	25X1
11	Bolivia: Grim Export Prospects <input type="text"/>	25X1
	La Paz needs to increase exports to resume servicing its \$4.8 billion foreign debt, but domestic economic chaos and an unstable political climate preclude such an effort. <input type="text"/>	25X1
15	Chile: Favorable Export Outlook <input type="text"/>	25X1
	Santiago is now focusing on expanding exports to meet its debt service obligations, and, despite a setback last year as copper revenues fell, copper will remain the key earner of foreign exchange. <input type="text"/>	25X1
19	Sudan: The Limited Role of the Private Sector <input type="text"/>	25X1
	Sudan's more immediate problems—including IMF arrearages and the government's reluctance to adhere to a previously agreed-upon package of reforms and austerity measures—tend to obscure more fundamental economic problems. As a first step, we believe Sudan needs to abandon a longstanding preference for statist economic solutions and move toward more decentralized private-sector participation in the economy. <input type="text"/>	25X1

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Perspective***West European Gas Prospects: Limiting Soviet Opportunities***

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The current gas surplus in Western Europe, together with the increased availability of low-cost Soviet gas, could prevent or delay the development of Western Europe's substantial reserves needed to meet domestic requirements beyond 1990. Although we expect the West European supply cushion to erode gradually, market forces may not adequately encourage investors to make the huge capital commitments to develop alternative supplies promptly. As a result, Moscow, as the lowest cost supplier with spare export capacity, will have a golden opportunity to increase its sales in Western Europe.

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Failure to develop acceptable alternatives to Soviet gas could force some West European countries to abandon their 1983 International Energy Agency (IEA) commitment to limit gas imports from the Soviet Union. If, over the next few years, weak demand, the high price of new gas, or stringent tax structures make development of European supplies unprofitable, market realities dictate that Western Europe will purchase additional Soviet gas. Under these circumstances, we believe continental Western Europe could be dependent on Soviet gas for nearly 35 percent of its gas consumption in the year 2000. Exports at this level could give Moscow annual hard currency gas earnings, at current prices, three to four times the 1984 level of nearly \$4 billion.

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West European countries have several choices if they hope to meet their IEA commitment:

- **Proceed with development of indigenous gas resources.** A decision to develop the Sleipner and Troll gasfields in the Norwegian North Sea would significantly increase West European production. Because of the five- to 10-year leadtimes, however, contracts will have to be concluded within the next few years to meet rising demand beginning in 1990.
- **Adapt the Norwegian tax structure to meet the needs of high-cost fields.** The current tax structure is estimated to more than double the price necessary to make Troll gas commercially attractive, and makes its price too high to compete with Soviet gas. In the past, Norway has shown flexibility in response to market conditions.
- **Institute or maintain realistic gas-pricing policies, especially in the United Kingdom.** Higher prices would help hold demand below forecast levels, and improve the outlook for expansion of domestic capacity.

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- **Build a gas pipeline linking the United Kingdom and the Continent.** Although this runs the risk of opening the United Kingdom to Soviet gas, it could force Oslo to price gas more competitively by increasing both UK and continental leverage. Furthermore, it could eliminate the need for one or more deepwater North Sea pipelines.
- **Internalize all costs associated with the purchase of Soviet gas.** Western Europe should assess the total costs of Soviet gas, including the expense of developing and maintaining the storage and surge capacity that would be required in the event of a cutoff, before buying additional volumes. This calculation would reduce the price advantage of Soviet gas.

A combination of these options, together with purchases from other non-OECD sources, could help prevent further Soviet inroads.

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Comprehensive regional planning and cooperation, including measures to accelerate OECD gas supplies on short notice through standby contracts, could alleviate some of the effects of a potential disruption in Soviet gas deliveries. Moreover, we believe awareness of such planning might discourage the Soviets or the Algerians from even attempting an embargo. Until West European governments view gas supply availability in a regional strategic perspective, the coordination required to reduce economic dislocations of a supply interruption is highly unlikely.

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**Nicaragua: Steps To Counter
the US Embargo** [redacted]

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Managua is adopting a broad strategy to deal with the US trade embargo announced in May. To cushion trade dislocations, the Sandinistas have begun a comprehensive search for new suppliers and alternate export markets. While Soviet Bloc benefactors have offered some new aid, most other donors have given little more than moral support. With Cuban assistance, the Sandinistas are also setting up third-country front companies to circumvent the sanctions. At the same time, Managua is using the embargo to deflect blame from its home-grown economic woes and justify tighter controls over the economy [redacted]

The Search for New Trade and More Aid

At the time of the embargo, President Ortega and several other official delegations traveled extensively looking for new trade and aid agreements. Ortega's announced priority for his trip was to firm up oil-supply commitments from the Soviets; he also was seeking new sources for agricultural equipment and pesticides, as well as increased trade and financial support from West European countries. During Ortega's visits to West European capitals, he also requested increased trade and financial support to offset the sanctions. [redacted]

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Before the Embargo

Before the announcement, Nicaragua had anticipated the sanctions and redirected trade away from the United States. During the past several years, the Sandinistas aggressively hammered out new trade pacts with a variety of Communist Bloc, Middle Eastern, Latin American, and West European countries. Meanwhile, Managua's purchases from the United States plunged from \$247 million in 1980 to \$110 million in 1984. At the same time, Managua's sales to the United States fell from \$214 million to \$58 million. [redacted]

The Soviet Bloc has been generous in their statements of support, and some new commitments of trade and aid were forthcoming. According to official Sandinista announcements, the Soviets assured Ortega of petroleum deliveries representing 80 to 90 percent of Nicaragua's overall oil needs for the rest of 1985, a policy already in effect before the embargo. We estimate that this oil is worth nearly \$120 million. In addition, the Soviet Foreign Trade Bank reportedly extended a new hard currency loan of around \$55-60 million on favorable terms, and at the same time Nicaragua opened new letters of credit for \$8 million worth of military deliveries. US Embassy reporting earlier had indicated that Ortega would request \$200 million in economic aid for 1985, but no new agreements were announced. [redacted]

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Much of this decline has been offset by soaring trade with the Soviet Bloc. In 1980, Managua imported \$1.5 million in merchandise from the Communists and sold them \$8.8 million worth of commodities. By 1983—the last year for which we have comprehensive trade data—Managua was importing \$135 million from the Bloc and selling them \$57 million worth of goods. According to preliminary reports, Nicaraguan trade with the Bloc continued its rapid rise during 1984, with increased oil from the Soviets leading the way. [redacted]

[redacted] substantial new aid and debt relief from other Bloc countries to support increased trade. We believe the sanctions encouraged these donors to increase commitments and accelerate disbursement schedules. During May, East Germany agreed to double economic aid disbursements from its 1984 level to \$54 million, Czechoslovakia provided new credits worth around \$20 million, and Romania and Poland donated

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various goods and transport equipment. Meanwhile, Bulgaria agreed in May to accept commodities in repayment of a \$6.5 million credit line it had granted earlier this year, while Czechoslovakia and Poland deferred principal repayments for five years. [redacted]

Nicaragua's recent appeals for new West European aid thus far have been generally unsuccessful, although these nations have voiced strong opposition to the US embargo. Only Sweden and Austria agreed to token increases in trade and aid beyond already promised levels. Following Ortega's visit, Spain made public an earlier decision to cut off export credits, citing growing debt arrearages. [redacted]

Many Latin American governments, according to press reports, have agreed to look for ways to assist Nicaragua in the coming months, but few concrete measures have emerged. One barrier to expanded trade is that Nicaragua and these countries export similar goods. A Mexican-Nicaraguan bilateral trade commission meeting in late May announced that Mexico would increase trade, but other reports indicate that Mexico's private sector is discouraging further official support. Mexico also has agreed to make some limited oil deliveries, but it is possible under terms more favorable than those of the San Jose accord.¹ Argentina announced that it will send a delegation to Managua to study expansion of trade credits. [redacted]

According to Sandinista press reports, Libya, Algeria, and Iran are planning increased oil aid to Managua, but the details are not clear. In the past, these countries have allowed Managua to resell crude on the market for hard currency, and then have given the Sandinistas several years to make repayments. Only the heavy Iranian crude could be used in the Managua refinery. We believe any new oil support would be in the form of petroleum for resale on the market, which would help Nicaragua in its hard currency situation but not affect actual petroleum supply problems. [redacted]

¹ The San Jose accord was set up by Mexico and Venezuela in 1980 to provide oil on concessional terms to countries in Central America and the Caribbean. [redacted]

Export Expansion Difficulties

Efforts to find alternate markets for meat and bananas, which made up the bulk of exports to the United States, have met with mixed success. The Sandinistas announced that they would sell beef to Canada, but we have seen indications that the Canadians have decided not to increase Nicaraguan imports at this time. [redacted]

Expansion of other exports to both the East and West continues to be hampered by low output and poor quality. Disappointing coffee, sugar, tobacco, and cotton harvests resulted from shortages of fertilizers and pesticides imported from the United States. [redacted] Libya, after examining samples, decided against importing Nicaraguan-grown tobacco for its cigarette-processing plant. In recent months, Managua replaced its Cuban tobacco advisers with Bulgarians, which may lead to increased tobacco sales to that Bloc nation. Press reports indicate that much of Nicaragua's sugar crop suffers from a rat-carried plague, [redacted]

Actions in the United States

Anticipating the trade embargo, the Sandinistas began making contingency plans in early 1985 to move their assets and companies out of the United States. Following through on earlier plans, Managua's World Credit Corporation headquarters was moved in mid-May from Miami to Canada. To minimize its susceptibility to an asset freeze, the Nicaraguan Central Bank has been trying to keep zero balances in its US bank accounts but has had difficulties because of poor management. [redacted]

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Rica. Targeted exports would not be readily identifiable as of Nicaraguan origin and would enter the United States under various industrial brands. For example, Tampa-based cigar companies could buy Nicaraguan tobacco, manufacture cigars in Honduran factories, and market the cigars in the United States. [Redacted]

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Operations of Aeronica, the profitable Sandinista airline, were hard hit by the embargo. [Redacted]

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[Redacted] the airline obtained 50 percent of its hard currency earnings from US routes. Aeronica has succeeded in establishing connecting flights in Mexico to serve the United States and is working on a similar arrangement with an international airline through other Central American countries. The airline had purchased a large supply of spare parts a few days before the embargo announcement, and its managers are making arrangements to pay back debts in an apparent effort to rebuild the airline's credit rating should the embargo end. [Redacted]

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Domestic Impact

At home, the Sandinistas have cited the US sanctions in calling for more sacrifice and in tightening economic controls. During May, the regime stiffened rationing of basic goods, ended payment of wages in kind, and set up exchange houses to counter black-market activity in foreign currencies. Beginning this month, all foreigners will be required to pay rent and land purchases in dollars to the Central Bank, which then will pay landlords and landowners in local currency. [Redacted]

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Circumvention of the Embargo

The Sandinistas, presumably drawing on Cuban expertise, also are taking steps to evade the US trade restrictions. [Redacted]

Domestic industry, already operating at less than half capacity before the embargo, is suffering shortages of vital equipment, spare parts, and raw materials that will cause additional downtime. For example, the US Embassy reported that maintenance problems had already idled more than half of Nicaragua's important shrimping fleet and that the embargo is compounding difficulties in obtaining parts for US-made boats. Even where the Sandinistas had stockpiled spare parts for key industries, shortages of imported raw materials are restricting production. [Redacted]

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[Redacted]

The Sandinistas also hope to channel some of their exports into the United States through witting and unwitting firms in Panama, Honduras, and Costa

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**Mexico: Shortsighted
Oil Policies Under
de la Madrid**

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Mexico is encountering problems meeting its oil development goals because of financing and marketing constraints. Efforts to maximize public-sector revenues from oil sales have caused Pemex, the national petroleum corporation, to fall short of critical maintenance, development, and exploration targets needed to sustain present petroleum production levels. Meanwhile, the country faces a continuing decline in world oil prices that would further erode petroleum revenues. Mexico's poor prospects for stemming the slide in oil revenues over the next few years probably will result in postponing needed investment in oil production for the remainder of de la Madrid's term in office.

1983-84. Consequently, Mexico's proved oil reserves dropped slightly for the first time last year.

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We believe, moreover, that Mexico City will be unable to meet its plan to boost oil production almost 60 percent in 1985-89 by drilling 1,000 new wells. Although the oilfields are technically capable of producing at this higher rate, we believe that the \$4.3 billion in outlays Pemex projected for its drilling program is less than 30 percent of actual drilling costs. Even the 1985 goal of discovering about 2 billion barrels of oil—six times more than last year's finds—appears to be out of reach for financial reasons.

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Impact of the Financial Crisis

Since the financial crisis in mid-1982, the government's dependence on oil revenues has increased sharply as foreign lending and investment have dried up. In turn, Mexico City has pushed Pemex to decrease the costs of production and distribution to boost net oil earnings and repay the large foreign debt accrued by the company during the oil boom years. As a result, Pemex in 1984 earned profits equal to more than 55 percent of revenues, compared with deficits of almost half of total earnings in 1981, the US Embassy reports. Moreover, Pemex reduced its debt by \$4 billion to a little over \$17 billion in 1983-84.

Reduced exploration has been accompanied by other cutbacks that already are reducing Mexico's current production capacity. Pemex is lowering maintenance expenditures—estimated by the US Embassy to be more than 50 percent below budget—by easing standards, reducing parts inventories, and cannibalizing equipment. Operational problems have resulted when foreign purchasing constraints led Pemex to buy inferior domestically produced equipment. As a result, Pemex no longer has 300,000 b/d excess production capacity to use to meet unexpected demand.

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Caught in an Oil Glut

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The de la Madrid administration's difficulties in achieving its overall economic goals are compounded by the continuing fall in oil prices. Early this year the government cut the price of its light crude oil by \$1.25 per barrel to stem a slide in petroleum export volume. Many oil purchasers had refused to take large portions of their allotments in January and February until the government reduced the

Cost Cuts Frustrate Other Petroleum Goals

The oil company's focus on profitability, however, has hampered its exploration program and its ability to maintain production levels in future years. Because of the emphasis on current production and marketing at the expense of aggressive exploration, we estimate that actual outlays for investment reached only about two-thirds of budgeted levels in

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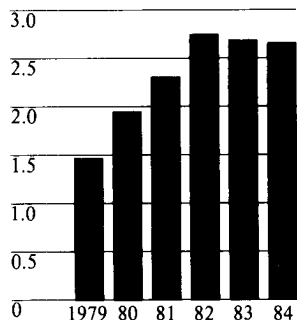
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Mexico: Selected Petroleum Indicators, 1979-84

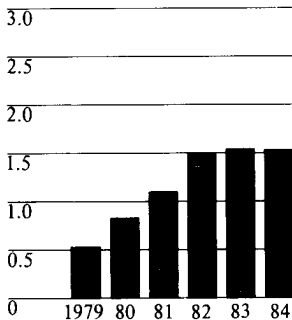
Average Daily Oil Production

Million b/d



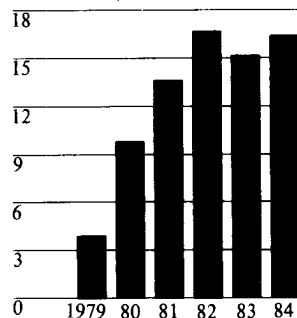
Average Daily Crude Oil Exports

Million b/d



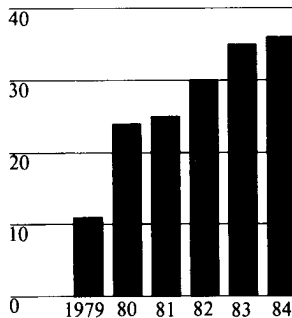
Oil Export Revenues

Billion US \$



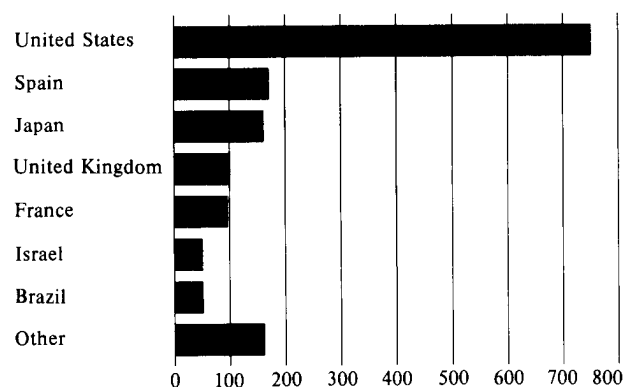
PEMEX Contribution to Public-Sector Revenues

Percent



Oil Purchases, 1984

Thousand b/d



cost [redacted] Even with the February price cut, which reduced projected revenues some \$300 million this year, the country still faces stiff price competition. Pressures from buyers are forcing Mexico City to consider dropping its average crude price by at least one dollar. Each additional dollar-per-barrel cut in light and heavy crude prices would cost Mexico some \$500 million annually. [redacted]

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Mounting competition from other producers is making it harder to secure annual sales contracts with foreign purchasers. Many US companies already are reluctant to sign long-term contracts, preferring to commit themselves for shorter periods to take advantage of price fluctuations. Despite Mexican rhetoric about reducing reliance on the US market—which accounts for about 50 percent of its oil exports—government officials are concerned that competitors will take a greater share of shrinking US oil purchases, according to the US Embassy. For example, Mexico City fears that Canada's aggressive sales and pricing strategies will reduce Mexico's shipments to the United States by about 60,000 b/d—about 8 percent of its current deliveries. [redacted]

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Mexico also expects that price cutting by US oil producers and rising protectionism among refiners will erode Mexico's previously secure market position. Independent refiners are pushing for higher US tariffs on refined products—particularly gasoline—that could cut into the refined product exports Pemex is counting on to offset losses in crude sales. Meanwhile, efforts to move away from the US market by boosting sales to Western Europe, Japan, and other Asian countries have met with little success. [redacted]

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[redacted]

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Limited Policy Options

Mexico City has little room to maneuver to respond to any drastic change in oil market conditions in the near term. With production near capacity and domestic demand rising, Pemex cannot boost output enough to offset a sharp drop in prices. Inadequate storage capacity also makes it difficult for Mexico City to vary exports in response even to short disruptions caused by bad weather or tanker scheduling problems. The de la Madrid administration supports the official OPEC price and will avoid dropping Mexican prices unilaterally, but we believe Mexico's need for revenues will lead to price adjustments necessary to meet export targets.

[Redacted]

and the President's concerns about declining petroleum reserves, Mexico City is unlikely to finance a significant increase in exploration activity. In an effort to offset declining reserves without incurring heavy costs, Pemex will continue to restrict exploration to the Bay of Campeche, where major discoveries already have been made and offshore drilling is inexpensive by international standards. Exploration in more risky but potentially promising areas will be avoided because of higher costs.

[Redacted]

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[Redacted]

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Nevertheless, Mexico City probably will try initially to stick to its present conservative policy of following the market, cutting back on price or production only after customers reduce their purchases.

[Redacted]

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We believe that Mexico probably will seek to reach its 1985 crude export goal of 1.5 million b/d by negotiating flexible sales contracts that allow for larger sales.

[Redacted]

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The government will try to maximize earnings by requiring overseas purchasers to take 40 percent of their imports in costlier light crude, according to industry press sources. Given Mexico City's present difficulties in selling its light oil overseas, however, Pemex probably will be forced to try to boost sales of its lower priced heavy crude. In addition, Pemex officials have announced that they will hike petroleum product exports—at competitive prices—to make up for any shortfalls in crude oil export earnings.

[Redacted]

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Dim Outlook

Prospects for stemming the decline in oil revenues during the remainder of de la Madrid's term are worsening. Despite elaborate development plans

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Bolivia: Grim Export Prospects

La Paz needs to increase exports to resume servicing its \$4.8 billion foreign debt, but domestic economic chaos and an unstable political climate preclude such an effort. Since 1980, Bolivia's export earnings have steadily contracted, and we project another earnings drop in 1985 because of the growing overvaluation of the peso and continued smuggling of export goods to circumvent price and foreign exchange controls. Despite Bolivia's rich resource base, we believe wide-scale changes in government policies are needed to restore export incentives.

Decline in Exports

A slide in world metal prices, chaotic economic policies, and political turbulence have caused a steady contraction in Bolivian exports. Between 1980 and 1984, Central Bank data indicate export earnings declined by more than 25 percent, while their share of GDP fell from 26 percent to 18 percent. Almost all commodities suffered setbacks during the period:

- Mineral exports declined almost 50 percent because of world recession, labor unrest in the mines, and the lack of new investment and exploration.
- Agricultural commodities, particularly sugar, coffee, and beef, plunged 80 percent as price controls have encouraged smuggling, and resources were diverted to coca production.
- Timber and other exports suffered from the overvalued peso, which undermined export incentives.

The only bright spot was natural gas exports—sold to Argentina under a long-term contract—which rose 70 percent and now account for one-half of foreign sales.

As a result of the export slump, Bolivia's debt service has become increasingly unmanageable. Judging from Central Bank data, interest and principal obligations as a share of exports doubled

Bolivia: Commodity Exports

Million US \$

	1980	1984 ^a
Total	1,035	763
Natural gas	221	374
Tin	377	214
Silver	118	36
Other metals	110	73
Petroleum	23	16
Sugar	52	12
Coffee	21	7
Timber	31	7
Other	82	24

^a Estimated.

to 56 percent between 1980 and 1984. Western credits are unavailable because La Paz has refused to negotiate an IMF-supported adjustment program. La Paz halted all payments to private foreign creditors last June. Overdue interest to commercial banks totaled \$127 million by the end of 1984.

Eroding Export Competitiveness

Weak international tin prices are only one facet of Bolivia's growing lack of competitiveness in world markets. Since 1980, tin production has fallen from 30,000 metric tons to an estimated 18,000 tons last year because of a lack of funds necessary to upgrade equipment and to purchase replacement parts.

Bolivia is the world's highest cost tin producer. The US Embassy reports the government currently

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Cocaine and the Current Account

Bolivia's flourishing cocaine trade bolsters the economy, but at the expense of legal exports earnings. Although over 90 percent of the estimated \$2.5 billion earned through the drug trade during 1984 remained in bank accounts outside the country, the proportion that flows back supports extensive drug-trafficking networks, including farmers who produce coca leaves. [redacted]

[redacted] we estimate that \$150-200 million in drug money was remitted to Bolivia last year, making coca Bolivia's third-largest foreign exchange earner. Because coca production is so lucrative, however, it drives farmers away from cultivation of legal crops. [redacted]

[redacted] a farmer in the fertile Santa Cruz region, for example, could earn 10 times more money producing coca leaves than banana or citrus crops destined for export. [redacted]

loses over US \$6 on every pound of tin it sells. Nevertheless, tin mining still accounts for about 30 percent of Bolivian export earnings. [redacted]

Bolivia's other mineral exports have also witnessed a loss of competitiveness, which has caused export volumes to contract since 1980. New exploration activity has nearly ceased in the face of foreign exchange shortages for imported equipment and onerous corporate taxes. Moreover, mismanagement, heightened by a 1983 decree that gave workers majority representation on the board of directors of the state mining corporation, has impeded investment in cost-saving technology. Press reports indicate that frequent work stoppages and strikes plague the minerals industry, disrupting exports and hastening Bolivia's displacement by alternative suppliers. A national strike in March cost the mining industry \$15 million in lost foreign exchange, according to Embassy reporting. [redacted]

Agricultural and other exports have been harmed by the government's failure to devalue in line with inflation, which is currently running at an 8,200-percent annual rate. Growing price controls have

led to a massive diversion of export trade into contraband channels, with up to 50 percent of some commodities—gasoline, flour, sugar—crossing the border illegally, according to Embassy reporting. The government must authorize all trade in agricultural commodities and sometimes bans export sales when domestic supplies are perceived to be insufficient. In addition, many farmers, attracted by the returns offered by cocaine, have abandoned production of legal crops. [redacted]

Although sales of natural gas have increased, this trade is vulnerable. Argentina is Bolivia's sole customer for natural gas, but US Embassy reporting suggests that energy-rich Argentina views the purchases as economic assistance. Although Buenos Aires is under contract to continue purchases through 1992, it has indicated it would suspend the contract in the event of a coup in Bolivia. [redacted]

Bleak Near-Term Prospects

The current policies of the politically weak, lame-duck Siles administration are further undermining export performance. Despite a large devaluation in May, the US Embassy indicates the black-market foreign exchange rate is still almost four times the official rate. Although private exporters are now allowed to keep 30 to 40 percent of their foreign exchange earnings, production for export remains unprofitable because of the overvalued peso and spiraling production costs. [redacted]

We believe the current economic disarray will impede export recovery this year. Work stoppages and strikes will probably continue to halt export production periodically. Despite a policy of periodic devaluations, inflation, likely to move into five digits because of the inability to restore fiscal discipline, will worsen the overvaluation of the currency. Price controls will continue to exert a chilling effect on export activity by encouraging smuggling. Moreover, commodity prices will remain weak through the end of the year. We believe Bolivia's exports will drop another 20 percent to

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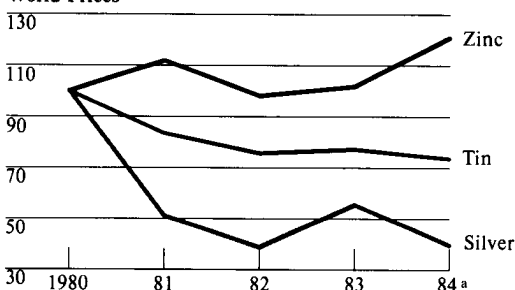
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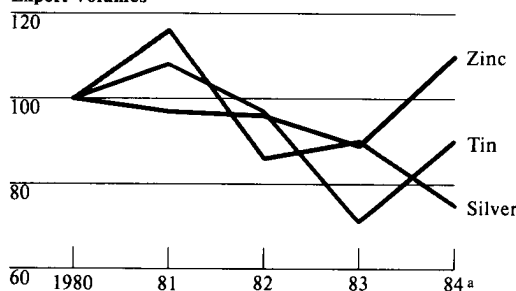
Bolivia: Key Export Trends, 1980-84

Index: 1980=100

World Prices



Export Volumes



^a Estimated.

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\$600 million in 1985. Foreign exchange earnings will likely be even lower because the Argentines have consistently fallen behind in paying for natural gas shipments, according to US Embassy reports. [redacted]

With the continued decline in exports, Bolivia will be unable to resume debt servicing this year. The country will owe \$1.3 billion this year on its \$4.8 billion external debt, according to the Planning Ministry, yielding a debt service ratio of nearly 220 percent. We judge that only a major debt rescheduling with highly concessional terms would enable the country to resume payments. [redacted]

[redacted] La Paz is proposing a 20-year repayment plan, with an eight-year grace period on principal and perhaps interest. Without an IMF-supported program, however, bankers would be unwilling to grant such debt relief. [redacted]

Longer-Run Outlook

The successor to Siles, expected to assume office in August, must find a way to increase exports to 25X1 lessen economic constraints. Rational development of the rich natural resource base could help turn around the export performance. World Bank studies indicate there are sizable natural gas reserves that could be developed for export to Brazil although negotiations have stalled because of Bolivian domestic criticism and inability to secure financing for a pipeline. In addition, oil and lithium deposits could be developed profitably [redacted] 25X1 [redacted] The fertile lowland provinces also 25X1 could yield sizable export crops, according to the 25X1 World Bank. [redacted] 25X1

We judge progress in fully realizing this export potential will be slow. The next administration will 25X1

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need to revamp policies to diminish economic uncertainty and provide export incentives:

- Fiscal and monetary discipline will be necessary to break hyperinflation and resuscitate production.
- The gap between official and black-market exchange rates must be eliminated through large-scale devaluations.
- Price decontrol will be necessary to discourage smuggling, and farmers must be wooed away from coca cultivation.

Beyond these measures, La Paz will need to revitalize its private sector and provide incentives to bring in multinational investment to develop the mineral and energy sectors.

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Chile: Favorable Export Outlook

Santiago is focusing on expanding exports to meet its debt service obligations, and, despite a setback last year as copper revenues fell, copper will remain the key earner of foreign exchange. Chile is trying to find new markets, but Western Europe, Japan, and the United States probably will continue to take the major export share. We believe that aggressive devaluations and enhanced marketing could bolster total export sales as much as 7 percent in 1985, and, barring new external shocks, we believe exports could expand at about a 12-percent average annual rate during 1985-87. Nonetheless, to meet its desired 4- to 5-percent economic growth targets and its growing debt service obligations, Chile needs about \$2 billion in new foreign borrowing over the next three years.

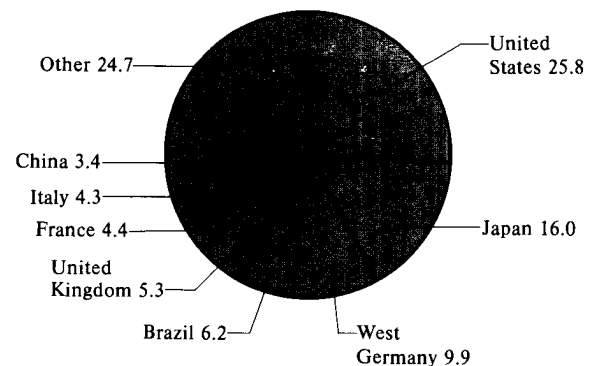
Export Performance in Perspective

Throughout the 1970s, free market reforms—such as removing subsidies, cutting tariffs, decontrolling prices, and boosting savings—permitted new export-oriented investments, which, combined with exchange rate reform and a policy of flexible devaluations, enhanced Chilean export competitiveness. As a result, exports doubled to \$4.8 billion between 1975 and 1979. Despite this success, the government abruptly shifted to a fixed exchange rate in 1979. This had the desired effect of cutting inflation, but it also resulted in a 22-percent plunge in exports by 1982. Flexible exchange rates were reinstated in 1982, and this helped exports grow nearly 4 percent in 1983.

Although Chile expanded its export volume in 1984, total export revenues fell. Copper revenue—the export mainstay—and sales of other mining products fell as world demand and prices remained depressed, and this more than offset healthy increases in sales of agricultural, forestry, and marine products. Although arms sales—estimated at over \$100 million in 1984—still account for a small

Chile: Exports to Main Markets, 1984

Percent



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share of overall exports, the emerging Chilean arms industry opened a new Middle Eastern market, selling cluster bombs to Iraq.

Santiago also sought new markets in 1984 to offset lackluster sales in traditional markets. Japan showed a 70-percent increase in purchases, largely for copper, agricultural, and fish products. Brazil increased purchases by 38 percent, and China expanded its purchases from Chile's fishing industry. In contrast, Chile suffered export declines in West Germany, the United Kingdom, France, and Italy, which purchase nearly 25 percent of the country's exports. The United States—the largest

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14 June 1985

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Chile: Commodity Exports, 1982-87

Million US \$

	1982 ^a	1983 ^a	1984 ^a	1985 ^b	1986 ^b	1987 ^b
Total exports	3,706	3,835	3,691	3,948	4,602	5,148
(Percent increase)	3.4	3.5	-3.7	7.0	16.6	11.9
Mining products	2,368	2,558	2,300	2,486	2,890	3,230
(Percent increase)	-4.1	8.0	-10.1	8.1	16.3	11.8
Copper	1,684	1,871	1,700	1,810	2,115	2,416
(Percent increase)	-3.1	11.1	-9.1	6.5	16.9	14.2
Agricultural products	375	328	448	404	484	582
(Percent increase)	2.7	-12.5	36.6	-9.8	19.8	20.2
Marine products	412	445	484	455	478	516
(Percent increase)	25.0	8.0	8.8	-6.0	5.1	8.0
Forestry products	342	324	383	397	445	490
(Percent increase)	-9.3	-5.3	18.2	3.7	12.1	10.1
Other	209	180	76	206	305	330
(Percent increase)	-29.5	-13.9	-57.8	171.0	48.1	8.2

^a Based on Central Bank statistics.^b Estimated.

single market—cut imports 12.2 percent, as copper purchases fell. [redacted]

The Export Imperative

Santiago is redoubling its efforts to encourage exports to eliminate its projected \$1.1 billion current account deficit this year. Santiago announced on 13 April that exporters will be able to reduce value-added tax liabilities for domestic sales by an amount equal to 20 percent of their exports. Moreover, press reports indicate that the government wants domestic arms producers to expand trade with Iraq and other Third World countries. Santiago is encouraging domestic producers to increase the value of copper exports by switching to the fabrication of wire and tubing [redacted]. The government is also considering providing enhanced marketing services to exporters, by increas-

ing representation at overseas trade fairs and seeking new markets for all of its exports:

- Santiago wants to increase its copper sales in Europe and the Far East to become less dependent on the US market.
- The government is pushing exports of fish to Japan, Far Eastern LDCs, Spain, and South Africa.
- Chile intends to expand the marketing of forestry products in South America and China. [redacted]

Should copper prices recover to an average \$0.67 per pound this year, as predicted by Chase Econometrics, we estimate that Chile's aggressive devaluations and export promotion plans will probably result in about 7-percent overall export growth in 1985. We believe CODELCO—the state mining company—will again boost copper production between 2 and 4 percent this year, causing export

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revenues to rise about 6.5 percent. Much of the additional volume probably will go to Japan, South Korea, and China. We also believe forestry exports are likely to increase by about 3.7 percent, but falling world prices will probably reduce agricultural export value 10 percent. We judge arms sales will be brisk—over \$100 million—as Chilean producers fill new orders in the Middle East. Additionally, arms sales could expand in Central America and West European countries. [redacted]

We believe agriculture and forestry products will experience the strongest growth. Forecasts of increasing prices and Santiago's aggressive marketing strategy—especially in Asia—should enable agricultural exports to rebound in 1986 and continue this growth in 1987. Meanwhile, forestry exports probably will grow to \$490 million in 1987. We believe paper and pulp sales probably will expand in South American countries, and all types of forestry products probably will be sold to China. Marine products will grow modestly from their 1984 level because of overfishing, but Chile's increasing marketing efforts in Third World countries—including those embargoed by the United States—should enable arms sales to reach well over \$200 million. [redacted]

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Longer Run Expansion Plans

Over the next few years, we believe Santiago will continue to pursue policies designed to capitalize on its established export base and to benefit from a recovery in world commodity prices. The government will probably concentrate on providing concessionary credit through the state development corporation for established export products while encouraging increased processing of commodities and higher quality standards to develop new markets. We believe Chile will continue to devalue the peso to improve the competitiveness of its products. According to press reporting, the government may also implement a differentiated tariff structure to favor imports of goods used in export production. The shortage of investment funds, however, is likely to impede research and development of new manufactures exports. [redacted]

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Continued Financing Needs

Santiago hopes that expanding exports will cover its debt service obligations and support a 4- to 5-percent domestic growth rate over the next several years. Judging from Chilean Government, US Embassy, and our own projections of exports and available foreign financing, Chile will still need additional new commercial lending. Santiago would require nearly \$1.9 billion in new commercial credits over three years—\$1 billion in 1985, \$600 million in 1986, and \$260 million in 1987. We believe Santiago will continue seeking new financing from official and private sources, particularly in the United States. [redacted] financial press reports indicate, however, that commercial banks will cover at most \$1.3 billion of the shortfall. The prospective \$600 million foreign financing gap will probably force the government to toughen austerity measures, reduce imports, and draw down reserves. We believe such measures will contribute to social restiveness in Chile at a time of growing national debate over the transition to civilian government. [redacted]

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Export earnings could expand by as much as 40 percent over the next three years if copper sales remain strong. [redacted]

[redacted] Chile will continue to reinvest earnings to expand copper production—the rate of return on investment even at the present low prices is averaging 24 percent. On the basis of Chase Econometrics world market forecasts,¹ we project that Chile's copper earnings will rise by as much as 40 percent to \$2.4 billion by 1987. New production will probably be directed largely at Chile's main trading partners, but Santiago will have some success in developing markets in South Korea and China. [redacted]

¹ Chase estimates copper prices will rise from an average of \$0.63 per pound in 1984 to \$0.84 per pound in 1987, while Chilean copper production expands by over 6 percent. [redacted]

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Sudan: The Limited Role of the Private Sector



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Sudan's more immediate problems—including IMF arrearages and the government's reluctance to adhere to a previously agreed upon package of reforms and austerity measures—tend to obscure more fundamental economic problems. Efforts by the struggling military/civilian government in Khartoum to simultaneously stimulate a comatose economy, cope with a staggering debt repayment schedule, and deal with famine and insurgency dramatize the seriousness of Sudan's plight. As a first step, we believe Sudan needs to abandon a longstanding preference for statist economic solutions and move toward more decentralized private-sector participation in the economy.

A Pentchant for Public-Sector Solutions

Sudan's economic development over the past 10 years includes a string of unsuccessful IMF-sponsored economic stabilization programs. In each case, Khartoum agreed to undertake major reforms to increase resource mobilization by the central government and correct distortions in the economy. Almost invariably these programs have bogged down, partly because of factors beyond the regime's control, but mostly as a result of inconsistent or heavyhanded government policy implementation.

A preference for government control over all facets of economic activity appears deeply ingrained in the political and cultural experience of the Sudanese. Arab socialism promulgates the concept of the state's responsibility to provide goods and services to the public. This attitude is reinforced by the Islamic construct of *umma*, which obligates the ruler to provide for the welfare of the community. Within this context, private economic initiatives are often seen as representing exploitive threats to the peoples' well-being.

Obstacles to Expanded Private-Sector Role

Despite Sudanese lipservice to greater private-sector participation, obstacles to private enterprise have grown over the past several years. In particular, the Islamization of the legal system has threatened elimination of the limited-liability business organization and also has introduced a vast number of minor, and often confusing, changes in business law. Moreover, foreign exchange rules adopted in February banned private-sector participation in the foreign exchange market and disrupted the flows of remittance earnings and private-sector import financing.

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Perhaps the greatest threat to the private sector has come from the creation of the Military Economic Board (MEB). In the past two years, this parastatal has moved into direct competition with private enterprises. Its preferential access to government funds and leaders allowed it to absorb many public-sector firms, form joint ventures with foreign firms, and organize several new subsidiaries. Donor pressure in the past year has reduced the MEB's preferential access to funds, and the new military leaders have suspended most of its operations pending corruption and waste investigations. The continued existence of the MEB will, however, remain a major obstacle to private-sector development.

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Agriculture: The Need for Divestiture

The sluggish performance in the irrigated agricultural sector—which produces almost all of Sudan's cotton, wheat, and sugar—is attributable to overcentralization and lack of private initiative. Cultivation is concentrated within five huge state-owned

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“schemes.” Management boards appointed by the central government dictate what is planted by the tenant farmer and also control access to agricultural inputs and capital. This management system has proved unwieldy and inefficient and has led to costly mistakes in resource allocation. [redacted]

The management-board-tenant relationship has also provided little incentive for farmers to maintain an active interest in field and equipment maintenance. Tenants tend to view problems such as breaks in canals and ruptures in pipes as the responsibility of management. As a result, in recent years there has been a marked physical deterioration within the major irrigation networks. [redacted]

The Sudanese response to problems in the irrigated sector concentrates on state-sponsored infrastructural rehabilitation and removal of financial disincentives for tenant farmers. In conjunction with international donors, principally the IBRD, irrigation canals are being dredged and access roads improved. Export taxes on crops such as cotton have been abolished, and management is providing tenants with added financial inducements. These measures may raise output, but they do not represent a long-term solution to the problem. Canals and access roads, once rehabilitated, will soon fall into disrepair again unless farmers are given reason to take a much more personal interest in the land. [redacted]

The need for private ownership has, however, been virtually ignored by Khartoum and international donors alike. Sudan’s leadership probably bases its opposition on deep-seated skepticism that farmers could manage irrigated systems without government supervision. Donor reluctance to push private ownership relates to Sudan’s already serious economic plight and the fear that further administrative turmoil in the agricultural sector could lead to an even worse situation. [redacted]

Prospects for Change

There appears to be little prospect that the change in government will produce a shift in Sudanese attitudes toward privatization. Both military and

civilian members of the provisional government are more concerned with correcting abuses within public-sector enterprises than in launching any bold economic initiatives. Moreover, outspoken criticism by high-level Sudanese officials of IMF policies probably ensures a hostile reception for the private-sector expansion, which the Fund emphasized as integral to reform. Most recently, the private bankers committee charged with setting the new exchange rate was denied permission by government authorities to adjust the rate—a clear violation of the understanding that had been reached with the IMF before Nimeiri’s fall and a major blow to currency reform efforts. [redacted]

Although donors have made repeated attempts to rekindle Sudanese interest in private-sector initiatives, a large gap remains between rhetoric and substance. Under the old regime the government restructured many public enterprises and registered them under standard business laws. Although these firms are listed as private, full ownership and control remains in government departments. Donors probably will not accept such cosmetic changes as representing progress toward private-sector participation in the economy. [redacted]

A reorientation of funding by major donors is probably also necessary. Currently the major share of funds is allocated to the public sector, which is where the large unfinished or poorly maintained projects are found. Donors, for example, could tie loans for the irrigated agricultural sector to transfers of land to existing tenants. [redacted]

Ultimately, no amount of donor pressure will suffice unless the Sudanese themselves are convinced of the necessity to decentralize and expand the private sector. Such acceptance would require a long-term modification of existing political and cultural values making the near-term outlook for private-sector development in Sudan bleak. [redacted]

[redacted]

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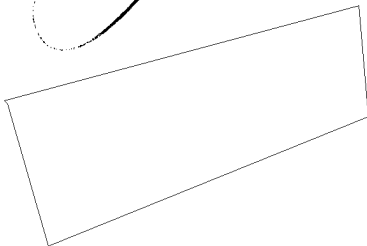
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Briefs

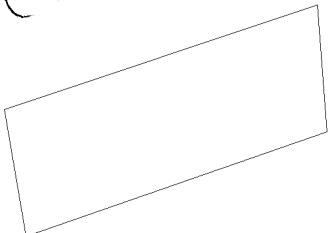
Energy

French-Soviet Gas Contract Renegotiation



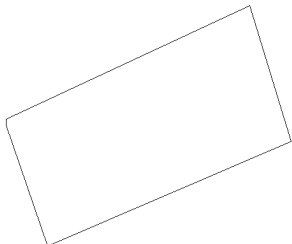
Gaz de France, the French state gas firm, has negotiated a reduction in the price of Soviet natural gas imported under its 1982 contract, [redacted] 25X1
[redacted] In the face of falling oil prices, the Soviet Union has lowered the price 7 percent to a level believed equivalent to the Soviet-Italian gas price of \$3.40 per million Btu. Because of French concerns about a possible oversupply of gas in 1986, the Soviets have also agreed to a postponement in maximum deliveries from 1986 to 1990, as well as a 20-percent downward flexibility in the original peak contract volume of 8 billion cubic meters (bcm) to 6.4 bcm annually. France currently imports nearly 80 percent of its natural gas requirements, receiving about 17 percent of its demand from the Soviet Union. In the 1990s, however, France could be dependent on Soviet gas for as much as 35 to 40 percent of French demand, unless new sources are developed at competitive prices. [redacted] 25X1

Italian-Libyan Natural Gas Dispute



The Italian-Libyan mixed commission will meet on 2 July to resolve the dispute over Italian purchases of Libyan liquefied natural gas (LNG). The Italian contract for 750 million cubic meters of LNG expired at the end of April, and Italy chose not to take any LNG during the summer. In response, Tripoli stopped oil shipments to Italy under its debt-repayment program. Libya wants a long-term contract with Italy as a matter of principle, because its neighbor Algeria has such a contract. Libya's LNG capacity is estimated to be less than 2 billion cubic meters annually and suffers from deteriorating facilities, [redacted] Tripoli is expected to demand both higher prices and higher quantities in a future long-term contract, but Rome is likely to resist because of the current gas surplus resulting from its rising imports of LNG from Algeria. [redacted] 25X1

Easing Iranian Policy on US Oil Equipment Purchases



Tehran has established new import guidelines that allow the National Iranian Oil Company (NIOC) to buy some US petroleum equipment, [redacted] 25X1
[redacted] The guidelines stipulate that only spare parts, and not whole units of machinery, can be purchased from the United States. [redacted] 25X1
[redacted] however, since the new policy took effect in March 1985, NIOC has placed orders for whole units of US oilfield and refining equipment by describing them as a "spare part." Much of the US-manufactured petroleum equipment in Iran is not operational or has deteriorated considerably over the past six years, and recent efforts to increase oil production could lead to substantial purchases [redacted] 25X1

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Kuwait Pushes Refined Products

Kuwait Petroleum Company (KPC), the state-owned oil company, has grown increasingly aggressive in selling its petroleum products. KPC—which refines more than half of its crude into products—fears that the addition of 500,000 b/d of Saudi refining capacity by the end of the year will further weaken an already soft market. To attract customers, KPC is pricing its products as much as \$1 per barrel below market levels. KPC is moving to expand its exports to Asia—which already purchases more than one-third of Kuwait's product exports—and has recently bid successfully on several deals on the Indian subcontinent. [redacted]

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Ecuador Boosts Oil Production Capacity

Quito completed the installation of additional pumps along the Trans-Ecuadorean Pipeline in late May, boosting the country's oil production capacity to about 300,000 b/d, according to the US Embassy. Despite the soft oil market, capacity has climbed more than 50,000 b/d over the past year as Ecuador brought new fields into production and started injecting water into its largest producing field. Production hit a record 282,000 b/d in May—about 100,000 b/d above Ecuador's OPEC quota. Quito steadfastly defends its policy of expanding output against sharp criticism from OPEC members—particularly Venezuela and Saudi Arabia. It plans to request an increase in its quota to 280,000 b/d from 183,000 b/d at the next OPEC meeting, scheduled for 30 June. Ecuador intends to continue expanding production even if its request is denied, as is likely. [redacted]

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International Finance

Egyptian Financial Outlook Worsens

Egypt faces a growing external deficit. The Embassy believes that the deficit for the fiscal year ending this month is likely to exceed its earlier projection of \$375 million in contrast to last year's \$162 million surplus. An IMF team that recently returned from Egypt reports that the financial gap for the 1985 fiscal year can only be closed with substantially increased aid or debt rescheduling. Egypt's principal foreign exchange earners—oil sales, workers' remittances, and Suez Canal earnings—are stagnating or falling. Moreover, the Fund believes that recent actions to relax foreign exchange controls and increase bread and energy prices have done little to stem the flow of red ink. Egypt has approached the Fund for a standby credit, but reaching an agreement will prove difficult and time consuming. An IMF-supported adjustment program probably will focus on raising prices and interest rates, cutting the government's budget, and further reforming the foreign exchange system. The government, however, would not accept any program that comes down too hard on the populace or gives the appearance of "caving in" to the IMF. [redacted]

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Cuba Reaches Paris Club Agreement

Havana and its official creditors have agreed on performance targets, paving the way for the rescheduling of 1985 debt principal. Although the terms are generous—particularly considering that Havana failed to meet six of nine

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targets last year—we anticipate that Cuba will have difficulty meeting several of the new targets. For example, we believe Havana will fall far short on increasing nonsugar hard currency exports by 44 percent this year. The short-term outlook for hard currency nickel and citrus earnings is bleak. Stagnating Soviet oil deliveries and Cuba's growing domestic energy needs also limit potential earnings from fuel reexports. Moreover, bureaucratic tangles prevent the development and marketing of nontraditional exports. We believe that goals for sugar exports to the West are also overly optimistic because of production problems and Havana's vow to fulfill its sugar quota to CEMA countries. Disappointing hard currency export earnings plus an anticipated 11-percent increase in Western imports probably will push the hard currency current account deficit this year far above the \$48 million approved by Paris Club creditors. As a result, the agreement may be reexamined, either later this summer, when repayment terms are negotiated, or during a formal review proposed for October [redacted]

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Czechoslovaks Enter Loan Market

Czechoslovakia has entered the international loan market for the first time in two years and probably will obtain a \$100 million syndicated credit at rates much better than those recently received by the USSR and East Germany. The excellent terms result from competition among banks and Prague's excellent hard currency payments picture—rather than its general economic performance that has not been good. This signals a break in the policy of not borrowing in the West in order to eliminate foreign debt and thereby prevent any economic leverage. The credit terms probably made it easier for Czechoslovak financial officials to convince senior policymakers that the policy should be eased. Czechoslovakia will also find it easier in the future to borrow at competitive rates by reestablishing a presence in the international credit market.

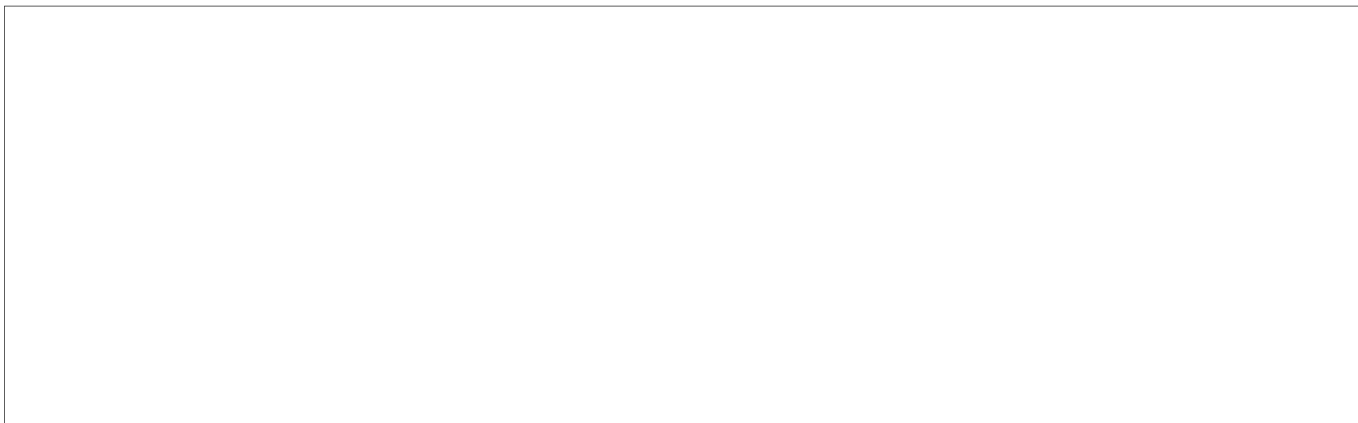
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Global and Regional Developments

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African Cloud-Seeding Efforts

Several African countries are preparing to start cloud-seeding projects to help alleviate the drought. [redacted] Nigeria may soon approve a US \$10 million contract with a Bahamian-registered firm. Libya, which has run a Western-assisted program since 1981, recently met with several other African nations, including Morocco, to establish joint projects. Tripoli is reportedly eager to use such programs for political good will—especially with Sudan. The head of Libya's Department of Meteorology will chair an OAU feasibility study of a multinational project and has met privately with a US firm to seek assistance. Given the high costs of such programs, the major benefits are more likely to be political than agricultural. It is doubtful that any additional rainfall from seeding would justify the expense of personnel and equipment. Effective soil and water conservation programs, designed to make better use of natural precipitation, would be a more efficient use of available funds. [redacted]

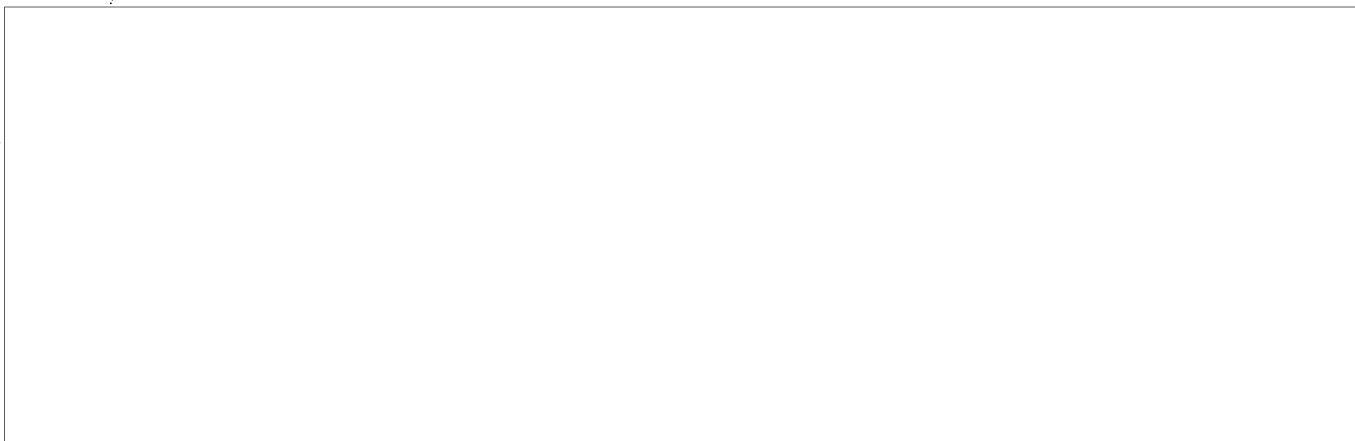
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National Developments

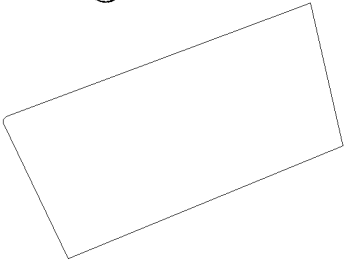
Developed Countries



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*West German Inflation
a Bright Spot for Kohl*



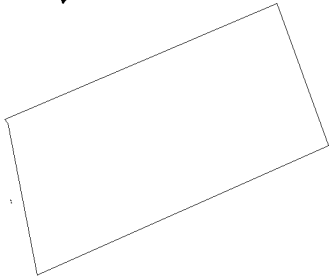
Despite rising import prices—up nearly 7 percent over first quarter 1984, mainly because of the strong dollar—inflation held at just 2.3 percent in first quarter 1985, and continued low in April. A disciplined monetary policy, fiscal restraint, and modest wage increases in the face of high unemployment counteracted the import price pressure. With the easing of the dollar in April and relative stability since, inflation promises to be at least one important economic issue Chancellor Kohl does not have to worry about for the remainder of the year. Polls show that the West German public's traditional fear of inflation has diminished markedly since his government took office.

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*Sluggish Spanish
Growth To Prompt
More Unemployment*



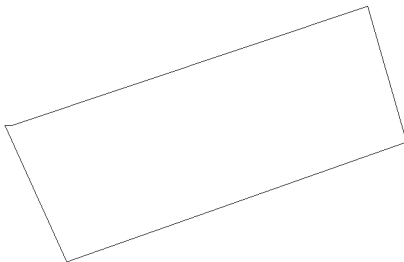
Preliminary first-quarter GDP growth of only 1.5 percent, at an annual rate, indicates Spanish unemployment—already 22 percent—almost certainly will rise again in 1985. As a result, the Bank of Spain has lowered its forecast for 1985 GDP growth to less than 2 percent—the government originally expected 3 percent. Central Bank economists have become more pessimistic because real wage losses and high unemployment have kept private consumption flat and because investment has turned up only marginally. Spanish officials now project that up to 150,000 jobs will be lost this year, which we estimate would raise the unemployment rate 1 percentage point. On the bright side, inflation—on a December/December basis—is expected to fall from 9 percent to 7.5 to 8 percent. Despite the likelihood of rising unemployment and mounting criticism from labor unions, we expect that the Socialists will continue their efforts to liberalize the economy and restructure industry.

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Israeli Labor Unrest



The US Embassy reports an increase in labor strikes and in work actions following a general calm during the first seven months of the national unity government. Protests arising from declining economic conditions are under way by teachers, doctors, taxi drivers, and court employees, and by textile workers at one financially strapped plant. A large demonstration on behalf of the textile workers was slated for this week, and work actions are expected soon by other public employees. The government's band-aid approach to curing the nation's economic ills has unevenly distributed the burden of austerity, and pressures remain for more broadly based economic measures. The government's preoccupation with security issues, however, reduces the likelihood that it would risk alienating labor as a bloc by continuing to turn the economic screws too hard in the near term.

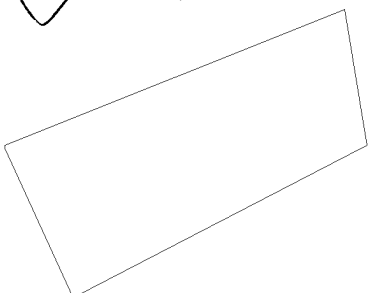
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Less Developed Countries

*Argentina's Economic
Team*



The lack of coherence that plagues Argentina's economic policy is evident in the views of two of President Alfonsin's principal economic advisers. Economy Minister Sourrouille would like to implement a five-year development plan that stresses private investment and agricultural and energy exports. Citing inflation as Argentina's most pressing short-term problem, Sourrouille's plan

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supports cutting the budget deficit by reducing public spending and divesting some public corporations. Central Bank President Concepcion, on the other hand, who favors expanded state intervention in the economy, is representative of old-line politicians in the ruling Radical party. He supports rapid devaluations to make Argentine goods more competitive and favors new restrictions on banking transactions. We doubt that Sourrouille's call for a reduction of the public sector will find much favor in the Alfonsin administration, which is hesitant to rely on free market principles.

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Nicaraguan Wildcat Strikes

About 500 workers at two factories in the important industrial city of Granada staged wildcat strikes last week to protest the government's decision to prohibit workers from being paid in merchandise. Authorities cited the need for more sacrifices as a result of the US sanctions. A clash with police resulted in 20 arrests and 10 injuries. The stoppages are the first since the regime effectively prohibited the right to strike late last summer. The new restrictions will further erode incomes because salaries in kind had permitted workers to double their wages by selling the merchandise on the black market. Consumer price inflation is currently running more than 100 percent annually, and wages have not kept pace. The regime will continue to deal firmly with strikes, but sporadic resistance is likely.

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Sudan-Libya Aid Pact Defined

Libya will supply 300,000 metric tons of crude oil to Sudan over the next six months under the terms of a recently signed petroleum accord. Deliveries of 50,000 tons per month--55 percent of domestic demand--are scheduled to begin by late June. Sudan must provide transportation and pay shipping costs. In addition, six planes are en route to Sudan for use by the joint agricultural company established in May. Food and humanitarian assistance continue to arrive in Khartoum by plane, but the 1,000-truck convoy from Libya has not materialized. Khartoum's new military leaders will be hard pressed to monitor the growing number of Libyans entering Sudan who probably will be used to influence the new regime or foment unrest should relations sour.

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Moroccan Devaluation Proceeding

The Moroccan dirham continues its slide, averaging—since January—11 percent against the US dollar, the French franc, and the deutsche mark. The government has yet to publicly acknowledge the IMF-suggested devaluation, which probably will reach the targeted 12 percent by the end of June. The opposition press, however, has highlighted the exchange rate movements and blamed them on pressure from international financial institutions. Nevertheless, the devaluation demonstrates Morocco's intention to abide by IMF financial guidelines—a key element in Rabat's forthcoming debt rescheduling negotiations with international creditors.

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Algerian Farmers Riot

Violence erupted recently in several communities in southern Algeria as farmers clashed with local authorities over land-allocation policies. Several

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dozen people were injured as tempers flared over foot-dragging by government officials and perceived favoritism in land grants. Since Algeria's land-distribution program began in 1983, 7,800 hectares of public land have been allocated in 3-hectare plots. An additional 12,000 hectares will be distributed this year, with a long-term goal of 70,000 hectares. Despite the recent protests, there is broad domestic interest in agrarian reform. The regime will have to move cautiously to avoid further unrest and criticism by remaining socialist hardliners opposed to President Bendjedid's reforms. [redacted]

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Zambian Miners Fired

Over 4,000 Zambian copper miners were fired after a wildcat strike over pay and benefits last week, according to US Embassy reporting. Tensions have flared over declining real wages as Lusaka has sought to boost food prices to encourage agricultural exports. As a result, union leaders are caught between rank and file demands and government efforts to diversify exports away from copper and cobalt, which account for over 90 percent of foreign exchange earnings. [redacted] Lusaka is under IMF pressure for a sharp devaluation and may agree to devalue during negotiations in mid-June. Although Lusaka successfully ended the latest strike, the devaluation would almost certainly add to Zambia's 20-percent inflation rate and trigger new walkouts. To avoid disruptions to the vital mining industry, the government may try again to bring the strong and independent unions under ruling party control. [redacted]

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Indian Economic Liberalization Continues

New Delhi has further eased government controls on private industry despite signs of mounting opposition to Rajiv Gandhi's liberalized economic policies. Large corporations no longer need special exemption from antimonopoly legislation before they establish or expand capacity in 27 industries, including electrical components, oil industry services, and fertilizers. Although the corporations must obtain an industrial production license, government approvals should be expedited by elimination of the formal opportunity for other manufacturers to object to their competitors' investment plans. The Cabinet has also approved a controversial proposal to permit domestic manufacturers to use the brand names of their foreign associates. In addition, New Delhi has reduced the share of cement output that manufacturers must sell to the government at controlled prices. [redacted]

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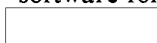
Indian Software Export Potential

Software development is expected to play a major role in Prime Minister Gandhi's campaign to expand India's technological capabilities. The development of software for export is receiving particular emphasis. With an abundance of trained, English-speaking software engineers and low labor costs, India has the potential to become a major player. Approximately 50 Indian firms are involved in software adaptation and development both for domestic use and for export. India has had a program to develop software for export since 1970, but production has been hindered by acute shortages of computer hardware. Nonetheless, software exports have more than tripled

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since the late 1970s, to about \$20 million a year. New Delhi plans to boost this level to \$300 million a year by 1990. Increased domestic computer production and the expected influx of advanced Western-origin systems in the coming years are expected to provide the equipment necessary for this expansion. By easing onerous production restrictions, New Delhi hopes to increase computer production by 20 times the current level of approximately 5,000 units by the 1990s. Indian software capabilities have attracted considerable foreign interest. Several major US computer companies are already purchasing Indian software services and more are interested. In addition, Norway has set up a software joint venture. Indian software promotion will almost certainly generate even greater interest in the Soviet Union, where software capabilities are weak. For some time the Soviets have used Indians to develop and convert Western-origin software for their computers, many of which are copies of Western machines.

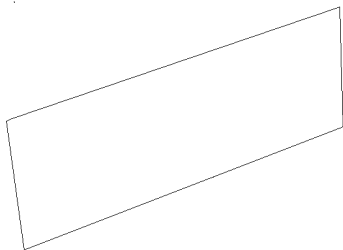


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Singapore Investment Ventures



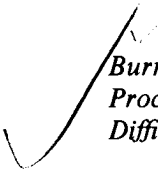
The government—struggling to revive an economic growth rate that slumped to a decade low of 3 percent (at an annual rate) during the first quarter of this year—has set up 11 companies to invest in as-yet-unspecified high-risk, high-technology ventures in the United States and elsewhere, according to press reports. The new firms, with capital assets of up to US \$64 million each, will be managed by the Government Investment Corporation. The firms are intended to provide Singaporeans firsthand experience with new technological developments and to help the government map out its strategy for redirecting the economy. Although the scheme will provide no immediate dividends, we believe it will firm up Prime Minister Lee's image as an economic activist at a time when traditional export industries are showing no growth.



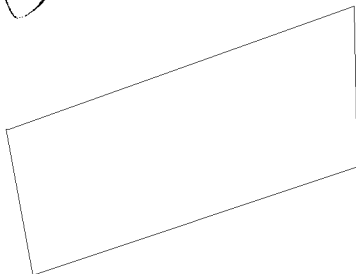
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Burma's Rice Procurement Difficulties



Rangoon's rice procurement during the fiscal year that ended in March fell 17 percent below target because farmers preferred to sell on the black market at substantially higher prices. Local officials are reluctant to press farmers to sell their rice to the government, however, fearing that they will lose votes in this fall's elections. Current export stocks are insufficient to fill outstanding commitments, and the shortfall probably will curtail exports this year. The US Embassy projects that exports will be no more than one-half of the 800,000 metric tons shipped in 1984. Moreover, domestic rice distribution problems will probably be aggravated, and government stores in outlying areas are already reporting shortages.

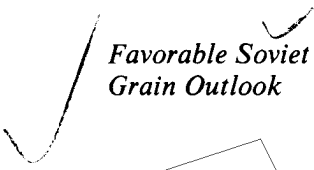


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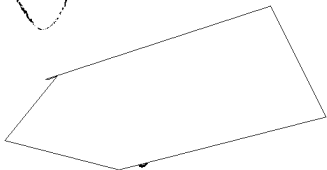
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Favorable Soviet Grain Outlook



Grain crop conditions in the USSR as of early June are mostly favorable. Serious crop damage from hot, dry weather during May was confined to parts of the Volga Valley, North Caucasus, Urals, and Kazakhstan—areas that produce less than 10 percent of the total harvest. In addition, the spring sowing is nearing completion on time despite earlier delays of two to three weeks,



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[redacted] the downward trend in total grain acreage—begun in the late 1970s—is continuing. With normal weather through July, the winter grain crop—roughly one-third of the total harvest—is likely to be about 65 million metric tons, second only to the record 86 million tons in 1978. The spring crop will be determined principally by growing conditions during the next three months. Even with ideal weather for the rest of the crop season, Moscow's target of 245 million tons is already well beyond reach, largely because the area sown to grain is expected to be one of the smallest since 1970. [redacted]

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✓ *Tacit Soviet Approval of Hungarian Reforms*

The party secretary for economics, Ferenc Havasi, told the US Ambassador in Budapest that the Soviets tacitly approved Hungarian economic reforms at the mid-May meeting of CEMA in Moscow. Havasi said the Soviets are willing to accept separate paths of economic growth by individual CEMA countries; they will tolerate, for example, some reduction in the extent of administered prices. He also believes that Soviet General Secretary Gorbachev will eventually implement his own long-range reform plans but must move cautiously. A source of the US Embassy in Moscow said that the USSR did not criticize East European economic policies at the meeting, "not even those of the Hungarians." This lack of criticism has apparently given the Hungarians confidence that they have at least a tenuous go-ahead—although not a ringing endorsement—for their reform program. [redacted]

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✓ *Expanding Chinese-Hungarian Trade*

Budapest and Beijing are planning a rapid expansion in economic cooperation and trade. Bilateral trade this year will increase by at least 50 percent to an alltime high of \$250 million, Chinese Vice Premier Li Peng—the most senior Chinese official to visit Hungary in recent years—signed the 1986-90 trade agreement in Budapest earlier this month calling for a doubling of trade over the previous five-year period. Li's visit was followed by the first meeting of the Sino-Hungarian commission for economic, scientific, and technical cooperation, which, among other things, will facilitate the exchange of experiences in the economic reform field. Hungary also promised to participate in unspecified Chinese development programs, and joint efforts will be expanded in agriculture, health, and education. Despite the upsurge in economic ties, we believe the Hungarians will await a Soviet lead before improving party-to-party relations. [redacted]

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✓ *New Chinese Technology Import Regulations*

China last week released regulations covering imports of technical information—including patents, prescriptions, product designs, blueprints, and production processes. The new rules establish approval procedures, restrict internal transfers of foreign proprietary information, and bar foreign suppliers of technology from interfering with China's right to set production and export levels and prices. The new rules are another step toward the creation of a stable and regulated business environment in China. Foreign businesses will

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probably view them as unduly restrictive, however, because of the difficulty in limiting China's export of goods produced under license. Businesses depending on royalties will also be displeased with clauses restricting their influence in determining the quantities and prices of goods. The language of the regulations, nonetheless, is sufficiently broad to allow for negotiation on all of these points.

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*Western China Railway
Nearing Soviet Border*

China plans to add some 400 kilometers to the single-track, Lanzhou-Urumqi railway, extending the line to within 50 to 80 km of the Soviet border by 1988. According to the Xinjiang Vice Governor, more than \$230 million will be invested eventually to link the standard-gauge Urumqi line to the Soviet broad-gauge rail system. The Chinese probably want to open the rail crossing quickly to facilitate expanding Sino-Soviet border trade. According to press reports, border trade through Xinjiang Province amounted to about \$55 million in 1983-84 and could reach \$69 million this year. Moreover, a crossing in western China would provide access to Soviet railways other than the heavily traveled Trans-Siberian railway. In addition, the new line will provide the Chinese improved access to their oil and mineral resources in the northwest.

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