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International Economic & Energy Weekly

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28 June 1985

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DI IEEW 85-026
28 June 1985

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28 June 1985

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28 June 1985

Perspective

Latin American Debt: Austerity and Political Strains [redacted] 25X1

Latin America is passing through its most severe postwar economic crisis at a time when the region is experiencing a resurgence of political democracy. The restoration of civilian government throughout Latin America continues to complicate national management of financial rescue programs. IMF-supported adjustment programs are sputtering, and the progress achieved by a few debtor countries in putting their economies in line is limited at best. [redacted] 25X1 25X1 The Andean debtors—Bolivia, Colombia, 25X1 and Peru—continue to avoid adopting a formal IMF-supported program, fearing domestic political consequences. [redacted] 25X1

Nonetheless, progress toward democracy and the popular pressures the transitions have unleashed have not forced the civilian leaders to act precipitously, in our opinion. Despite dire predictions in the press, the new leaders have avoided the temptation to form a debtors' cartel to extract easier debt repayment terms from creditors. Moreover, these leaders still recognize the need to stabilize their economies to maintain creditor support and lay a solid foundation for democratic institutions. Even so, public statements [redacted] 25X1 now indicate a growing number of Latin leaders are coming to believe that continued implementation of IMF-supported adjustment programs is politically risky and, if not executed with caution, could precipitate violence and threaten democratic rule. [redacted] 25X1

Recent history indicates that rigorously followed adjustment programs can spur violent protests against such measures as higher taxes, increased prices, and reduced subsidies. For example, new austerity measures enacted in Bolivia sparked a paralyzing general strike in March that seriously threatened the Siles government. We believe that tough economic adjustments will probably provide a rallying point for leftists as well as military opponents of the new civilian government in Argentina. [redacted] 25X1

On the financial side, we judge that, with the injection of domestic political considerations, country negotiations with the IMF will become more contentious. There is a modest chance that some Latin American debtors will opt out of the IMF-supported financial rescue programs in 1985. Some, such as Brazil, might negotiate directly with creditors for financial support while others may suspend payments in an attempt to force concessions. The failure to achieve initial adjustment targets has led to a virtual halt in the modest progress toward economic reform in the region, which—if not reversed—could more seriously undermine economic performance and heighten vulnerability to external shocks for the rest of the decade. [redacted] 25X1

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On the political side, continued financial turmoil will provide new, albeit limited, opportunities for the Soviets and their surrogates. Moscow has already moved to take advantage of Peru's financing difficulties by rescheduling its debt payments in exchange for commodities. The US Embassy expects this will result in a growing trade relationship the Soviets believe will pay political dividends. Havana has also begun to exploit the debt crisis for its propaganda value. In a recent series of published interviews, Castro advocated the formation of a debtors' club to combat economic imperialism—rhetoric that has popular appeal in the region. [redacted] 25X1

For the longer run, we judge that continuing uncertainty surrounding Latin America's external financial situation adversely affects US interests in a number of other areas. We expect these conditions will improve prospects for the election of more radical leaders, provide incentives for increased narcotics trafficking, and impede the ability of regional governments to control insurgency movements by limiting funds available for social spending programs as well as military action. [redacted] 25X1

[redacted] 25X1

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Latin America: Alternatives to IMF Programs [redacted]

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Since the LDC debt crisis broke in 1982, most Latin American countries have adopted IMF-supported adjustment programs to stabilize their external finances. Their relationship with the Fund has been uneasy, however, and US embassies throughout the region report that it is worsening as the financing crisis persists. As 1985 wears on, we believe popular dissatisfaction with economic hardship is likely to conflict increasingly with the stabilization requirements of international lenders. Adjustment programs probably will be the battleground, and the risk is that Latin debtors will opt to bypass the Fund and seek alternative arrangements to service their debt, including the $84 billion owed to US banks. Beyond the immediate threat to debt repayment, such a break would undermine both creditors' willingness to provide continued financial support and the debtors' long-run economic performance. [redacted]

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Major Latin American Countries: Debt Owed to US Banks[a] *Billion US $*

Latin America	**84.0**
Brazil	23.6
Mexico	26.6
Argentina	8.2
Venezuela	11.0
Chile	6.7
Peru	2.4
Colombia	3.0
Ecuador	2.2
Bolivia	0.3

[a] Includes short- and medium-term loans owed by public- and private-sector borrowers to US banks.

[redacted]

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Financial Rescue Programs Sputtering

Various financial sources note that Latin American debtors' compliance with IMF programs is still the key to $5-10 billion in new foreign financing as well as the rescheduling of $40 billion in payments due in 1985. According to US Embassy reporting and generally reliable sources, however, all signs point to continued difficulty in meeting IMF performance criteria this year:

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[redacted]

- Brazil—declared out of compliance in February—is publicly indicating that tough IMF austerity is unacceptable and that the Fund will need to become more flexible.

- Argentine President Alfonsin will be concerned that compliance with the new IMF-supported adjustment program will provide a rallying point for his political opponents.

- Peru's President Belaunde has let IMF assistance lapse rather than implement tougher measures, which he views as socially destabilizing, while Alan Garcia, who will assume the presidency this July, has publicly called for bypassing the Fund.

- Bolivian President Siles and Colombian President Betancur refuse to implement IMF-supported stabilization programs for fear of the political consequences. [redacted]

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Foreign bankers will likely continue to react to the spate of noncompliance by delaying rescheduling agreements and new loans for Latin American debtors. Bankers had postponed for six months the

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Consequences of Brazil's Abrogation of Its 1962 IMF Agreement

Stagnant exports and a falloff in foreign investment led to a Brazilian foreign payments crisis in 1961. The civilian Quadros government agreed to a $2 billion refinancing package in cooperation with the IMF, international bankers, and the US Government, but the succeeding Goulart administration did not follow through on promised economic stabilization measures. The IMF halted disbursement of standby credits in mid-1962, and Brasilia abrogated the accord, causing a cutoff of foreign funding. 25X1

According to academic studies, Goulart was unable to implement austerity and comprehensive economic reforms in the face of civilian demands for sustained growth. Brazil's economic difficulties intensified throughout 1963—manifested in accelerating inflation, growing joblessness, and recurrent payment crises. Some academic sources contend that this decline helped bring about the 1964 military takeover. Three months after assuming power, the military government of Castello Branco concluded an agreement with its creditors by implementing tough financial reforms. 25X1

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formal conclusion of Mexico's $49 billion debt restructuring program until the IMF approved a revised program in March, according to the financial press. Brazil's bank advisory committee—which had reached tentative agreement on a multiyear rescheduling of some $45 billion in debt—and the Paris Club halted their respective debt negotiations pending a new accord between Brazil and the IMF. Argentina's bank creditors are withholding the $4.2 billion loan package signed last December until Buenos Aires's new Fund accord and bridge financing are finalized. Financial assistance packages for Peru and Bolivia remain stalled over their unwillingness to negotiate with the IMF and clear interest arrears. 25X1

Political Challenges on the Horizon

With the inaugurations of civilian presidents in Brazil and Uruguay last March, almost all the Latin American heads of state are civilians. Although we judge that these leaders recognize the necessity of economic stabilization to maintain creditor cooperation and to foster recovery, they are of necessity more sensitive than military presidents to the political vulnerabilities posed by the IMF's recommendations. In our judgment, the new civilian authorities—elected on promises of change and improvement—feel they must demonstrate economic progress or see civilian rule threatened. 25X1

The principal challenges to the stabilization programs, in our opinion, will come from an array of domestic interest groups and the conflicting demands they make on the governments:

- Labor unions in Argentina, Bolivia, Brazil, Peru, Uruguay, and Venezuela are becoming strident in their demands for higher wages.
- Business is seeking wage restraints, price hikes, import protection, and growth policies.
- Middle-class constituents are questioning the advisability of IMF-recommended adjustments, according to public opinion polls.
- Legislatures will likely become more involved in financial matters; Brazil's Congress has already served notice that it intends to scrutinize any new debt accords.
- Leftists, including radical factions in Argentina, Brazil, and Peru, are advocating repudiation of the foreign debt to restore social spending and accelerate growth.
- Military leaders—watching these moves closely in the event they need to intervene to quell unrest—are criticizing cuts in the armed forces' budgets. 25X1

Financial Alternatives

If the Fund proves relatively uncompromising in setting economic targets, we believe there is a 25X1

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moderate chance that some Latin American debtors will seek to bypass the IMF and negotiate directly with creditors. There is also a small risk that some debtors may simply refuse to make fiscal responsibility their top priority and instead seek to
25X1 "go it alone."

A Separate Deal With Creditors. Venezuela has set the precedent for debtors seeking to cut a deal with bankers that excludes an IMF role. Strengthened by $14 billion in annual oil exports and $13 billion in foreign reserves, Caracas refused to adopt a formal IMF-supported program in return for debt rescheduling. Instead, Caracas imposed its own adjustments and in September 1984 negotiated an agreement in principle with bankers to reschedule
25X1 $21 billion of its public-sector debt.

We believe that ***Colombia*** will—and ***Brazil*** may—also seek to set a more independent course:

- Colombia has publicly stated it wants to avoid IMF conditions that will fuel popular criticism. Bankers are now working on a debt restructuring and new money package that would include informal IMF monitoring of Colombia's self-imposed stabilization program.

- Brazil is increasingly unwilling to acquiesce to IMF demands for tough austerity. If the Fund insists on measures Brasilia regards as draconian in order to achieve a sharp cut in inflation, we judge Sarney would abrogate relations and probably press foreign bankers for a multiyear debt
25X1 rescheduling without an IMF program.

Go It Alone. Although we believe that Latin American governments are not likely to repudiate their debts, ***Bolivia*** established something of a precedent in June 1984 by declaring a moratorium on commercial bank interest and principal repayments. Bankers reacted by cutting off all credits, and Bolivia's international trade is now conducted largely on a cash-and-carry basis. Bankers have not taken legal action to attach Bolivian assets, but many have written off loans, and it is highly unlikely that La Paz will be declared creditworthy any time soon.
25X1

We judge that no Latin American country can pursue autarky indefinitely, but some debtors may choose to "go it alone" temporarily to force concessions from creditors:

- ***Argentina's*** self-sufficiency in food and fuel puts it in the strongest position to repudiate its debt. If Buenos Aires's financial rescue package falls through, it may again consider plans to suspend interest payments in an attempt to gain easier repayment terms.

- ***Peru's*** next president, Alan Garcia, has publicly threatened to break relations with the IMF, and we believe he may also suspend all commercial debt repayments and pursue policies aimed at achieving economic and financial self-sufficiency.
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A Debtors' Cartel

On the basis of reliable reporting, we judge that the Latin countries participating in the Cartagena Group at present lack the unity to form a debtors' cartel. They will probably continue to support positions that do not interfere with bilateral debt renegotiation. We also believe, however, that, if Latin debtors see little financial relief in sight, they will be increasingly inclined over the longer term to seek joint action. Creditor banks and developed-country governments would then face demands to share the adjustment burden by granting easier repayment terms and trade concessions. 25X1

Even in the absence of organized collective action, we speculate that a refusal by one country to pay debt could conceivably produce a domino effect. Or, the smaller debtors could quietly suspend payments and receive the tacit support of larger debtors hoping to benefit from any concessions granted by creditors. Finally, we can also envision a spontaneous debtors' rebellion wherein most of the Cartagena countries withhold debt repayments as their negotiations with creditors individually reach an impasse. 25X1

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The Consequences of Breaking With the IMF

In our judgment, commercial bankers may soon be forced to reassess their partnership with the IMF. On the basis of reports of creditor reactions to date, we believe a debtor break with Fund programs would lead to a near cessation of new credit to the region, immediately straining repayment capabilities for many debtors. For the longer run, we believe lending and repayment decisions would be more discretionary, heightening both the potential for confrontation between creditors and debtors and the risk of prolonged payments suspensions.

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We believe the cessation of new lending would markedly hurt Latin growth prospects. A recent academic study concludes that the forced import cutback that would follow a retrenchment in lending would reduce Latin American output by over 6 percent in the first year—an economic plunge twice as severe as the region's 1983 recession, the worst on record. Without foreign lending, according to this study, Latin America probably would follow a lower growth path for a decade with reduced imports undercutting investment in productive capacity. Moreover, prolonged economic stagnation would: (1) provide incentives for increased narcotics trafficking, (2) impede the elimination of domestic insurgency by reducing resources for rural development as well as military action, (3) present opportunities for Soviet inroads, and (4) provide a rallying point for antidemocratic forces.

We believe Latin debtors, faced with such bleak prospects, would have little choice but to try to revive their economies through nationalistic policies. Foreign exchange scarcity would encourage countertrade, greater intraregional barter trade, a new round of import substitution, and tighter controls on foreign direct investment. The major danger is that the weakest civilian governments would follow Bolivia's example and resort to more populist policies—deficit spending, large wage increases, and rapid monetary expansion—that would boost growth in the short run but drive inflation higher.

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IMF: Problems With Arrears ([redacted] 25X1

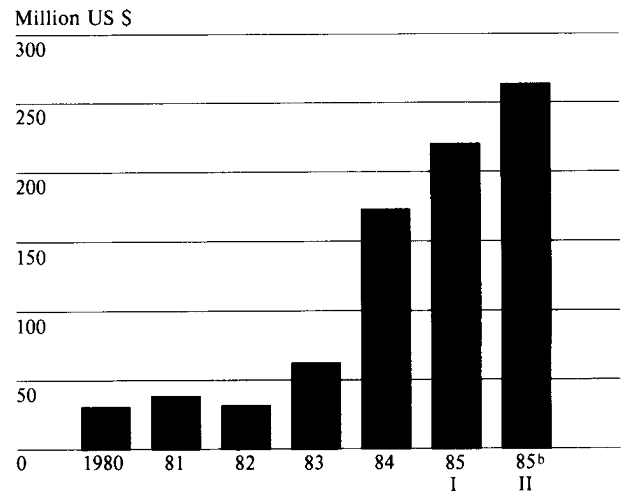
LDC members increasingly are failing to meet their payments on time, causing arrears outstanding to the Fund to rise sharply. Overdue payments this year will cause a net deficit for the IMF, and the need to bolster reserves to hedge against further loan problems may require increasing interest rates on loans to members. With a large bulge in payments to the IMF falling due over the next several years, we foresee worsening problems with arrears that may cause the Fund—for the first time—to agree to reschedule some of the debt. [redacted] 25X1

A New Concern

The IMF has had little difficulty with overdue loan repayments from its members in the past. From 1975 through 1980, only about 11 percent of all payments were late. Almost all of these delays were resolved within two weeks. Since 1980, however, the Fund's LDC members increasingly have failed to meet their payments on time, causing the total amount of arrears outstanding to rise sharply, from about $31 million at the end of 1980 to about $174 million at the end of 1984. By the end of this month, we estimate outstanding overdue obligations will have climbed to $265 million, half of which will be over three months' past due. [redacted]

The sudden increase in arrears has far outpaced growth of the Fund's reserve cushion. Although the IMF has steadily increased its reserves by more than its 3-percent-per-year target since 1981, outstanding arrears have risen by an average of 65 percent annually, climbing from about 4 percent of total reserves to 15 percent over the last three years. Outstanding arrears could rise to almost 70 percent of reserves over the next several years, according to an IMF study. [redacted]

Outstanding Arrears[a] to the IMF, 1980-85



[a] End of period, arrears include: quarterly and semiannual charges; SDR charges; Trust Fund repayments and charges; repurchases under credit tranche, CFF, EFF, SFF, BSF, and enlarged access.
[b] Estimated.

[redacted] 25X1

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Of the roughly 10 members currently behind in their IMF repayments, six are particularly troublesome to the Fund: 25X1

- ***Sudan***—with the largest arrears—has piled up at least $110 million in obligations since it fell out of compliance with its IMF-supported program in July 1984. In February 1985 the IMF halted Sudan's use of Fund resources until the country becomes current in its obligations. In response to a request by Sudan's new government for time to evaluate the country's financial position, the Fund has postponed a decision on further action until later this summer. 25X1

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- Although ***Zambia*** missed its first payments only this past April, its arrears have mounted quickly to about $50 million. The Fund has not yet taken action against Zambia.

- ***Vietnam*** has accumulated about $30 million in arrears since February 1984. The IMF suspended Vietnam's use of Fund resources in August 1984, reviewed the limitation last November, and this January declared Vietnam ineligible to use Fund resources.

- ***Cambodia*** halted payments to the IMF in 1975 and owes about $25 million in arrears. In November 1978 the Fund halted Cambodia's use of Fund resources but has taken no further action against the country. The Cambodian Government has not communicated with the Fund since 1975 and has effectively defaulted on its obligations.

- ***Liberia*** has $23 million in overdue obligations that have accrued since December 1984. Liberia's recent suspension will be reviewed this August.

- ***Guyana*** owes some $19 million in overdue payments dating back to May 1983. After a June 1984 cutoff, Guyana made some payments and won several reprieves but was finally declared ineligible in May 1985. 25X1

Implications for the Fund

In expectation that members would clear their arrears quickly, the IMF has been treating overdue interest charges as current income for accounting purposes. Outstanding arrears now have become large enough to seriously distort the Fund's balance sheet, however, and this year the Fund—for the first time—will shift some $55 million in interest overdue by six months or more into a "deferred income" category. As a result of this change, the Fund expects to incur its first net deficit since 1977 and will have to draw down reserves to cover the gap. 25X1

IMF Disciplinary Procedure for Arrears

Because protracted arrears are a new experience for the IMF, its disciplinary procedure for late members is still evolving. Over the last 18 months, however, measures taken by the Fund have generally followed this pattern:

- *After an obligation has been overdue about three months, the Fund's managing director issues to the executive board a complaint that the member is not fulfilling its membership obligations.*

- *The executive board meets to consider the complaint one to two months later, to allow the late member time to prepare a reply. If the executive board and the member do not reach agreement on settling the arrears, the board can limit—that is, prohibit—the member's further use of Fund resources until all arrears are settled. This limitation is automatically lifted when the member becomes current in its payments.*

- *The executive board reviews a limitation about three months after imposing it. If the member has made some repayments, or, if prospects for repayment have improved, the board can extend the limitation and schedule another review. If a member has not made progress, however, the board can declare the member ineligible to use the Fund's resources. Unlike limitation, ineligibility is not automatically lifted when the arrears are settled, but must be reversed by the executive board.* 25X1

As a final—and as yet unused—step, a member who still has not made progress in clearing overdue payments can be required to withdraw from the Fund. Expulsion of a member requires a decision by a majority of the Fund's governors holding 85 percent of the total voting power. 25X1

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To recover from this year's deficit and to hedge against the possibility that more members will follow Cambodia's lead and refuse to repay, the Fund will need to strengthen its reserve position. Bolstering reserves, however, will require increasing the Fund's annual income targets, which in turn means members could face higher interest charges for use of Fund resources. Some of the Fund's executive directors believe the annual growth target for reserves should be raised substantially in response to growing arrears. This move could require boosting the current 7-percent interest rate according to Fund calculations. [redacted]

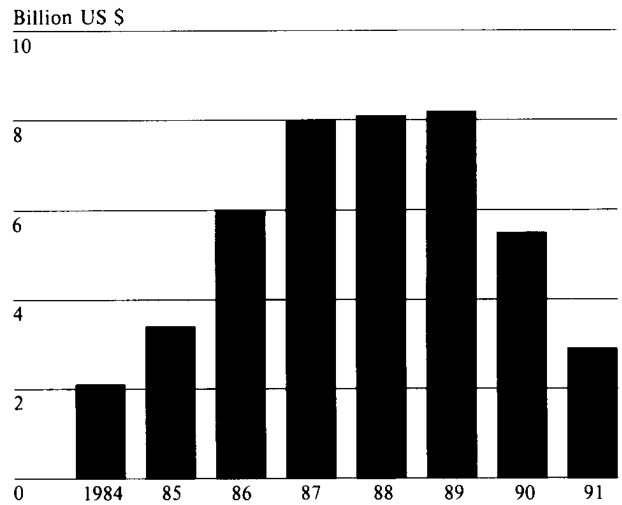
To date the IMF has relied on the threat of losing Fund credit to motivate late members to clear arrears, but this tactic has had only limited success in recent years. The Fund has taken disciplinary steps against at least seven countries, but only two have regained their standing with the Fund. The IMF also can impose penalty charges on late members, but it believes, as we do, that a penalty large enough to be meaningful probably only would aggravate repayment difficulties. [redacted]

Another possible approach—one the IMF has been reluctant to take—is to reschedule debt owed to the Fund. Fund regulations allow rescheduling of principal payments (but not interest charges) in cases of "exceptional hardship," but Fund officials believe this would compromise its intermediary role in the international monetary system and have refused to participate in the Paris Club rescheduling process. The Fund also can postpone payments within an existing loan term, but this only increases amounts due later, likely leading to even greater repayment difficulties. In 1981 and 1982 the Fund postponed several of Guyana's and Nicaragua's payments, but neither was able to pay its obligations by the extended deadlines. [redacted]

Outlook

According to IMF estimates, principal payments due from the LDCs will rise sharply over the next several years as grace periods expire on loans arranged in 1983-85. Scheduled repayments will climb from $3.4 billion this year to a peak of about $8 billion annually during 1987-89, according to the Fund. The two largest IMF debtors—Brazil and Mexico—are due to start repaying their current loans in 1987. With the LDC aggregate current account and reserve positions showing only limited improvement recently, we believe the LDCs will have increasing difficulty meeting this large payments bulge. [redacted] 25X1

Estimated Principal Falling Due on IMF Loans, 1984-91 [a]



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[a] Includes loans projected to be arranged through 31 December 1985.

[redacted] 25X1

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If more members begin falling into arrears on their IMF loan repayments, we foresee new political pressures on the Fund to reschedule—either bilaterally or within the Paris Club framework. Financial pressures to reschedule also would mount, since allowing members to default on their loans would deplete the Fund's revolving stock of credit, making borrowing or a new round of quota increases necessary [redacted] 25X1

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International Financial Situation: Political Update [redacted] 25X1

In recent months political events have introduced new dimensions to the international debt problem. Fidel Castro has called for a general strike by debtor countries to force creditors to renegotiate. We believe he is using the issue to step up attacks against the United States while increasing his ties with other Latin American countries. In Chile, President Pinochet recently lifted the seven-month-old state of siege. Interior Minister Garcia justified the relaxation citing improvements in internal security, but the move is more likely an effort to accommodate US concerns and break the impasse in debt negotiations. [redacted]

Other debtor country governments are continuing to encounter difficulties in trying to balance the need to implement austerity measures against the demands of increasingly restive populations. Some of these measures are being implemented to comply with IMF targets, while others are being forced by domestic economic straits. [redacted]

Last week's agreement between Argentina and the IMF for a $1.2 billion loan portends continued labor troubles for the Alfonsin government. The agreement calls for maintaining tight monetary policy, freezing wages, decreasing government spending, and aggressive devaluations. Opposition from labor makes Alfonsin's position a difficult one. The government had pledged to consult labor on economic policy, temporarily avoiding protest, but the exclusion of labor from recent loan negotiations points to recurring conflicts. Alfonsin also faces opposition to drastic economic measures from his own Radical Party in the face of November congressional elections. [redacted]

In Nicaragua, wildcat strikes took place in response to the government's refusal to allow workers to be paid in merchandise in an effort to avoid the reduced buying power brought about by rampant inflation. More than 500 workers were involved in the strikes in Granada, an important industrial center. Arrests and injuries resulted. The government continues to blame Nicaragua's economic ills on the United States, and uses actions like the recent embargo to justify stricter controls [redacted] 25X1

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Nigerian Head of State Buhari faces mounting opposition as economic deterioration continues, largely as a result of falling oil prices. [redacted] 25X1

[redacted] A radical Shia Muslim group, reported to receive guidance from Tehran, has formed in the north, according to a generally reliable source. Although not expected to commit any acts of violence in the near future, this group could present an additional destabilizing force in Nigeria, a country with over 40 million Muslims. [redacted] 25X1

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In Bolivia, last month's 50-percent devaluation of the peso, combined with shortages and inflation at an annual rate of 8,200 percent, provoked panic buying and labor unrest. This unrest has caused export production to drop, especially mineral exports, on which Bolivia is heavily dependent. The lure of profits from coca production has also prompted a shift from legal export crops. This decreased export volume plus falling prices will produce a $100 million drop in Bolivia's official export earnings this year, according to our estimates. IMF assistance is precluded by La Paz's refusal to negotiate an adjustment program. [redacted] 25X1

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[redacted]

[redacted] 25X1

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Romania: Relentless Squeeze on Living Standards 25X1

President Ceausescu responded to the financial crisis of 1981 by imposing severe austerity measures in order to pay off rapidly the country's hard currency debt. Since then, living standards have fallen to a near-subsistence level, and, during the harsh winter of 1984-85, the populace experienced hardships probably unprecedented since the immediate postwar period. Moreover, the decline in consumer welfare apparently has contributed to a sharp rise in mortality rates. The outlook for improvements in living standards is not promising. Ceausescu's drive to recover last winter's production and export losses and to eliminate the debt will claim the bulk of available resources, and economic plans for 1986-90 allocate most growth to investment and exports.

The Five-Year Slide

From the outset of the financial crisis, Ceausescu has been determined to pay off the debt quickly in order to return to rapid growth without interference from foreign creditors. Apparently confident in his powerful security apparatus, he has squeezed the domestic economy to boost export earnings. This is in sharp contrast to most financially strapped East European regimes, which, for fear of popular discontent, have given greater priority to protecting consumer welfare.

Bucharest's adjustment effort quickly produced a major improvement in the foreign payments performance, but at high cost to economic growth and living standards. Between 1980 and 1984 hard currency trade shifted from a $1.5 billion deficit to a $2.3 billion surplus largely through sharp cutbacks in imports. Although the debt fell from $10.1 billion in 1981 to $7.5 billion at yearend 1984, economic growth sagged to an average annual rate of about 1 percent in 1981-83—compared with an average 4 percent per year during the 1976-80 period. A modest recovery begun in 1984 was cut short by the severe weather earlier this year. The decline in production and a shift of resources to the external sector slashed domestic consumption—already lower than any other East European country except Albania. 25X1

The Romanians achieved much of their trade gain by slashing oil imports nearly in half, and bartering food, consumer goods, fertilizer, and agricultural machinery for most of the remainder. To shield industry from energy shortfalls, the authorities cut supplies sharply to the household sector and increased consumer energy prices by 80 percent over 1980-83. In the winter of 1983-84, the government ordered a 50-percent reduction in household energy consumption and cut off electricity sporadically. In early 1985, the authorities mandated a further 50-percent cut in electricity usage, and cut off gas and electricity to residential neighborhoods in many cities for several days during exceptionally cold weather. Households were limited to one 15-watt lightbulb and one appliance with militia inspecting residences, fining violators, and sometimes plastering over electrical outlets. Transport suffered serious disruptions, interrupting deliveries of food and other goods and causing employees difficulty in getting to and from work. The use of private automobiles was banned from January until late March this year, and gasoline has been rationed since 1981. Schools in many areas were closed for up to two months this winter for lack of heat and electricity.

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The regime reacted to food shortages in late 1981 and early 1982 by imposing formal rationing on sugar, flour, and cooking oil. Since 1982, the agricultural performance—despite official claims—has deteriorated in large part because inputs such as fertilizer have increasingly been redirected to export markets. The regime's response has been to decrease food supplies to local distributors, causing a reduction of about 25 percent in

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State Retail Food Price Increases, 1981-84 *Percent*

Beef	100
Pork	83
Sausage	28
Chicken	77
Milk	39
Cheese	76
Rice	69
Sugar	72
Flour	37
Bread	8
Eggs	24
Coffee	106
Butter	35
Margarine	83
Oranges	38
Lemons	52
Apple	78
Vegetable oil	55
Vodka	37

[redacted]

rations below the 1983 level. Meat and milk are so scarce that they are not formally rationed. Although Bucharest claims per capita meat consumption is about 60 kg per year, our analysis indicates it is less than half of this amount. Moreover, food prices at state stores have surged by over 50 percent since 1981, with only bread prices remaining relatively stable. [redacted]

Despite official data to the contrary, we believe real incomes have fallen sharply—at least 20 percent—during the 1980-84 period. In addition to increases in prices for energy and food, many emigres have reported that rents have doubled, the prices of clothing and durable goods have jumped steeply, and the quality and variety of consumer goods have deteriorated. Meanwhile, some 2 to 5 percent of worker wages are being withheld under a mandatory "investment" program [redacted] 25X1

Selected Countries: Infant Mortality Rates,[a] 1983

Romania	26.8
Poland	23.2
Hungary	19.0
Bulgaria	16.5
Czechoslovakia	15.6
Italy	12.0
United States	10.9
East Germany	10.7
Spain	10.0
Sweden	8.0

[a] Deaths per 1,000 children under one year old.

[redacted] 25X1

Increased Mortality Rates

As a result of poor nutrition, inadequate heat, the unavailability of medications, and Ceausescu's ban on abortions, mortality rates have increased in the past few years. The infant mortality rate, already significantly higher than elsewhere in Europe, climbed by 35 percent in November 1984–January 1985 compared with January-September 1984, according to a Romanian medical official. In some areas, baby formula is not available, and young children can obtain milk only with a doctor's prescription. Maternal mortality rates apparently have increased as well. Ceausescu's ban in early 1984 on abortions has made deaths from illegal abortions common, according to several reports from emigre physicians. These sources also report a jump in the death rate among the elderly. The crude death rate for the entire population since 1980 has increased far more rapidly than in any other East European country. [redacted]

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Eastern Europe: Crude Death Rates

	Deaths Per 1,000 Population		Percent Change
	1980	1983	
Romania	10.4	12.3	18
Bulgaria	11.1	11.4	3
Hungary	13.6	13.9	2
Czechoslovakia	12.2	12.0	−2
Poland	9.9	9.5	−4
East Germany	14.2	13.3	−6

Tightening the Screws

Bucharest's reaction to the effect of deteriorating popular morale on worker productivity has been a steady increase in coercion, a heightening of the campaign to foster Romanian nationalism, and exhortations to work harder. Worker discontent since a rash of disturbances in 1981-82 has generally been limited to grumbling, increased absenteeism, and apathy. The security apparatus has increased surveillance of workers in industrial installations where unrest has occurred in past years and among the Hungarian minority. Except for special food supplies for coal miners and workers in some large plants, the regime has not relied upon positive incentives.

Economic coercion has taken several forms:

- The regime in 1983 raised production goals and installed a new wage system closely linking salaries to production targets. Workers in factories where targets are not met may lose 25 to 30 percent of their monthly base wages. In addition, workers receive only a small portion of their base wages when a factory shuts down for lack of energy or raw materials.
- Retirement ages have been raised, pensions cut, and workers in some factories and mines are being forced to work double shifts.
- The regime has cracked down on black-market activity to limit shortage-caused disruptions in retail markets.
- To increase control over private agriculture, Ceausescu imposed price ceilings in 1983 and compulsory deliveries to the state in 1984. Private farmers, who provide about half of all livestock products and some crops, responded by cutting output and sales. The regime has retaliated by limiting food sales in rural state stores to spur more local production and by making supplies of animal feed and other inputs contingent upon delivering animals to the state. 25X1

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The Coming Years

The next few years, in our judgment, will see little improvement in living standards. Ceausescu has shown no indication of easing his drive to pay off the debt. Despite good performance in reducing debt so far, the bunching of obligations in the next few years will continue to strain the economy. Indeed, a financial scare in May 1985—when an emergency short-term loan was required from Western banks to make a payment on rescheduled debt—is likely to spur Ceausescu to push exports even harder at the expense of the domestic economy. 25X1

In its effort to generate exports, the regime probably has aggravated its structural economic problems. 25X1 While relying on energy-intensive exports, such as steel and heavy machinery, it has failed to make industry more efficient in its use of raw materials and energy. Cutbacks on imports of spare parts for industrial equipment and neglect of maintenance have further undercut efficiency. Meanwhile, it has undermined its natural advantage in agriculture by exporting inputs desperately needed at home. Ceausescu also has continued to push ahead with grandiose investment projects that will not produce meaningful economic returns for many years. 25X1

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The populace—cowed by the pervasive security forces and preoccupied with day-to-day existence—expects worsening conditions. Under the current energy conservation program, the priority for energy is industrial production and stockpiling to prevent the serious industrial shutdowns of the past two winters. Widespread rumors circulate that the authorities will completely cease supplying heating fuels to households next winter, and many families are scrounging for coal and wood in preparation. Food supplies are unlikely to improve much, with grain crop prospects only mediocre and a decrease in animal herds last winter. The regime has shown no inclination to reduce food exports, and may well attempt to increase agricultural exports to recoup first-quarter 1985 export losses. Because goods and services needed to maintain health and welfare are likely to remain curtailed, we expect mortality rates will continue their upward trend. [redacted] 25X1

[redacted] 25X1

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Australia: On the Eve of the Tax Reform Summit 25X1

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More than 100 delegates from leading domestic interest groups will assemble in Canberra on 1 July to discuss Prime Minister Hawke's program for stimulating the economy through tax reform. Treasurer Paul Keating—the primary architect of the program—has persuaded his fellow Cabinet ministers and the Australian Council of Trade Unions (ACTU) to approach the summit with "an open mind," despite the serious reservations of both groups about his proposal to impose a retail sales tax. We believe Keating has at least a 50-percent chance of maintaining support at the summit for his radical revision of the tax system. On the other hand, delegates may have saved their strongest arguments for the summit. If the meeting bogs down, Hawke's bold political gamble will be a failure, threatening not only tax reform but also his chances in the next election. 25X1

The Challenge of the Summit

Australia's tax system is long overdue for reform. The average Australian wage earner now pays one-fourth of his income in federal income taxes—up from 10 percent in 1955—because inflation has pushed workers into higher brackets. Although the top marginal tax rate has been reduced from 67 percent to 60 percent, it is now applied to incomes of less than twice the average wage, compared with about 20 times the average wage 30 years ago. As a result, tax avoidance has become rampant. Government data show that workers earning more than two and a half times the average wage paid nearly half of total tax revenue in 1955, but they now pay less than one-tenth. 25X1

Hawke promised to correct these anomalies in his first campaign for office in 1983. His November 1984 campaign renewed the commitment and added three objectives for the national budget that we judge will shape what tax reform he finally achieves. Hawke believes:

- Government spending should not increase as a proportion of total output—about 31 percent of GNP in fiscal year 1984.
- The total tax burden as a percentage of total output should not rise.
- The budget deficit should be reduced both absolutely and as a proportion of total output—about US $4.8 billion in fiscal year 1984 or 3 percent of GNP.

The task of tax reform has been complicated by Hawke's budget objectives because the level of government spending for the fiscal year beginning 1 July has been set. Many business groups believe the primary issue—the level of federal spending—will be ignored. 25X1

The Tax Proposal

One of Keating's reform objectives is improving the efficiency of tax collection. For years local economists have been suggesting Australia shift its dependence on high, but avoidable, income taxes to enforceable consumption taxes. Canberra's chief goal, however, is to reduce the personal income tax burden in hopes of sparking economic growth. In order to provide incentives for both entrepreneurs and average wage earners, Keating proposes to cut

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Australia: Impact of Tax Reform on Government Revenue [a] *Billion US $*

Revenue gains	10.9
Retail sales tax	9.6
Capital tax and tax evasion crackdown	1.3
Revenue losses	9.2
Income tax reductions	6.6
Wholesale tax deletion	2.6
Remainder for compensating the needy	1.7

[a] Australian treasury estimates.

both marginal tax rates and overall income tax payments. The top rate is to fall from 60 percent to 46 percent and the zero bracket rate will rise by about one-third. Income taxes for the average wage earner would be cut approximately 30 percent, according to the government's calculations

Canberra is considering a variety of measures to replace anticipated revenue losses. After debates within the Treasury Department and Labor Party over the merits of value-added, wholesale, and retail sales taxes, Keating is recommending a 12.5-percent retail sales tax. In addition, he is proposing a capital gains tax, a tax on various fringe benefits for high-salary employees, and a crackdown on tax evaders.

Keating's sales tax plans have faced serious obstacles from the outset. Trade unions, charitable organizations, and the Labor Party left wing have complained that all consumption taxes are regressive. According to Keating's calculations, however, the average wage earner will more than recoup his sales tax payments from income tax reductions netting a yearly savings of about $350. Moreover, under the new tax system, the government estimates it will take in more than it forfeits, enough to compensate those low-wage earners and pensioners who presently pay little or no income tax.

Managing the Political Challenges

Although the tax summit is intended to involve the public directly in the decisionmaking, some Australian observers have labeled it a purely political exercise, saying delegates will be asked to rubber-stamp what the government is already determined to do.[1] Many complain that the deck is stacked in favor of the ACTU—labor's most important constituency—because over one-fourth of the delegates represent the ACTU. Employers' organizations have received at least twelve invitations. The National Farmers Federation and the Australian Mining Industry Council, however, were granted only one delegate apiece in the original distribution, despite the Labor government's insistence that the two industries are vital to the country's prosperity.

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ACTU Secretary Crean has laid out three conditions for ACTU approval of any proposed change in the mix of income and sales taxes:

- That ACTU members be better off.
- That Australians in the lowest income brackets be better off.
- That the government not cut vital welfare spending.

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Keating met six weeks ago with the ACTU Executive Council and won approval of a six-option tax package ranging from the ACTU's preferred option—no sales tax—to Keating's 12.5-percent sales tax. By avoiding approval of any specific plan, the ACTU has left itself room to maneuver at the summit

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ACTU cooperation is essential if reform is to proceed. In the coming months the government's Arbitration Commission will face several wage

[1] This is Hawke's second exercise in domestic summitry. Immediately following his March 1983 election, Hawke called together business, labor, and government representatives to forge a consensus on economic policy. Hawke's primary triumph at the first summit was obtaining agreement to a new, less confrontational wage negotiating process—now called the Wage and Price Accord.

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demands unrelated to tax reform: raises linked to productivity increases, pension plan extensions, and cost of living adjustments—which are likely to be larger than last year's settlements because the 20-percent depreciation of the Australian dollar during the first four months of 1985 is boosting inflation. Cabinet ministers have cautioned unions not to expect both pay hikes and income tax cuts to compensate for the effects of the new sales tax on prices. Many Australian economists, however, are predicting new wage demands, new rounds of industrial disputes, and the end of Hawke's Wage and Price Accord if the Arbitration Commission refuses to award pay increases. If Hawke hopes to avoid this, he must gear tax reform to the wishes of the ACTU.

Within the often fractious Labor Party caucus, leftwing leaders have called the proposed retail sales tax "electoral suicide" because it is regressive. Moreover, several members of Foreign Minister Hayden's Center-Left faction—which has the strength to veto any measure in a caucus vote—have denounced various aspects of Keating's plan and made their own proposals. They argue that a broadly based consumption tax would boost inflation dramatically and take 18 months to implement, jeopardizing Labor's chances in the next election, which must be held by the end of 1987. In their view, a 5- to 10-percent sales tax on selected services added to the existing wholesale tax on some "luxury" goods is an achievable target. They also claim lowering marginal tax rates is unnecessary because the same results could be achieved by raising the income brackets.[2]

On the surface, Keating has overcome internal party dissent—primarily by winning over reluctant Cabinet ministers—as summit delegates prepare to convene. With the continued support of the 27 Cabinet ministers, we believe Hawke's faction could pass the Keating package in a caucus vote. If the debate heats up at the tax summit, however, the Center-Left version of tax reform is likely to resurface as a compromise all can live with 25X1

After the Summit: Outlook for Parliamentary Action

The opposition coalition—Liberal and National Parties—has declined to attend the summit, claiming that the proper place for tax debate is Parliament. Although media commentators have criticized the decision, in our judgment, the opposition has made a politically shrewd move. With its attention focused on the nonparliamentary interest groups, the government at this stage would pay 25X1 little attention to opposition suggestions. Moreover, we believe there is about an even chance that the tax summit will erupt into a brawl between the factions of the Labor Party or between various interest groups, providing the opposition an issue to exploit in public and in Parliament. In addition, by boycotting the summit, the opposition has avoided involving itself in the same debate twice. This will allow its leaders time to reach consensus on tax reform goals and reduce the risk of arguing contradictory positions. 25X1

In any case, we judge that the opposition will contest the capital gains tax if it is adopted at the summit and may defeat it in the Australian Senate. Keating's original capital gains tax proposal has drawn intense criticism from the farming sector because it makes no exception for family-owned farms. Business opinion is divided: real estate brokers and builders are displeased, but many companies believe they will profit if investors turn away from currently popular tax shelters. 25X1 25X1

The fringe benefits tax stands a better chance of passage. Keating has removed most of the dangers by excluding items such as company cars that are offered to employees at all salary levels. The opposition, therefore, will appear to be blatantly partial to the rich if it opposes the tax. In the end, the

[2] Keating's plan has a technical advantage over alternatives. According to Treasury projections of economic growth and inflation over the next yer, it satisfies Hawke's campaign criteria for spending and deficit restraint. Any alternative must mathematically be proved as acceptable in order to win government support and pass through Parliament.

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opposition may support the new income tax schedule and the retail sales tax because those are "conservative" positions and the party is trying to regain its conservative constituencies. 25X1

In our judgment, Australia has much to gain from tax reform, even if Keating has to accept compromises. If Keating is able to reduce marginal tax rates and implement a capital gains tax of any significance, his tax reform will spur savings and thus investment growth—the one element of economic recovery that was lacking in the Australian rebound of 1984, when real GNP growth reached 6 percent, up from about 1 percent the year before. Some economists argue that increased retail prices will choke off consumption spending, but we believe reductions in monthly income tax payments and increases in pension benefits will be timed to offset price increases. Recent estimates of Australian economic growth in fiscal year 1985 have been revised upward to 4.5 percent. This is achievable, in our judgment, with Keating's tax program and barring a severe bout of industrial disputes. If Keating's plan fails at the summit, however, Hawke's political standing would suffer. An equally bad outcome would be the economic uncertainty that would result from a stalemate that prolonged the acrimony over tax reform. 25X1

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Briefs

Energy

Saudi Arabia to Aggressively Market Oil

[redacted] 25X1

[redacted] 25X1

[redacted] Meanwhile, the US Embassy reports that an oil barter arrangement also may be in the offing for military equipment but is skeptical that the barter deal will be completed. A similar oil-for-airplanes deal last year with Boeing, however, was viewed by the rest of OPEC as a major change in Saudi oil policy and as justification to violate the organizations's pricing guidelines. Such aggressive marketing tactics will make it more difficult for the Saudis to restore faltering OPEC discipline. [redacted] 25X1 25X1

Austria Buys US Oil Interests in Libya

[redacted] 25X1

The Austrian state oil company, OMV, has agreed in principle to buy 25 percent of a major US oil company's production interests in Libya, according to press reports. Occidental of Libya is 51 percent owned by the Libyan Government and currently produces about 140,000 b/d, or 14 percent of Libya's estimated oil output. OMV's equity purchase would give it access to low-sulfur crude equal to about 9 percent of Austria's 200,000 b/d demand. The deal should also benefit the Austrian state-owned oilfield supply company, Voest-Alpine. Tripoli probably welcomes Austrian equity involvement as a means to acquire Western petroleum technology and equipment for its deteriorating petroleum infrastructure and to further diversify its sales during the ongoing crude oil supply glut. [redacted] 25X1

Japan May Withdraw From Soviet Oil and Gas Project

[redacted] 25X1

[redacted] Tokyo may back out of the Sakhalin Project because Japanese electric power companies are reluctant to sign long-term liquefied natural gas (LNG) contracts. Although the Japanese firm Sodeco has invested about $175 million in Sakhalin exploration over the past decade, Japanese electric utilities have shown little interest in buying the anticipated production of 20,000 to 40,000 b/d of oil and 3 million tons a year of LNG. Moscow, however, may develop Sakhalin's offshore oil and gas fields independently, [redacted] A final decision is expected by Japan this fall. Japan now has numerous other options in covering expected future energy needs—Australia, Indonesia, Malaysia, Thailand, Qatar, Canada, and Alaska. The extent of participation by Japanese steel and trading firms in these projects will weigh heavily in Tokyo's choice of energy suppliers [redacted] 25X1

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Colombian Oil Situation

Harassment by guerrillas of the National Liberation Army and unfavorable weather conditions are constraining development of Colombia's oil potential. In late May, guerrillas dynamited an oil drilling camp causing approximately $2 million in damages and shot down a helicopter carrying a number of Occidental Petroleum employees. 25X1

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North Yemen Oil Update

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China Pushing Energy Conservation

China recently kicked off a new drive to conserve energy last week with a national conference and an exhibition of foreign energy conservation equipment and technology. Vice Premier Li Peng told the conference that enterprises must use technical innovations as well as economic reforms to improve conservation. The drive builds on past conservation measures that have attempted to ease chronic energy shortages impeding the growth of industrial production. According to Chinese statistics, enterprises saved an equivalent of 30 million tons of coal in 1984, about 4 percent of total energy production. Most of these savings were the result of economic reforms. The cost for above-quota energy supplies has been allowed to rise above state prices. In addition, Beijing is pressing to hold enterprises responsible for their losses, which has discouraged wasteful practices. 25X1

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New Chinese Power Corporation

The Huaneng Energy Corporation was officially established this week to import thermal power plants for cities willing to pay for the plants. This underscores Beijing's increasing reliance on coal-fired power and off-budget financing of electricity supplies. Cities desiring more power capacity than is funded by state plans can petition Huaneng to negotiate and sign contracts with foreign suppliers, import equipment and materials, and solicit foreign investment. Huaneng has already sought bids from 10 international firms to

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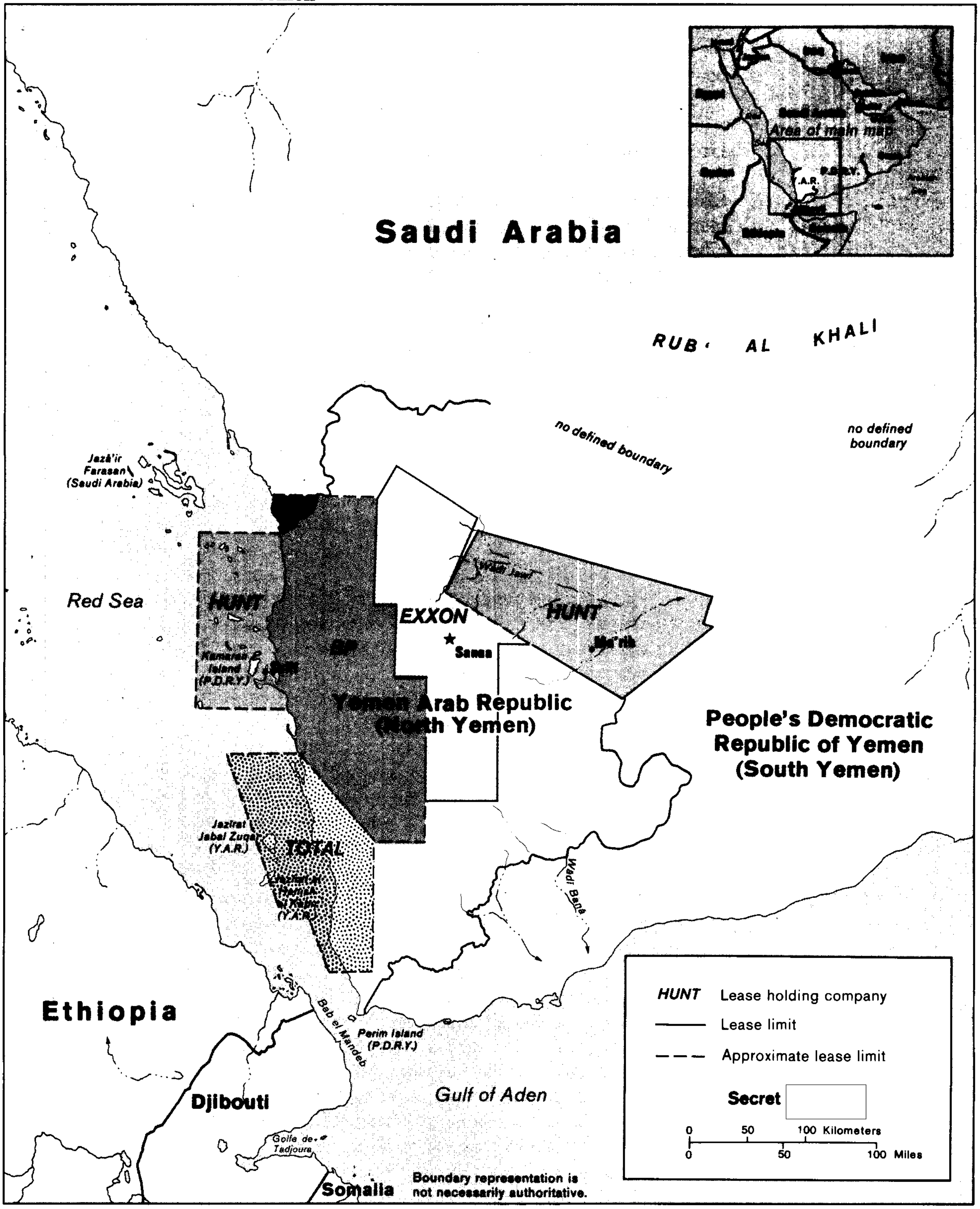
Oil Concessions in North Yemen



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supply eight generators for Dalian, Nantong, Fuzhou, and Shijiazhuang. Chinese Vice Premier Li Peng, a strong supporter of the new corporation, wants these four plants on line within three years to help solve worsening power shortages on the east coast. [redacted] 25X1

International Finance

Chile's Debt Package Progress

[redacted]

Chile made progress on relieving its acute financial bind last week. Santiago indicated it will accept a proposal to reschedule some of its $170-190 million in official credits and guarantees coming due between July 1985 and the end of 1986, according to US Embassy reporting [redacted] 25X1 25X1 25X1 These moves, together with the Pinochet regime's decision to lift the state of siege, have increased bank creditor willingness to lend new money and conclude a debt package. Although banks are pressing the government to guarantee rescheduled private debt, we believe a compromise will be worked out. We believe Chile probably will wrap up its bank negotiations and conclude an IMF agreement by the end of July. While this will remove the immediate threat of a debt moratorium, major loan disbursements will not occur until late 1985 or early 1986, leaving Chile under financial strain well into the fall. [redacted] 25X1

Saudi Arabia Considers Private-Sector Bailout

[redacted]

[redacted] 25X1

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Large New East German Credit

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[redacted]

East Germany has received a commitment from a group of Western banks for an eight-year, $600 million loan after asking for $200 million—its third large oversubscription since late 1984. According to the US Embassy, the East Germans will pay 0.75 percentage point over LIBOR for most of the money. The syndicate is led by the Arab Banking Corporation of Bahrain and includes about 75 banks; seven US banks reportedly will lend $50-60 million. East German Foreign Trade Bank President Polze told the US Embassy that East Berlin will use the funds to maintain reserves and boost imports from the West in 1986-90. Polze said it is now East German "national policy" to maintain hard currency trade surpluses, but indicated interest in Western capital goods to modernize the coal mining, oil refining, chemicals, textiles, and microelectronics sectors [redacted] 25X1

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Global and Regional Developments

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OECD Export Credit Arrangement

[redacted]

The OECD Secretariat is expected to propose a plan for automatically reclassifying recipient countries by relative wealth under the Export Credit Arrangement at next week's meeting, according to US Embassy reporting. If implemented, Singapore, Hong Kong, Venezuela, Netherlands Antilles, Trinidad and Tobago, and Oman would graduate to the highest category and therefore be ineligible for subsidized credits. The last reclassification, in 1982, graduated the USSR into this category. The plan recommends reclassification whenever the World Bank issues new per capita GNP data or revises its list of countries eligible for IDA credits. In order to avoid repeated crossovers between categories, countries would be reclassified only after they had met the criteria for the new category for at least two consecutive years. Countries with no new per capita GNP data would not be reclassified but would be subject to periodic review. The EC is reportedly concerned about Portugal's accession. Other OECD participants would be able to undercut EC export credit offers because Community nations cannot subsidize credits to fellow members. According to US Embassy reporting, the EC probably will delay progress on the plan until agreement can be reached with Portugal to give up Lisbon's claim to subsidized credits. [redacted]

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Opposition to West German EC Grain Price Veto

[redacted]

Domestic opposition to Agriculture Minister Kiechle's stand against EC grain price reductions is strong. Kiechle, whose Christian Social Union Party is worried about the farm vote, invoked West Germany's first-ever EC veto on 12 June to block a proposed cut in the subsidized price paid to cereal farmers. Economics Minister Bangemann and Foreign Minister Genscher, for whose Free Democratic Party the farm vote is relatively unimportant, have been most outspoken. They contend that continued resistance to price cuts is inconsistent with West Germany's longer term goals, such as reducing overproduction, limiting West German financial contributions to the EC, and reducing tensions with EC trade partners. Moreover, they lament the setback to Bonn's push for European integration and the addition of another irritant to strained ties with the French. Barring a last minute compromise, grain prices will be a contentious issue on the agenda for this weekend's EC Summit in Milan. [redacted]

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Debate on the Airbus A330

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Moroccan–East Bloc Ties Improve

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Thailand Eying Trade Deficit With Japan

The Thai delegation to the ASEAN-Japan ministerials in Tokyo later this month will likely present proposals to redress Bangkok's $2 billion annual trade deficit with Tokyo, according to Thai press reports. Bangkok intends to call for immediate action to open Japanese markets to Thai exports as well as longer term assistance in developing Thai export capabilities. Suggested measures focus on liberalizing Tokyo's foreign investment policy to promote export-oriented Thai industries, to increase local content, and to step up technology transfer. Bangkok also wants to use countertrade, triangular trade, and buy-back arrangements to boost exports. Tokyo has announced that it will cut tariffs on some agricultural products but is unlikely to offer any meaningful response to the rest of Bangkok's demands.

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National Developments

Developed Countries

Japanese Tariff Cuts Announced

After intense internal debate, Tokyo this week announced that it would reduce tariffs by 20 percent on 1,850 products as part of its "action program" to ease trade friction. Most cuts will take effect next April. Duties will be abolished on 35 products from the United States, and tariffs on special interest items for Japan's other trading partners—such as boneless chicken, bananas, and palm oil from Southeast Asia—will fall by more than 20 percent. Tokyo also called for

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reciprocal tariff elimination on manufactured goods to promote a new round of global trade talks. Strong ruling party and Agricultural Ministry opposition blocked original plans for tariff cuts on all 2,400 items now carrying duties. The cuts on Southeast Asian products were clearly designed to avoid criticism at the Japan-ASEAN Economic Ministers Conference held in Tokyo this week. The reductions probably will have little affect on Japan's trade surplus because tariffs were already low. Government officials also have said Tokyo may suspend specific cuts if an import surge harms domestic industry. 25X1

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Successful Belgian Employment Program

[redacted]

A year-old government program that allows unemployed individuals to start small businesses by borrowing against future unemployment benefits appears to be successfully promoting entrepreneurial spirit, as well as generating new jobs. According to government officials, roughly 5,000 people—about 1 percent of those drawing unemployment compensation—are participating. The Caisse Nationale de Credit Professionnel, the government's small business bank, issues the loans at below market rates in amounts up to $8,000—roughly equivalent to three years of unemployment compensation. While the national government provides the capital, the Flemish and Walloon regional governments subsidize the interest rates. If the fledgling entrepreneur is unable to repay the loan, he risks forfeiting as much as three years of otherwise open-ended unemployment benefits. At present about 90 percent of the businesses are current on their payments. Although the program will have only a small impact on the country's 13.5-percent unemployment rate, it will nonetheless score some badly needed points for the center-right coalition, which faces a general election by December. [redacted]

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Less Developed Countries

Argentine Reaction to Economic Program

[redacted]

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Domestic reaction to President Alfonsin's tough anti-inflationary program has been mostly favorable, but difficulties in carrying out the program may eventually undermine much of this support. The program features wage and price controls, increased taxes, higher utility rates, cuts in public spending, monetary reforms, and aggressive devaluations. Several steps already have been taken on price controls, but the new currency, the "austral," will enter circulation gradually. The government intends to maintain the currency's value by ending the practice of printing money to balance the budget and relying instead on increased taxes and foreign financing. While media polls indicate widespread public support, some businessmen worry that it may cause a recession, according to the US Embassy. The opposition Peronist party and the Peronist-led labor confederation argue that the program will aggravate unemployment and reduce real wages. Leftist parties have denounced the plan as a "sellout to the IMF," while conservatives criticize price controls but support other provisions. According to press reports, the armed forces favor the new program, viewing it as similar to measures taken under military rule.
[redacted]

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Alfonsin's plan is basically sound, but its success hinges on the government's ability to freeze prices, while deterring union protest strikes. Considerable risks remain even if prices can be controlled. Argentina's last bold attempt to crush inflation, in the early 1970s, led to widespread shortages and unrest.
[redacted]

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Kuwaiti Aid Payments to Syria in Doubt

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[redacted]

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Egypt's 1985 Military Budget

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Egypt's Defense Minister said the military will receive 2.4 billion Egyptian pounds (about $3 billion) in the current fiscal year, 38 percent of which is for debt repayment to the United States. The Defense Minister told US Embassy officials that the military budget has not grown since 1983 and that current defense expenditures represent 13 percent of the national budget and 10 percent of GNP. The military reportedly will devote 51 percent of the remaining funds after debt repayment to wages and salaries. The Defense Ministry also expects to receive additional funds for military procurement—$150-200 million for hard currency purchases abroad and about $240 million for domestic items.

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Indian Textile Policy Reforms

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New Delhi has announced long-term plans to restructure India's huge textile industry, which has many factories that are underutilized and unprofitable. Tax and industrial licensing policies that discriminate against large mills and against the use of popular synthetic fibers and high-quality cotton will be gradually phased out. Private corporations will be permitted to establish or expand capacity for manmade fibers and yarn. In order to modernize production and make exports competitive, the government will allow imports of textile machinery not produced in India at near-international prices—which implies low import duties. Extensive provisions to protect displaced factory workers suggest that the government is serious about permitting some hopelessly obsolete units to close. Production of cloth for distribution by the government will be shifted away from nationalized factories to private handlooms, a move that will probably lead to increased government subsidies

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but also help protect low-wage jobs for almost 10 million workers. The reforms were quickly praised by corporate leaders and criticized by spokesmen for small factories and labor unions. US officials in India caution that the new policy may have to be watered down as it is implemented. 25X1

Cautious Tanzanian Budget Initiatives

A much overvalued exchange rate is likely to blunt the impact of a number of limited economic liberalization measures in the fiscal year 1985 budget, introduced on 13 June. To improve economic efficiency and bolster anemic agricultural exports, the budget calls for sharp reductions in export and customs duties, the elimination of export taxes on a number of agricultural products, and 50-percent reduction of the income tax on cooperatives. 25X1 Contrary to expectations, the announcement did not include a devaluation. Despite repeated devaluations over the past six years, the shilling has appreciated in real terms by about 60 percent against the dollar since 1979. This effectively guts any production incentives from the new budget proposals. In the absence of more substantial reforms, the economy will continue to falter as Tanzania makes the transition this October to the post-Nyerere era, and the new president could face growing popular discontent. 25X1

Communist

Possible Expansion of US-Soviet Fertilizer Exchange

At a recent meeting with General Secretary Gorbachev, Occidental Petroleum Chairman Armand Hammer proposed to expand an existing 20-year agreement for the exchange of superphosphoric acid (SPA) for Soviet ammonia, urea, and potash. The original agreement, signed in 1973, provides for annual shipments of 1 million metric tons of SPA by the US firm and 1.5 million tons of ammonia and 1 million tons each of urea and potash by the USSR. The Soviets have yet to deliver the stipulated quantities. In 1984 the USSR shipped 25X1 only 886,000 tons of ammonia, 380,000 tons of urea, and 125,000 tons of potash. Occidental supplied 720,000 tons of SPA last year. The United States supplies at least three-fourths of Soviet imports of SPA. Needed to hasten the maturing of grain crops during the short Soviet growing season, additional quantities of SPA would be an important input for increasing grain production, a major goal of the Food Program. 25X1

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Increased Soviet Purchases of US Fungicides

Soviet imports of US fungicides and miticides for treatment of grain and other crops in 1985 continue at the high 1984 level, more than double that of the early 1980s. Purchases of these pesticides from the United States may reach $9 million this year. The Soviets are pressing US suppliers to accept barter arrangements. Moscow has stepped up purchases of Western pesticides dramatically in 1984-85, particularly herbicides for use on grain. Some are being used in an experimental program, under the direction of General Secretary Gorbachev, to increase wheat yields. These imports underline the priority that the Soviets have accorded the role of pesticides in helping to meet the output goals of the Food Program. Despite the push for barter arrangements, Moscow, if necessary, will use foreign exchange to obtain the needed amount. 25X1

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Vietnamese Economic Reforms

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The Central Committee has ratified long-debated measures to curtail expensive food and salary subsidies, according to the communique of the eighth plenum released last week. Although the communique offers few specifics, the new policy follows efforts over the past few months to revive the economy including a sharp devaluation, rescheduling $160 million in overdue debts with Japanese banks, and encouragement of private foreign investment from Western Europe. The language of the communique suggests top Vietnamese leaders are in agreement on the need for economic reform, but opposition on Marxist ideological grounds by party officials and a sluggish bureaucratic system will make implementation of subsidy cuts difficult. Hanoi may also be considering another attempt to reschedule its $1.6 billion hard currency debt. The IMF has told Vietnam that it must reduce subsidies as well as further devalue the currency and repay its $30 million debt to the Fund before official creditors will consider a debt rescheduling package. 25X1

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