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Directorate of
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International Economic & Energy Weekly (U)

22 June 1990

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DI IEEW 90-025
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International Economic & Energy Weekly (U)

Synopsis

1 **Perspective—Growing Concerns Over Environmental Protection Costs** (b)(3)

The high price tag for protecting the environment is becoming more apparent as environmental issues attract greater political attention worldwide. Nevertheless, the momentum of international efforts to stem environmental degradation is unlikely to slow, and plans to address climate change, ozone depletion, and other environmental concerns will continue to develop at a rapid pace. (b)(3)

5 **USSR: Environmental Pressures Hurting Industrial Performance** (b)(3)

Over the past several years, numerous Soviet industrial plants have been closed for damaging the environment. Although the closings have helped reduce pollution, they also have led to shortages of critical products. Moscow has acknowledged that such closures endanger economic performance but has yet to develop an effective strategy to deal with the problem. (b)(3)

11 **Taiwan: Economic Considerations Outweighing Environmental Concerns** (b)(3)

Taiwan's growing pollution problems stem mainly from the government's "growth at any cost" economic policies over the past four decades. Although popular support for cleaning up the environment has increased in recent years, environmentalists face an uphill battle because of Taipei's concern about the current slowdown in economic growth. We believe the issue will remain politically contentious, but environmental cleanup is unlikely to become a major part of Taipei's industrial policy, at least in the near term. (b)(3)

17 **EC: Impact of German Unification and East European Reforms on Agriculture Policy** (b)(3)

Although progress toward German unification and East European economic reform will gradually build pressure for reform of the European Community's protectionist Common Agricultural Policy (CAP), they are unlikely to significantly alter the EC's resistance to rapid liberalization of agricultural trade in the GATT Uruguay Round. By the mid-1990s, however, we believe rising East German farm output will increase CAP spending at a time when the EC will probably have to deal with mounting surpluses of such commodities as grain. Although budget constraints are likely to increase the likelihood of dramatic cutbacks in EC agricultural subsidies, EC member demands for some continued protection of agriculture might lead the Community to contemplate other policies troublesome to the United States. (b)(3)

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International
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Perspective

Growing Concerns Over Environmental Protection Costs [redacted] (b)(3)

The high price tag for protecting the environment is becoming more apparent as environmental issues attract greater political attention worldwide. Although West European countries generally remain firm advocates of strong environmental protection policies, some officials are beginning to have second thoughts. Japan believes environmental agreements offer opportunities to improve its image, but it also views such accords as potential threats to Japanese economic growth. East European and Soviet governments, meanwhile, are torn between domestic pressures to clean up the environment and the impact of such action on their ailing economies. Although the newly industrializing economies (NIEs) are beginning to face up to serious environmental problems, they are largely unwilling to adopt policies that may impede continued rapid economic expansion. Similarly, some LDCs have already indicated they will oppose any global environmental protection agreements that compromise their prospects for economic development. Despite the growing concern over costs, the momentum of international efforts to stem environmental degradation is unlikely to slow, and plans to address climate change, ozone depletion, and other environmental concerns will continue to develop at a rapid pace. Economic issues nevertheless will almost certainly play a growing role in upcoming international environmental debates. [redacted] (b)(3)

Growing economic concerns about the cost of environmental protection may affect—albeit modestly—Western Europe's continuing determination to press for agreements on global environmental issues—particularly climate change. Although most West European countries remain solidly behind efforts to develop agreements to address the climate issue and other concerns, economic ministries are becoming increasingly vocal in their criticism of greenhouse gas emission targets and may force governments to modify their environmental goals. [redacted] (b)(1) (b)(3)

In Japan, economic considerations carry greater weight than in Western Europe. Japan, for example, has opposed the carbon dioxide emission targets favored by West Europeans because it sees such targets as limiting Japanese economic expansion. The Japanese trade ministry is attempting to divert attention from emission targets by promoting a 100-year plan to tackle climate change, ozone depletion, and other environmental problems through the development of new technologies. Although the plan lacks formal government approval or funding, Japan's final policies, which may eventually include loose emission targets, will carefully protect its economic interests. [redacted] (b)(3)

In Eastern Europe, governments will have to face hard choices—balancing the popular mandate to clean up the environment with concerns over continued poor economic performance and rising unemployment. The GDR, Poland, Czechoslovakia, and Bulgaria already have announced plant closings or production cuts because of the negative environmental impact of specific plants. Some countries in the region also have begun to close coal mines as part of their effort to reduce their reliance on soft coal, which is particularly harmful to the environment. But demands for plant and mine closings on environmental grounds are beginning to be matched by union organization to defend jobs. Popular dissatisfaction with the environmental policies of the former East European governments helped bring about their downfall; the economic dislocation caused by policies such as plant closings could help crystallize discontent and lead to rejection of the newly elected governments. Although East Germany almost certainly will be spared this fate, its environmental problems are likely to become a significant economic burden for West Germany with the economic and environment union on 2 July. (b)(3)

Moscow faces a dilemma similar to that of its East European neighbors. Despite growing grassroots activism that has forced Soviet central authorities to give greater attention to environmental problems, if additional plant closing further exacerbate shortages of key industrial and consumer goods, public pressure for an environmental cleanup may be subordinated to the goal of restoring economic growth. In any event, although Moscow is likely to be responsive to international environmental pressures, it will probably use its economic problems as a reason for not participating in many environmental agreements unless it can receive Western financial and technical assistance. (b)(3)

Developing countries also demand aid and technology transfer as their price for participating in international environmental agreements. For example, some LDCs refuse to ratify the Montreal Protocol on Substances That Deplete the Ozone Layer until specific provisions are made to fund LDC acquisition of costly alternative technology needed to comply with the agreement's restrictions on common refrigerants, foams, and solvents. India is chief proponent of this view and recently sponsored a meeting of developing countries designed to build an LDC coalition that will pressure developed countries into providing aid in exchange for LDC acquiescence to environmental accords. LDC leaders also see environmentalism as a means to attract badly needed foreign investment. Countries such as Mexico, Brazil (in a reversal of its former policy), Paraguay, Ecuador, Chile, and Venezuela are actively seeking debt-for-nature swaps. (b)(3)

The next several months, meanwhile, may indicate the extent to which China intends to enforce the sweeping environmental protection law it enacted early this year. It will likely further concentrate its efforts on cleaning up at least some of its worst polluted cities and rivers. Nevertheless, China admitted recently that it cannot afford to reduce greenhouse gas emissions. Among the NIEs, Taiwan is slowly beginning to face up to the environmental problems that arose from rapid industrialization, although its unwillingness to make significant economic concessions will limit cleanup efforts. (b)(3)

The growing concern over the cost of environmental protection is likely to influence debates leading toward an agreement on climate change, in our judgment. In late August, the UN's Intergovernmental Panel on Climate Change (IPCC) will hold a plenary session in Sweden to thrash out the final version of its first assessment report on the causes, consequences, and policy responses to climate change. The report will be reviewed by the Second World Climate Conference in Geneva (29 October–7 November) and by the UN General Assembly. Both bodies almost certainly will make recommendations for a global climate convention, the negotiations for which could begin as early as December. Although economic issues such as targets and timetables for reducing greenhouse gas emissions and for providing aid to LDCs will probably be contentious, they are unlikely to delay passage of the convention. Nevertheless, economic concerns may prevent a number of countries from ratifying the convention or enforcing its provisions. (b)(3)

Several other ongoing or upcoming environmental conferences also will almost certainly be affected by economic issues. The Conference of the Parties to the Montreal Protocol that began this week in London, for example, will devote a significant portion of the meeting to discuss the establishment of a financial assistance mechanism to help LDCs reduce their CFC use. Concerns over the cost of environmental protection also are likely to affect the second preparatory conference for the 1992 UN Conference on Environment and Development, in August in Nairobi, and a meeting in Santiago in November on the Antarctic Minerals Regime Treaty. (b)(3)

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USSR: Environmental Pressures Hurting Industrial Performance [redacted]

(b)(3)

Over the last several years, numerous industrial plants throughout the USSR have been closed for damaging the environment. Most of the closures are a result of local initiative, with republic and national officials generally going along with local decisions. Although the closings have helped reduce pollution to some extent, they also have had a negative impact on already weak industrial performance. Indeed, the closure of polluting facilities has led to shortages of critical products—in particular, chemical and paper and pulp products. Although the leadership has acknowledged that plant closings endanger economic performance, it has yet to develop an effective strategy to deal with such closures. Gorbachev may believe shutdowns are less costly in the short run than devoting the resources necessary to clean up the environment—particularly at a time of large budget deficits and stiff competition for resources. [redacted]

Growing Environmental Concerns

Although the central government has ordered some plant closings because of pollution, most of the pressure has been at the local level. Soviet citizens—joining together in informal groups—have seized upon *glasnost* to vent their anger at the environmental degradation in which they live. Local officials—no longer able to ignore the problem in the open political climate—have in most cases agreed to the demands of such groups. In an about-face, the central leadership, which once would have stifled such dissent, has acquiesced. Indeed, key policymakers now freely admit the country faces serious environmental problems. Prime Minister Nikolay Ryzhkov, for example, noted earlier this year that more than 100 large cities in the Soviet Union have air pollution 10 times the acceptable levels set by the central government. The Soviet media—undoubtedly with Moscow's permission—also have encouraged the environmental movement by publishing disturbing stories on the human costs of pollution. As a result of the growing pressure, 70 to 100 Soviet industrial facilities were shut down in 1989, and almost twice as many have been closed or threatened with closure this year for violations of Soviet law on environmental protection, according to the Soviet press. Most of the closings involve chemical and timber-processing plants that have been polluting their surroundings for years. [redacted] (b)(3)

High Cost of Closures

Plant closings have led to shortages of critical products and have contributed to the poor performance of the Soviet economy. The deputy chairman of the State Committee for Statistics stated in April, for example, that "mass shutdowns—owing to public

USSR: Environmental Horror Stories

The Soviet media over the past year has helped fuel the nascent Soviet environmental movement with stories about the consequences of pollution. For example:

- *In Chardzhou, Turkmen SSR, children have been given gas masks to protect them from air pollution from a cotton-processing plant.*
- *In Ufa, Bashkir ASSR, poisonous phenol leaked from a chemical plant into the river that is the city's main water source, forcing the people to rely on supplies brought in by truck.*
- *In Ventspils, Latvian SSR—the site of a large chemical plant—40 percent of infants are born with serious congenital defects, such as blindness and mental retardation.* (b)(3)
- *In Chernovtsy, Ukrainian SSR, children developed baldness because of pollution from a local chemical plant.*
- *In Nizhniy Tagil, RSFSR, children's faces have been burned by smog caused by a 45-year-old coke oven at a steel plant there.* [redacted] (b)(3)

Soviet Popular Opinion:
The Environment Comes First

In a recent poll in the Moscow region conducted jointly by the Institute of Sociological Research of the USSR Academy of Sciences and a US university, those responding were more worried about domestic environmental problems than rising crime rates, food shortages, AIDS, and interethnic conflicts. More than three of four said they would refuse to tolerate environmental pollution for the sake of economic development. Moreover, respondents indicated they trusted "Green" groups more than any other institution in the Soviet Union apart from the church.

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Survey results are as follows:

Importance of Domestic Problems (percent)

	Very Important	*Important*	*Not Very Important*	*Unimportant*
Pollution	*75*	*23*	*1*	*1*
Crime	*72*	*23*	*4*	*1*
Food shortages	*69*	*25*	*4*	*1*
AIDS	*61*	*24*	*7*	*7*
Interethnic conflicts	*59*	*27*	*7*	*5*

Trust in Domestic Institutions (percent)

	Complete Trust	*Trust*	*Not Much Trust*	*No Trust*
Church	*18*	*47*	*24*	*5*
Green movement	*13*	*42*	*16*	*9*
Armed Forces	*12*	*44*	*34*	*8*
Communist Party	*5*	*33*	*37*	*17*
Trade unions	*4*	*33*	*39*	*19*
Government	*4*	*24*	*42*	*23*

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demand—of environmentally hazardous production units" were a major factor in the poor industrial performance during the first quarter of this year. For example:

- Closure of the Nairit Production Association—part of the huge Yerevan Synthetic Rubber and Chemical Plant, in Armenia—has halted the USSR's production of a particular type of synthetic rubber and has led to a severe shortage of certain medicines. Ryzhkov warned that closing the Nairit plant would result in shutting down 750 other industrial facilities that depend on it for materials, costing the national economy at least 14 billion rubles in lost output in 1990. As a result, he urged Armenian authorities to resume production despite the ecological costs, but the plant remains closed.

- The shutdown of several paper and pulp production plants has resulted in widespread shortages of various paper products. For example, the Sloka Pulp Plant in Latvia—closed earlier this year because it had contaminated popular vacation beaches by dumping untreated waste into the nearby Baltic—was the USSR's sole source of paper for computer punchcards, book and magazine covers, braille publications, and packaging for cigarettes and ice cream cups. The USSR Council of Ministers has predicted the closing of such plants will lead to an overall pulp shortage of 500,000 tons and losses of 1 billion rubles per year.

USSR: Major Plants Closed During the First Quarter of 1990 for Environmental Reasons

	Location	Principal Products
Nairit Production Association (entire plant)	Yerevan, Armenian SSR	Plastics, synthetic rubber, chemicals for medicines.
Copper-smelting combine (production unit)	Kirovgrad, RSFSR	Acid used in production of medicines.
Azot (Nitrogen) Production Association (production unit)	Kemerovo, RSFSR	Chemicals for medicines.
Kiev Chemicals Plant (production unit)	Kiev, Ukrainian SSR	Chemicals for medicines.
Azot Production Association (production unit)	Dneprodzerzhinsk, Ukrainian SSR	Chemicals, including medicines.
Khimprom (production unit)	Ufa, Bashkir ASSR	Chemical fibers.
Sloka Pulp Plant (entire plant)	Jurmala, Latvian SSR	Paper products, including computer punchcards.
Sulfuric acid plants (three entire plants)	Kedainiai, Lithuanian SSR	Fertilizer.
Synthetic and fatty acid plant (entire plant)	Berdyansk, Ukrainian SSR	Soap.
Copper-smelting combine (entire plant)	Karabash, RSFSR	Copper.

This table is Unclassified.

- The closing—for environmental reasons—of three sulfuric acid plants in Lithuania before its declaration of independence will mean that all-union production of fertilizers is likely to be 1 million tons—or some 3 percent—less than planned, according to Western reporting. [redacted]

The social costs of closing polluting plants—in particular, increased unemployment—also may be high. According to *Pravda*, more than 6,000 workers in the printing industry will have to find other jobs because of the Sloka closing. To help minimize the social costs of closures and reduce the threat of unrest, authorities in some cases have closed only small production units rather than the entire plant. In other cases, plants have been closed repeatedly because the ministries made either few or no changes. For example, the Nairit plant had been closed in 1988, and the Kemerovo plant had been closed in 1984 and again in 1989. [redacted]

Despite the economic and social costs, closing polluting plants is generally less expensive than modernizing or converting the facilities. Where the costs of conversion appear to be acceptable, the Soviets have begun to make such changes. A chemical plant in Barnaul, for example, shifted from the production of paints and solvents to the production of medicines. Converting a plant from one product to another that is compatible with the facility's equipment, however, does not guarantee against further pollution. [redacted] (b)(3)

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Moscow Lacks a Game Plan

Although the Soviet leadership has acknowledged that plant closings endanger economic performance, it has yet to develop an effective strategy to deal with such closures. To date, Moscow's response has been largely bureaucratic, calling upon a national commission, the ministries, and oblast and republic officials to work toward reopening the plants on an environmentally sound basis. The two governmental agencies charged with protecting the environment—Goskomgidromet, the State Committee for Hydrometeorology and Environmental Control, and Goskompriroda, the State Committee for the Protection of Environment—have been jockeying for power since Goskompriroda (b)(3)

Shortages of Essential Medicines

Soviet officials agree that an emergency situation in availability of medicines has developed as a result of chemical plant closings. The Ministry of the Medical Industry projected a 30- to 40-percent decrease in production in 1990 because of the shortages of raw materials. At least one-third of all Soviet plants that produced medicines and drugs were closed for environmental reasons in 1989, according to a Western specialist speaking at an international conference in March. The Nairit plant in Armenia, which was closed earlier this year, produced cardiovascular drugs, muscle relaxants, fever retardants, pain relievers, and vitamins. Closing the production unit at the fertilizer plant in Kemerovo, meanwhile, halted the output of chemicals necessary for the manufacture of 14 medicines, including antibiotics and gastrointestinal and cardiovascular drugs, as well as medical supplies such as X-ray film. Shutdowns of chemical plants in Kiev and Dneprodzerzhinsk resulted in similar losses, and the copper-smelting combine at Kirovgrad was forced to stop production of an acid used in the manufacture of antibiotics and cardiovascular medicines. [redacted]

According to Prime Minister Ryzhkov, the USSR in 1989 was forced to buy some $954 million worth of medicines abroad—much of it for hard currency. He implied that the government would be hard pressed to meet similar expenses in 1990. Nevertheless, additional medicines have been purchased abroad, according to an official in charge of distribution. [redacted]

Soviet Environmental Legislation

Over the past 20 years, the Soviets have passed numerous environmental protection regulations in an effort to deal with their serious pollution problems. The legislation sets penalties for noncompliance such as:

- *Jail terms and confiscations of property for damages caused by mining.*
- *Jail terms, correctional tasks, or fines for illegal deforestation.*
- *Fines and imprisonment for release of industrial pollutants into water sources that supply the population and agriculture.*
- *Fees charged for disposal of industrial pollutants.*

The Soviets, however, have not enforced environmental protection regulations equally against offenders. Indeed, some industries—including the worst polluter, the chemical industry—have been exempted. [redacted] (b)(3)

More recently, the Supreme Soviet in 1989 announced the "Urgent Measures for the Country's Ecological Improvement" that set standards for reduced levels of air and water pollution by the year 2005. The legislation, however, is still under discussion in the Committee on Ecology and Rational Utilization of Natural Resources. Even if it clears the committee, the legislation is unlikely to be passed by the Supreme Soviet because of its high price tag. Moreover, Goskompriroda, the national government agency created in 1988 to enforce environmental protection laws, still does not have the constitutional authority to carry out all-union compliance. [redacted] (b)(3)

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was created in 1988. Goskomgidromet is mandated to function as the monitoring agency and Goskompriroda as the policymaking and enforcement agency. The former, however, has not given up many of its activities that may be perceived as endangering the environment such as damming and rerouting rivers, and Goskompriroda still does not have the constitutional authority to enforce all-union compliance. As a result of the bureaucratic wrangling, enforcement of existing environmental protection laws is weak, and additional empowering legislation languishes in the Ecology Committee. [redacted] (b)(3)

Moscow also has failed to provide the economic incentives needed to motivate republics and industrial enterprises to clean up the environment. For example,

Old man: "In our youth, this is where we swam, dived . . ."
Boy: "So that's why you're sick and old!" (U)

although the Soviets allocated only an estimated 1 percent of GNP to environmental protection, the ministries and republics have been spending only about half to two-thirds of the funds they are granted. The Council of Ministers took a step in the right direction recently by creating Ekoprom—a consortium to produce ecologically mandated equipment. The Council hopes a proposed tax system that imposes large fines on polluters will encourage enterprises to buy such equipment. Moscow, however, would have to strengthen enforcement capabilities if it expects the legislation to be effective. [redacted] (b)(3)

Moscow's foot-dragging on environmental protection issues, to some extent, may be deliberate. Gorbachev probably views sporadic plant closings as a short-term way of dealing with environmental problems, with a cost less expensive than that of undertaking a complete industrial cleanup. The longer he delays in taking the necessary steps to modernize existing plants, however, the greater risk he runs that additional unplanned closings will occur, lowering output still more and further worsening shortages of industrial and consumer goods. [redacted] (b)(3)

[redacted] (b)(3)

Taiwan: Economic Considerations Outweighing Environmental Concerns [redacted]

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Taiwan's growing pollution problems stem mainly from the government's "growth at any cost" economic policies over the past four decades. Popular support for cleaning up the environment has increased in recent years; the issue played a role in last December's legislative elections. Nevertheless, environmentalists face an uphill battle because of Taipei's concern about the current slowdown in economic growth. Moreover, the government's plans to push ahead with several industrial projects to alleviate domestic shortages suggest that the environmental situation is likely to become even worse. We believe the issue will remain politically contentious, but environmental cleanup is unlikely to become a major part of Taipei's industrial policy, at least in the near term. [redacted]

Pollution on the Rise

Although a dearth of information makes it difficult to assess the extent of Taiwan's pollution problem, it is becoming increasingly clear that pollution has become a serious problem over the past decade:

- International environmental experts estimate that Taiwan produces at least 60,000 metric tons of industrial waste daily, which would rank it third—behind Poland and Czechoslovakia—in the amount of waste produced per square kilometer, according to recent OECD statistics.
- The island produces some 5,700 tons of sludge daily—40 percent of which is contaminated with pesticide residues and heavy metals.
- According to press reports, more than half of Taiwan's pesticide factories do not use advanced pollution control technology—such as incinerators—and fail to meet the Taiwan Environmental Protection Agency's (TEPA) [1] air and water emission standards, which are more lax than their US counterparts.
- Water pollution helped lower Taiwan's inland fisheries production by approximately 80,000 tons—some 23 percent—during the 1980s. According to press reports, three of Taiwan's 15 rivers no longer contain any fish, except for very short stretches. [redacted]

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Government Policies Largely to Blame

Taiwan's "growth at any cost" economic development policies over the past 40 years and, to a lesser extent, the growing wealth of its citizens are largely responsible for the increase in pollution: (b)(3)

- The government has encouraged domestic and foreign investment in "dirty industries," such as petrochemicals, pesticides, paper production, and leather tanning. For example, investment in such industries during the 1980s accounted for nearly 30 percent of total investment, with the chemical industry alone absorbing nearly 20 percent.
- Taipei has done little to stem the growth of illegal factories. Roughly a third of Taiwan's estimated 90,000 factories are not registered and thus are ineligible to take part in any government-assisted cleanup programs.

[1] The cabinet-level TEPA was established in August 1987, replacing the Bureau of Environmental Protection, which was under the Department of Health. TEPA employs more than 900 enforcement officers, and its budget for 1990 is approximately $360 million. (U)

Taiwan's Major Pollutants

Inert and semi-inert substances *include the nonbiodegradeable plastics, glass, and metal found in ordinary garbage. Taiwan's average daily output of household waste has increased 8 to 10 percent annually since the early 1980s, according to press reports, reaching over 17,000 tons a day and bringing per capita garbage output close to the 2- to 4-pounds-per-day level of developed nations. A particular problem is the 250-million plastic soda bottles Taiwan consumes annually, which, since becoming popular in the mid-1980s, have been blocking drainage systems and causing flooding in large cities.* [redacted]

Biologically active wastes*, such as food wastes, paper, fertilizers, human and animal bodily wastes, often cause health problems. Only 2 percent of Taiwan's 20 million people receive sewer service, and less than 3 percent of Taiwan's human and animal sewage, which flows directly into groundwater, rivers, and the sea, is treated. As a result, approximately 20 percent of Taiwan's population is infected with hepatitis B, the highest rate in the world, according to press reports. Hepatitis B causes approximately 85 percent of Taiwan's cases of cirrhosis and cancer of the liver and causes some 4,000 deaths annually.* [redacted]

Hazardous wastes *include caustic chemicals, pesticides, radioactive wastes, heavy metals, and a range of other substances used or produced by industry, agriculture, or people. The Taiwan Environmental Protection Agency (TEPA) lists 13 of Taiwan's 21 rivers as heavily polluted, and eight others as lightly to moderately polluted. According to press reports, only 15 percent of Taiwan's groundwater supply is safe to drink.* [redacted] (b)(3)

Atmospheric emissions *consisting of gases, such as carbon monoxide, hydrocarbons, and chloroflurocarbons, are produced by motor vehicles, factories, and aerosols. Some of the island's worst air pollution occurs in the Kaohsiung region because of its heavy concentration of petrochemical, cement, steel, and paper-processing facilities. Fifty-six percent of all air quality warnings in Taiwan in the first 10 months of 1989 were issued in the Kaohsiung region. The TEPA issues warnings only when a given monitoring station records a pollution standard index (PSI) rating over 200 or when weather in an area prevents speedy air diffusion; international standards rate PSIs under 50 to be light, between 50 and 100 to be moderate, between 100 and 150 to be high, and PSIs over 150 to be medically dangerous.* [redacted]

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- The government's ambitious highway construction program has opened Taiwan's mountain interior and less congested west coast to illegal logging and waste dumping. The program also has encouraged auto ownership.

- Taipei's rural industrialization policy—aimed at balancing regional development and discouraging emigration to overcrowded cities—has spread polluting industries across the island and prevented centralization of waste treatment and recycling facilities. For example, Taipei's plan to ease Taiwan's severe shortage of industrial land by constructing its first offshore industrial zone on an undeveloped island near Yunlin County in southeastern Taiwan will introduce heavily polluting industries, such as petroleum processing.

- Government regulations require the government-owned Taiwan Power Company (Taipower)—a major polluter—to purchase locally produced coal, although it generates more smoke and sulfur than imports. Environmentalists and fishermen also charge Taipower with destroying aquatic life by dumping hot water from power plants into lakes and the sea.

- The island's economic success, which has more than doubled annual per capital income over the past five years to about $7,500, has launched a buying spree that has played a significant role in Taiwan's pollution problems. Taiwan now has 2 million cars and 7 million motorcycles—and the island is importing more than 10,000 automobiles per month. According to press reports, Taipei's traffic density is 10 times greater than that of Los Angeles. Taiwan's lack of an adequate public transportation system compounds the problem; major portions of the island's $16 billion subway system are 10 years behind schedule.

Despite Growing Support for the Environment . . .

Public anger over the ruling Kuomintang's (KMT)—or Nationalist Party's—failure to deal with pollution has risen in recent years. Indeed, environmental issues, along with a host of other social problems, are sparking almost daily protests. According to Taiwan media surveys, 20 percent of the demonstrations held since the lifting of martial law in 1987, which legalized open dissent, were linked to the environment; some 400 antipollution protests were staged between October 1988 and November 1989. Although the majority of these demonstrations are loosely organized outbursts over local issues—such as gas leaks, damage to fisheries, or the construction of new factories—concern over the environment helped reduce the KMT's share of the vote in last December's legislative elections to below 70 percent for the first time, according to the American Institute in Taiwan (AIT). Meanwhile, the victories of several Democratic Progressive Party (DPP) candidates—the major opposition party—stemmed in part to the party's pledges to prevent construction of environmentally controversial projects such as a fifth naptha cracking plant and a fourth nuclear power plant.[2]

. . . Environmentalists Face An Uphill Struggle

Despite the groundswell of popular support, rising public demands for reform of Taiwan's outdated legislative system and jockeying for power within the KMT are preoccupying the leadership and pushing the environment onto a back burner. Moreover, recent changes in the government's leadership mean an especially tough battle for environmentalists. In his first interview after being appointed premier in May, Hao Po-ts'un pledged to push ahead with the construction of several major projects—presumably the fifth naptha cracking plant, the fourth nuclear power plant, and the DuPont titanium dioxide complex[3]—that have been delayed by environmental protests and to prevent such demonstrations from interfering with economic development. In addition, according to press reports, newly appointed Defense Minister Chen Li-an is an outspoken supporter of the progrowth philosophy and believes all environmental motivated protesters are seeking to blackmail government and private corporations rather than improve the environment. Although he has called on firms to give greater priority to controlling pollution, Chen and other KMT officials have threatened to use the military police to reopen factories during several prolonged protests. (b)(3)

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Even before these appointments, however, the depth of official support for environmental cleanup was questionable. In May 1989, for example, Taiwan's legislature cut TEPA's budget by some 5 percent—$28 million—claiming that the Agency performed poorly. Meanwhile, other government agencies have opposed TEPA's enforcement of environmental protection laws. The Taiwan Board of Health, for example, so far has successfully opposed TEPA's efforts to press hospitals to dispose of medical waste properly. According to press reports, the Industrial Development Bureau (IDB)—which represents industry's interests in government economic planning and administers the special economic zones—last year refused to pay a TEPA fine for illegally discharging hot water from one of its waste water treatment facilities and, subsequently, won a court case brought against it by the TEPA. (b)(3) (b)(3)

[2] China Petroleum Corporation's fifth naptha cracking plant—naptha is a petroleum product used in producing solvents, petrochemicals, and synthetic natural gas—and Taipower's fourth nuclear power plant have met with stiff opposition and sometimes violent protests from residents of the areas in which they are scheduled to be built. These protests have delayed the government's plan to construct the facilities from the middle-to-late 1980s. (U)

[3] DuPont has attempted to build this $235 million paint pigment facility in Taiwan since 1984. Environmental protests have prevented construction, despite government support for the plant's construction. (U)

Taipei's Cleanup Program: A Paper Tiger?

During the past three years, Taipei has announced a number of ambitious plans it hopes will significantly reduce pollution by the year 2000. Although we harbor serious doubts about senior Taipei officials' commitment to many cleanup programs, TEPA director Eugene Chien claims Taipei and the private sector will spend approximately $40 billion over the next decade to improve Taiwan's environment. The government is also considering new environmental protection regulations and incentive packages—including tax breaks and low interest loans—to encourage businesses to import antipollution equipment:

- *In an effort to strengthen Taiwan's antipollution legislation, the TEPA is drafting 60 new and amended laws and regulations. Although the TEPA will begin submitting the new measures to the Executive Yuan—Taiwan's cabinet—early next year, press reporting indicates they are unlikely to go into effect before 1993.*

- *TEPA and Taipower are working on a plan to cut off electricity supplies to serious polluters because many ignore TEPA fines or bribe officials to look the other way. If Taipower cooperates fully, this program could become TEPA's most important weapon against polluters because, according to press reports, the fines issued by the TEPA—$40 million last year, double the 1988 figure—failed to deter polluters who accept them as a cost of doing business. According to AIT reporting, many corporations routinely budget funds for fines imposed for violating pollution regulations or refuse to pay fines because the TEPA has little enforcement authority.*

- *To help reduce air pollution, Taiwan required catalytic converters on all domestic and imported cars beginning this year.* [redacted]

(b)(3)

The antipollution drive also has been hampered by overlapping authority and bureaucratic infighting between the various government agencies responsible for overseeing cleanup operations. For example, jurisdictional ambiguities among the TEPA, the Defense Ministry, and the Communications Ministry delayed action for several days last April when a storm-damaged freighter dumped more than 1,300 barrels of oil onto Taiwan's north coast. Currently, a dispute between the TEPA and the IDB over the number of factories Taiwan's first toxic waste disposal facility will serve is delaying construction of the facility. [redacted] (b)(3)

Environmentalists also face a formidable opponent in Taiwan's business community, which has argued the government should focus more attention on economic growth and less on environmental concerns. Industries point to Taiwan's economic slowdown over the past two years—industrial production grew by only 4.1 percent annually during the 1988-89 period compared with 13.9 percent in 1987, according to press reports—as proof that environmental protests and stricter government pollution standards are harming the economy. In particular, businessmen claim:

- Environmental protests are partially responsible for domestic and foreign companies postponing or canceling investments.[4] They point to Taiwan authorities' willingness to give into environmentalists' demands at the Linyuan petrochemical zone protest in 1988 and the decision by Formosa Plastics—Taiwan's largest private corporation—to suspend investment in Taiwan because of opposition to the firm's plans to build a petrochemical plant on the island.

[4] The Linyuan incident, Taiwan's first major environmental protest, was staged in October 1988 by local residents angered by heavy soil and water pollution caused by the zone's 18 petrochemical facilities. To stop the protest and reopen the zone—which produces 75 percent of Taiwan's petrochemicals and supplies more than 30,000 secondary factories—government authorities awarded Linyuan residents $45 million. Taipei then demanded that the Linyuan plants finance the compensation fund, a move that sparked a series of copycat demonstrations during the first half of 1989 that were largely motivated by hopes of similar settlements, according to AIT reporting. [redacted] (b)(3)

Exporting Pollution: The Case of Formosa Plastics

Formosa Plastics is moving forward on a deal to construct a $3.5 billion industrial complex in Xiamen Special Industrial Zone in China, according to the US Consulate in Guangzhou, because Taiwan environmentalists prevented such construction on the island. The complex, which would roughly triple the dollar value of Taiwan's mainland holdings, is expected to include a naptha cracking plant and related factories producing plastics and raw materials for synthetic fibers. Industry specialists estimate that total investment could reach $7 billion once secondary apparel, toy, and electronics-manufacturing facilities are added. Increasingly eager to attract Taiwan investment as Western investors look to Eastern Europe and Southeast Asia, Chinese authorities are offering Formosa Plastics a number of incentives, including the use of roughly 100 square kilometers of land, $1.2 billion in transportation and communications upgrades, and more than $210 million in financing, according to US Embassy reporting. The project, however, faces several obstacles. Taipei officially bans investment on the mainland, and, although the ban has not been enforced, the high visibility of this project is causing concern among Taiwan authorities, who believe it would open the floodgates of large-scale investment, further binding Taiwan's economy to the mainland. [redacted]

- The cost of pollution control equipment and plant startups delayed by environmental protests have helped push a number of industries offshore. (Taiwan's direct overseas investment in 1989 was more than $7 billion—equivalent to 5 percent of GNP—and is expected to reach $11 billion in 1990.) Even state-owned firms—such as China Steel Corporation—are looking to build new facilities overseas because of antipollution protests against its construction plans. While China Steel is examining sites in Australia, Malaysia, and Canada for an $80 million factory capable of producing more than 3 million tons of steel annually, Taiwan is relying increasingly on steel imports from South Korea and Japan—nearly 3 million tons in 1989—to meet domestic demand. [redacted]

Little Relief in Sight

Despite the growing public support for environmental protection, we believe concern over the economy makes it unlikely the government will take the necessary steps to significantly curtail pollution. Indeed, barring a major environmental accident—such as an explosion at a petrochemical complex or the release of a significant quantity of radioactive material from a nuclear plant—Taipei is likely to make several decisions in the coming years that will risk further damage to the environment:

- Growing power shortages are likely to convince Taipei to move ahead on plans to build a third oil refinery. Environmentalists have delayed construction of the facility since 1988, but, with Taiwan's two plants falling short of daily consumption by 70,000 barrels and government officials anticipating serious shortages of gasoline, low-sulfur fuel oil, and liquefied petroleum gas by the mid-1990s, construction is likely.
- The Ministry of Economic Affairs is vowing to begin construction of a $5 billion, 2,000 megawatt fourth nuclear power plant next year, despite strong opposition from Taipei County residents and the DPP. Environmentalist are worried about Taipower's poor nuclear safety record. (b)(3)
- The government is likely to move forward on the construction of a fifth naptha cracking plant. Taiwan authorities probably believe they must act quickly to avoid greater shortages of ethylene, which would cripple the island's petrochemical, and related industries. These industries account for 37 percent of Taiwan's gross national product. [redacted] (b)(3)

If economic growth rises, the government will probably focus more on environmental protection but is unlikely, in our judgment, to make it a major part of Taiwan's industrial policy, at least in the near term. (b)(3) In any event, environment issues are likely to remain contentious and to continue to play a political role—particularly at the local level. [redacted] (b)(3)

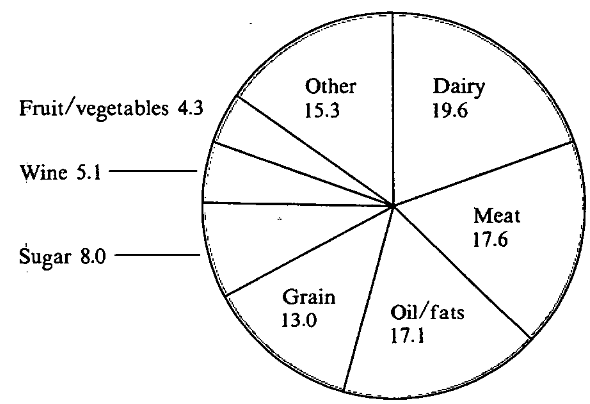
[redacted] (b)(3)

EC: Impact of German Unification and East European Reforms on Agriculture Policy [1]

Although progress toward German unification and East European economic reform will gradually build pressure for reform of the European Community's protectionist Common Agricultural Policy (CAP), they are unlikely to significantly alter the EC's resistance to rapid liberalization of agricultural trade in the GATT Uruguay Round. In the near term, the CAP can readily accommodate East Germany because an increase in demand for food in the GDR is expected to exceed any rise in GDR agricultural output. By the mid-1990s, however, we believe rising East German farm output will increase CAP spending at a time when the EC will probably have to deal with mounting surpluses of such commodities as grain. Moreover, Eastern Europe's likely shift from a net food importer to a net exporter by the end of the decade will probably add to the CAP's subsidy costs by pushing down global food prices. Although budget constraints are likely to increase the likelihood of dramatic cutbacks in EC agricultural subsidies, member-states are likely to demand some continued protection of agriculture. As a result, the Community may contemplate other policies troublesome to the United States, such as indirectly reducing US exports to the EC market by granting East European products wider access. [redacted]

1989 EC CAP Budget, by Product *Percent*

Total: 25.7 billion ECU



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(b)(3)

Limited Impact in the Near Term but . . .

Over the next year or two, we expect continued German integration to provide more opportunities than problems for Western farmers. East Germany's demand for more varied and better quality food products almost certainly will rise as economic recovery progresses, with the growth in demand likely to outpace the country's agriculture production. As a result, the imbalance is likely to create greater sales possibilities for European and US food producers and widen the GDR's $1.2 billion deficit in agricultural trade—already one of the highest in Eastern Europe. [redacted]

[redacted]

Because East Germany is likely to remain a net agricultural importer at least in the near term, its absorption into the CAP should pose few problems—especially in the important dairy and grain sectors; these two sectors, along with meat and oilseeds, currently account for the bulk of CAP spending.[2] [redacted]

(b)(3)

[2] East Berlin will introduce the EC price and market intervention system on 1 July, adjusting producer prices to EC levels in one step. A subsidy program will be introduced to reduce output of some goods and a cash compensation program will be implemented. T(b)(3) latter aid is intended to strengthen the liquidity of GDR farms. [redacted]

(b)(3)

(b)(3)

East European Food Exports: Knocking on the EC's Door

East European countries view agriculture as an important sector of their economies and will emphasize it in their reform programs. Food production accounts for about 20 percent of the region's GNP and employs nearly 22 percent of the labor force. This compares with 2.3 percent of GDP and 8 percent of the labor force for the EC. Moreover, exports of food and raw agricultural products have been both a major earner of hard currency on Western markets and important in barter trade with the USSR to acquire energy and raw materials. [redacted]

The East Europeans are pressing for increased access to the EC market—particularly in meat, dairy, and grains—in order to earn badly needed hard currency to modernize their economies. A Hungarian economic official, for example, has expressed concerns over EC protectionist tendencies, arguing that the EC needs to open its agricultural markets and abandon its agriculture subsidies if it is serious about aiding the East. The EC has always been a key market for East European agricultural goods, taking about a third of the region's agricultural exports. In fact, Eastern Europe is a net exporter of foodstuffs to the Community despite protectionist EC policies, such as quotas on East European beef that were imposed in 1974. [redacted] (b)(3)

The EC probably realizes that it will have to make concessions to Eastern Europe in agriculture or face the anomaly of supporting liberalizing economic reforms in the East European countries while still protecting the EC's own highly managed agricultural system. In our view, the EC is likely to grant the East Europeans "controlled access" to its agriculture market. Potential East European food exports are in sensitive EC sectors, and the Community is likely to negotiate new voluntary restraint-type agreements with the individual East European countries or expand existing quotas. These would most likely be in meat and dairy products, along with some grains. It already has increased the beef quotas granted to Hungary, Romania, Poland, and Yugoslavia and suspended import levies for sheep and goat meat for all the East European countries except Romania. [redacted] (b)(3)

(b)(3)

The EC is likely to be generous when deciding how to adjust existing production quotas on dairy products and grain to take account of the GDR's entry, in part to avoid antagonizing Bonn at a time when most Europeans want to "anchor" Germany more firmly in the Community. In addition, with Europe's famous butter-and-cheese mountains now virtually eliminated, the EC has more leeway in raising its milk quota to accommodate most East German milk production—currently equivalent to an estimated 8 percent of EC production. The EC also will probably have little trouble expanding the Community's grain production limit by some 6-7 percent because the GDR at present is a large net grain importer. The Community, however, is unlikely to agree to any West German demands to suspend the rules mandating automatic price cuts if the new production limits are breached. Offsetting these increased costs will be the likely expanded sales to the GDR of EC surplus products such as fruit, vegetables, and wine. [redacted] (b)(3)

. . . Competitive Challenge Expected Eventually

By the mid-1990s, East German agriculture may pose a major competitive challenge to West German farmers. West German agricultural specialists note that parts of the GDR were once considered the "granary of Germany" and that some of its land is still the most productive in Germany. More important, the economies of scale made possible by East Germany's large farm cooperatives confer significant advantages. Although many of the collectives' component farms are

Comparison of West and East German Agricultural Sectors, 1987

	FRG	GDR
Size		
Hectares *(million)*	12.0	6.0
Farms *(thousands)*	685	4
Employment *(millions)*	1.5	0.9
Average farm size *(hectares)*	17.0	1,500.0
Grain production *(million metric tons)*		
Wheat	9.9	4.0
Barley	8.5	4.2
Rye	1.5	2.2
Yields *(100 kilogram/hectares)*		
Grains	50.6	45.6
Winter wheat	60.0	54.2
Barley	47.0	47.1
Potatoes	332.0	272.7
Sugar beets	507.1	350.2

This table is Unclassified.

Eastern Europe: Supply and Demand for Wheat and Coarse Grains [a]

	Area Harvested *(million hectares)*	Yield *(metric tons per hectare)*	Production *(million metric tons)*	Net Imports *(million metric tons)*
1979/80	29.0	3.14	91.1	14.7
1980/81	29.0	3.35	96.9	11.5
1981/82	28.8	3.31	95.1	8.2
1982/83	28.8	3.70	106.5	3.9
1983/84	28.9	3.54	102.3	2.4
1984/85	29.0	3.96	114.8	−0.6
1985/86	28.7	3.56	102.1	4.6
1986/87	29.1	3.86	112.3	2.4
1987/88	28.5	3.61	102.7	4.3
1988/89	29.1	3.59	104.3	3.0
1989/90	29.2	3.73	108.9	4.7

[a] Includes Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania.

This table is Unclassified.

likely to be reprivatized as part of the reform effort in the GDR, we expect East German farms to remain much larger than those in West Germany.

In light of economic reforms and modernization accompanying unification of the two Germanys, the GDR could increase its agricultural output 20 to 30 percent by the middle of the decade because:

- Market-determined prices will strengthen incentives for the production of goods in which East Germany is most efficient.
- Western know-how will improve crop yields, which currently are roughly 20 percent below West German levels.
- Investments in transportation, storage, and distribution systems will remove bottlenecks that currently limit production and keep costs high.

Embassy reporting, however, indicates that some East German officials are less optimistic and that they believe the emphasis being placed on the environment may limit GDR yield increases—or take land out of production—and dampen the anticipated competitive challenge.

If, as we expect, East Germany's agricultural output significantly exceeds the GDR's demand for food by the mid-to-late 1990s, a sharp rise in CAP spending is (b)(3) likely. Surpluses in commodities such as grain would grow, forcing the EC to spend larger sums to subsidize exports—if still permissible under post-GATT–Uruguay Round rules—or store the excess.[3] The size of the increase in CAP outlays will depend on world agricultural prices and the health of EC economies. The greater the decline in world food prices, the more untentable high EC support prices are in the face of rising surpluses. Increases in outlays for the CAP are restricted to 74 percent of the Community's GNP growth rate. (b)(3)

A similar transformation of other East European countries into substantial agricultural exporters would (b)(3) add to the pressure on the CAP—by lowering world prices—even if the EC does not open its doors to Eastern agricultural products. (b)(3)

[3] The USDA estimates that merely bringing East German yields up, and feed use levels down, to West German levels would make (b)(3) approximately 3-4 million tons of wheat and barley available for export each year. (b)(3)

EC Agriculture Policy and the Uruguay Round

Movement toward German unification is unlikely to have a significant impact on the EC's hardline position on agriculture in the GATT Uruguay Round talks. The EC already has submitted its proposal for the talks, which are scheduled to end in December. The EC is pushing a minimalist "global approach" that would entail "rebalancing," a concept that would allow raising protection on some products while lowering it on others, as long as the overall level of protection is reduced:

- *The EC advocates a progressive reduction in domestic support for farmers over five years with the goal left undefined, rejecting the US call for the elimination within 10 years of these subsidies.*
- *Brussels, adamantly rejecting the US proposal for eliminating export subsidies, urges instead that they only be reduced in line with cuts in import levies.*
- *The EC accepts only in part the US concept of "tariffication," a process that would convert all nontariff barriers to tariffs and then reduce them to near zero, but would permit a "corrective factor" to be added to allow tariffs to counteract changes in exchange rates and world market prices. In addition, Brussels has tied partial "tariffication" to acceptance of "rebalancing."*

The Community feels it already has made a major concession by accepting partial tariffication and appears to hope that a delay in serious talks at least until September will prompt concessions from GATT members concerned about meeting the December deadline for concluding the round. Indeed, the Kohl government is facing national elections in December and is loath to antagonize the crucial farm vote by making sweeping concessions. While the EC may be reluctant to make major concessions because of the uncertainty of incorporating the GDR into the CAP, we believe the Community still places a high value on successfully completing the GATT talks and will give them the high-level political attention necessary to make last-minute concessions when negotiations enter the homestretch. [redacted] (b)(3)

According to a recent USDA study, the region has the capability to become self-sufficient in most foods and to become a substantial overall net exporter of agricultural products by the end of the decade. For example, should the region close its agricultural productivity gap with the West by half, it would become a net grain exporter, according to USDA [redacted] (b)(3)

Additional Pressures for CAP Reform

In addition to growing agricultural surpluses, other factors are likely to sow the seeds for CAP reform during the last half of the decade. Unification is likely to shift the regional balance of power within Germany, changing Bonn's traditional opposition to agricultural reform. At present, West German policy is shaped by the politically influential south—Bavarians have held the Agriculture Ministry for over 20 years—rather than the more efficient north. The addition of more efficient farmers in eastern Germany will eventually dilute Bavaria's influence on agricultural policy and probably tip the balance in favor of greater market liberalization. Assuming northern Germany shares in the economic boom unification is expected to bring, northern farmers are likely to find common cause with their eastern counterparts and be more supportive of a more market-oriented agriculture regime. [redacted] (b)(3)

Other Community members are also likely to view more favorably fundamental reform of the CAP—that is, increased production quotas, and virtual elimination of the dual-price system—by the end of the decade. Indeed, Paris—a frequent hardliner—already is indicating that it believes French grains are competitive in a free market and occasionally espouses making the CAP more market oriented. Other factors will probably work to weaken political support for subsidization of agriculture in Europe:

- Concerns over the environmental effects of agricultural overproduction are likely to grow in coming years, pushing the EC to implement reforms that would reduce its agricultural surpluses.
- Demographic trends—especially the expected retirement of the majority of farmers during the next decade in both Germany and France—will reduce the farm lobby's political influence [redacted]

Even with reform of the CAP, the EC likely will remain committed to some protection for agriculture, as evidenced by its hardline position at the GATT Uruguay Round negotiations. Over the next several years, as the scope of Eastern Europe's challenge to the CAP and world agriculture trade becomes clearer, we expect the EC to discuss options ranging from retargeting subsidy policies to market-sharing arrangements. Community agricultural policy may move closer to US preferences, such as the EC ending its resistance to the US-favored idea of substituting direct income supports to farmers for price supports. US exports to Western Europe could face major obstacles, however, if the West German Government gives in to growing political pressure to limit the access of US agricultural products to the Community—particularly soybeans and nongrain feedstuffs. Bonn presumably would try to persuade its EC partners that such limits on US exports is an acceptable price for reform of CAP subsidy mechanisms. [redacted]

(b)(3)

[redacted]

(b)(3)

(b)(3)

China: Seeking GATT Membership [redacted] (b)(3)

Beijing's desire to become a full member of the General Agreement on Tariffs and Trade (GATT) has increased in light of the recent changes in Eastern Europe and the Soviet Union and of China's need to boost exports because of poor prospects for foreign investment and tourism earnings. But China's case for GATT membership as an LDC on the basis of promised economic reforms has been weakened by Beijing's backtracking on decentralization and trade reforms. In any event, Chinese accession to GATT, in addition to raising a number of thorny issues such as Soviet and East European membership, would probably accelerate the growth of Chinese exports to the United States but would have little impact on US sales. As a result, China's bilateral trade surplus would grow at a faster pace and economic frictions would intensify. [redacted]

Membership Becoming Increasingly Important

Beijing's sense of urgency that GATT members approve China's application for membership has grown this year because of:

- Taiwan's application for GATT membership in early January.
- Chinese fears that many Western nations will begin to consider China less important as a result of recent changes in Eastern Europe and the Soviet Union.
- The need to promote exports has become more pressing as hard currency earnings from tourism have plummeted and prospects for foreign investment have dimmed following the crackdown last June on prodemocracy demonstrators. [redacted]

GATT membership would provide several tangible economic benefits to China that observer status—granted to China in 1985—does not. For example, membership provides China unconditional most-favored-nation trading status from other GATT members, except those that opt to decline to apply GATT principles to their trade with China at the time of Beijing's accession. In addition, GATT membership would give Beijing recourse to the GATT's dispute settlement provisions to protect China from unfair adjudication of complaints by its trade partners. [redacted] (b)(3)

Key Stumblingblock: Applying as an LDC

Beijing's insistence that it be admitted to the GATT as a less developed country (LDC) rather than as a nonmarket economy is a major impediment to China's accession. Since applying for membership in 1986, Beijing has argued that it is moving toward a market-oriented economy and thus should be admitted as an LDC. This claim, however, has been undercut over the past two years as China has increasingly resorted to central plans and administrative measures—such as price controls and import licenses—to rein in inflation and halt a deterioration in China's trade balance. Moreover, China's economic problems and its weak and divided leadership are likely to prevent Beijing from undertaking any major economic reform initiatives in the near term. [redacted] (b)(3)

Almost certainly aware that its case for GATT membership on the basis of promised economic reforms has been weakened, Beijing is likely to increasingly justify accession on foreign policy considerations, arguing that the way Western nations treat China's GATT application is a test of their commitment to China's full participation in the global economic system. In addition, Beijing may try to overcome resistance to its membership by offering other major Western members minor concessions similar to those extended to the United States. For example, Beijing is likely to offer to discuss more freely the policies and regulatory mechanisms that govern China's foreign trade regime—a key sticking point in the GATT negotiations thus far. In mid-January, Beijing authorized such discussions with a group from the US Embassy. [redacted] (b)(3)

(b)(3)

Implications of Acceding as an LDC

LDC status would permit Beijing to use high tariffs and quantitative import restrictions to protect infant domestic industries or to reverse balance-of-payments difficulties. GATT membership as a nonmarket economy, however, carries stringent obligations. For example, it generally enables other GATT members to retain quotas and other nontariff barriers on imports from the nonmarket economy to protect them from a flood of exports at state-set, often subsidized, prices. [redacted]

The issue is crucial to GATT members because China is the first predominantly state-controlled economy with a huge export potential to apply for membership under the preferential terms accorded less developed economies. Many GATT members fear China's accession as an LDC would significantly increase its access to foreign markets; China's exports have grown at a 13-percent average annual rate since 1980, a rate matched during the period only by Taiwan, South Korea, and Hong Kong, among major exporters. In addition, GATT members are concerned that the reduction of Chinese tariff rates, the normal requirement for LDCs acceding to the GATT, would not meaningfully improve their access to the Chinese market because central plans and administrative measures—rather than markets, prices, and duties—largely determine the volume and composition of Chinese imports. [redacted]

Beijing also may reiterate its willingness to accept "temporary safeguards" as a condition of GATT membership; this would allow GATT members to treat China as a nonmarket economy initially and hold out the promise of full LDC privileges if Beijing makes substantial progress on reforms. Chinese trade officials objected to such "temporary safeguards" when US negotiators raised the possibility several years ago, but during bilateral talks in May 1989, officials agreed to incorporate these provisions in a draft protocol of accession to be considered by the GATT working party on China. [redacted]

Membership Likely To Raise Thorny Issues

Chinese accession to the GATT would set a precedent for Soviet membership in the GATT and would lend credibility to efforts by East European countries such as Poland and Hungary to renegotiate the terms of their GATT membership on the basis of economic reforms they have undertaken recently. If China is granted GATT membership even though it has moved away from market-oriented reforms, Moscow almost certainly would argue it should be granted similar treatment; Moscow's application for GATT observer status was recently accepted. The incorporation of a large nonmarket economy such as China's on the basis of its promises to undertake further reforms would make it difficult for GATT members to turn down a Soviet bid—even if Moscow were to request special treatment as a reforming, rather than a nonmarket economy. [redacted]

(b)(3)

(b)(3)

China's early accession also would complicate resolution of Taiwan's GATT application. If Beijing accedes to the GATT first, it would most likely support Taiwan's accession only if Taipei agreed to membership as a customs territory under the governing authority of Beijing, which we believe Taiwan would be unwilling to do. Both Beijing and Taipei will expect the United States to take the lead in resolving these differences, and their lobbying efforts are likely to escalate this year. [redacted]

(b)(3)

(b)(3)

Limited Leverage for the United States . . .

We do not believe granting GATT membership to China would markedly influence Beijing to implement further economic reforms. China's leaders are currently constrained by the country's economic difficulties, particularly by the fear that—as in 1988—a new round of price reforms would release inflationary pressures and that decontrol of the trade sector would cause imports to balloon. The direction of economic policy in China, in our judgment, will largely be determined by the jockeying for position to succeed Deng Xiaoping as China's paramount leader. [redacted]

(b)(3)

(b)(3)

In addition, Chinese membership in the GATT is unlikely to substantially improve US sales to China even if China reduced administrative barriers to imports and made dramatic progress on its trade and price reforms—a prospect we consider remote over the next few years. Foreign exchange will probably remain tight because of lower earnings from tourism and foreign investment, combined with the reluctance of China's orthodox leaders to take on more foreign debt. Growth in US exports to China in recent years has generally reflected gains in sales of wheat and agricultural chemicals—sales that are more influenced by trends in Chinese agricultural production than by trade barriers. In addition, US sales of machinery, which have languished for several years, will probably continue to stagnate because China's sluggish domestic economy has depressed demand for industrial equipment and because the resumption of export credits by Japan and the European Community will reduce the United States' ability to compete. [redacted]

China: Targeting the US Market

The United States last year became China's primary export market, and Beijing has targeted the United States for rapid export growth in the 1990s. In the coming decade, Beijing plans to focus on the US market for sales of machinery and consumer electronics; China has invested heavily in these sectors with an eye to boosting export earnings, and, according to diplomatic reporting, has found it much easier to sell these products to the United States than to the more heavily protected markets in Japan and Western Europe. China's exports of labor-intensive manufactured goods such as televisions, radios, toys, footwear, hand tools, and household electrical appliances are likely to grow most rapidly, in our view, because China's low wages give it a comparative advantage relative to producers in countries with higher labor costs and because foreign as well as domestic investment has been concentrated in these sectors. [redacted] (b)(3)

(b)(3)

. . . And Formidable Challenges

By facilitating Chinese efforts to boost exports to the United States, however, Chinese membership in the GATT could enable China's trade surplus with the United States to burgeon.[1] US Commerce Department statistics indicate that China's bilateral trade surplus jumped nearly 70 percent in 1989 to about $7 billion, and, even without GATT membership, China's surplus could exceed $10 billion this year. We believe the surplus could grow even more rapidly if Chinese membership in the GATT gives Beijing more clout in efforts by textile exporters to eliminate the global quota system on textiles—the Multifibre Arrangement—that, under a GATT waiver, now permits the United States and the European Community to impose volume quotas on textile imports. Such a move would probably cause China's clothing exports to the United States to accelerate; they currently account for roughly one-fourth of China's sales to the US market. [redacted] (b)(3)

In addition, if the United States wishes to apply the GATT to China, it must grant Beijing unconditional most-favored-nation (MFN) trading status.[2] Such a move would require a Congressional amendment to the Jackson-Vanik Amendment to the Trade Act of 1974, which withholds MFN status to nonmarket economies except through annual waivers by the President. If the United States fails to apply the

[1] We anticipate that even without GATT membership, China's exports to the United States may continue to average more than 30-percent annual growth over the next few years. Beijing will probably achieve this rapid export growth by continuing to move into higher-value export product lines, boosting credit to the export sector, and directing scarce raw materials to export-producing factories. Targeting of the US market and continued growth in US demand for the products China exports will probably enable China's exports to the United States to grow two or three times as fast as its overall exports, continuing the pattern of the last decade. [redacted]

[2] Article 35 of the General Agreement permits members to decline to accord new members GATT privileges—including most-favored-nation trading status—at the time of accession provided that the countries concerned have not entered into bilateral tariff negotiations. [redacted] (b)(3)

(b)(3)

GATT to China, however, US products could face higher tariffs in China than products from countries that agree to grant MFN status because Washington would not be eligible to conduct tariff reduction negotiations with Beijing. [redacted]

If China accedes to the GATT with temporary safeguards—pending the implementation of comprehensive trade and price reforms—the United States and other GATT members would have to decide when to eliminate the interim measures. They would need to continually reevaluate China's trade system to determine when market forces had developed to the point where tariffs were sufficient to regulate trade with China. The reassessment process would be contentious and prolonged because the stakes are high for both sides. If Beijing cannot shed the safeguards, GATT membership would do little to improve China's access to foreign markets. If, on the other hand, GATT members agreed to drop the safeguards before market forces played a predominant role in the Chinese economy, the Chinese market would remain largely closed to their products, and they could be subjected to Chinese targeting of their markets with state-subsidized products. We believe that China would apply enormous bilateral pressure for the removal of safeguards because Beijing regards US support as critical to making headway within the GATT. [redacted] (b)(3)

(b)(3)

[redacted] (b)(3)

International Financial Situation: Update on LDC Debt [redacted] (b)(3)

Developments this week focus on Mexico, Egypt, and G-15 Summit issues:

- ***Mexico City Anticipates Reprivatization of Commercial Banks.*** Mexico City expects a majority of the state legislatures to approve the constitutional amendment to begin reprivatizing commercial banks by the end of this summer. [redacted] the first two banks to be put (b)(3) on the auction block will be Banca Serfin and Banorte— institutions that the Mexican VISA Group of Monterrey is interested in reaquiring. Foreign banks are likely to be permitted to play a larger role once new bank regulations are in place. According to press reports, foreign investors will probably be allowed to own up to 49 percent of the shares of the reprivatized banks. In addition, [redacted] the government intends to allow foreign banks to open branches in Mexico. [redacted] (b)(3)

- ***Cairo's US Military Debt Worries Mubarak.*** Last week President Mubarak informed a visiting US official that Egypt will be unable to meet its annual Foreign Military Sales (FMS) obligations of more than $1 billion. Cairo must pay $287 million from June through September to avoid triggering sanctions under the Brooke Amendment, which mandates the suspension of US aid to FMS debtors who are a year in arrears. The US Embassy reports the government's foreign exchange resources are perilously low, and Cairo is scrambling to finance wheat imports with the aid of Persian Gulf Arab states. Grain on hand and scheduled shipments will last only until early August, but Egypt hopes gift wheat from the United Arab Emirates—and possibly Kuwait—will stretch supplies through October. [redacted] (b)(3)

  Mubarak's concern about debt service is well founded, in our view, although the Egyptians may be painting a bleak picture in the hope that Washington will forgive at least part of Egypt's $6 billion military debt. Cairo is seeking an IMF standby arrangement to facilitate debt rescheduling, but an accord may be months away. The IMF wants to see additional budget measures and a more flexible exchange rate regime before agreeing to a standby, according to an Embassy readout from the IMF team in Cairo. In the interim, Cairo may be required to take unusual steps to avoid Brooke Amendment sanctions. Possible measures to raise foreign exchange include halting imports by the Central Bank of nonessential rationed foods, buying dollars from commercial banks or private moneychangers, or drawing from foreign exchange accounts held by the Oil and Defense Ministries. [redacted] (b)(3)

**Key LDC Debtors:
Economic/Financial Indicators**

Foreign Debt *(yearend 1989 in billion US $)* [a]	Exchange Rate *(per US $)*	Months of Import Coverage by Reserves	Other Indicators
Brazil 112	56.00 (19 Jun 90) 12.74 (Jan 90)	6.3 (Dec 89) [a i] 4.2 (Aug 89) [b]	Trade balance figures show a surplus of $1.7 billion for May, the highest monthly trade surplus since June 1989. Exports amounted to $3.2 billion and imports reached $1.5 billion, according to press reports.
Mexico 98	2,846 (19 Jun 90) [c] 2,682 (Jan 90)	2.65 (Dec 89) [d] 3.49 (Aug 89) [d]	Consumer prices rose 1.7 percent in May compared with April's 1.5-percent increase, according to press reports.
Argentina 59	5,330 (19 Jun 90) [e] 1,100.0 (Jan 90)	3.62 (Mar 90) [d] 1.6 (Dec 89) [d]	The Central Bank projects June's inflation rate to be between 10.4 and 12.5 percent, [redacted] Inflation for May was 13.6 percent, according to official statistics.
Egypt 47	2.708 (19 Jun 90) [g] 2.558 (Jan 90)	1.6 (Aug 89) [d] 1.6 (Jul 89)	Central Bank Governor Salah Hamed announced the Central Bank exchange rate would be devalued from le 1.10/US$ to le 2.00/US$ on 1 July. This rate affects 25 percent of all imports.
Venezuela 39	47.65 (19 Jun 90) [c] 43.50 (Jan 90)	4.59 (Mar 90) [d] 3.5 (Nov 89) [d]	Caracas suspended plans to increase gasoline prices because of student protests, according to press reports.
Nigeria 34	7.88 (19 Jun 90) 7.70 (Jan 90)	3.4 (Nov 89) [d] 2.0 (Jul 89) [d]	Consumer prices rose 5.8 percent in May, led by price increases in paper products, kerosene, bus fares, and milk products. Inflation for April was 0.2 percent.
Philippines 29	22.72 (19 Jun 90) [c] 22.08 (Jan 90)	1.1 (Mar 90) [d] 1.0 (Nov 89) [d]	The unemployment rate for the first quarter of 1990 was 8.6 percent, according to official sources. The employment prospects for the next two years are bleak, according to US Embassy reports.
Morocco 22	8.69 (19 Jun 90) 8.00 (Jan 90)	1.0 (Aug 89) 0.7 (Oct 89)	Although Finance Ministry officials insist inflation for 1990 will not exceed 10 percent, if the first quarter trend continues, inflation could reach 15 percent for the year, according to US Embassy reports.
Chile 19	286.44 (19 Jun 90) [h] 282.95 (Jan 90)	5.01 (Nov 89) [d] 3.8 (Oct 89) [d]	Consumer prices rose 1.5 percent in May, and cumulative inflation for the year is now 8.8 percent, according to press reports.
Peru 19	61,072 (19 Jun 90) [h] 8,389 (Jan 90)	1.42 (Feb 90) [d] 4.0 (Oct 89) [d]	Lima imposed sharp restrictions on withdrawals from savings accounts in early June in an apparent effort to ease speculation on the US dollar. The value of the inti dropped 25 percent in the last two weeks of May.

[a] Estimated.
[b] Ratio of foreign exchange to imports.
[c] Floating rate.
[d] Ratio of gross reserves, minus gold, to imports.
[e] Financial rate.
[f] Ratio of net reserves to import.
[g] Free market rate.
[h] Official rate.
[i] Ratio of gross reserves, minus gold, to imports of goods.

(b)(3)
(b)(3)

[redacted]

(b)(3)

Status of Debtor-Creditor Relations	Domestic Political Scene
Chief debt negotiator Jorio Dauster announced the IMF visit to Brazil, scheduled for mid-June, will be delayed for a few weeks, while the government continues to work on budget revisions.	The 12 June general strike fizzled because many transportation, communication, and bank workers refused to participate for fear of losing their jobs, [redacted] (b)(3)
Mexico City will receive $776 million in loans from Tokyo for the fight against air pollution. This includes a $315 million loan for the construction of an oil refinery.	Mexico City is preparing to receive bids in the sale of the government's 51-percent stake in Telefonos de Mexico S. A., which could bring over $4 billion, according to press reports. (b)(3) (b)(3)
Three international banks with substantial Argentine exposure stated Buenos Aires's token $40 million interest payment was not sufficient to restart talks.	At least three foreign investor groups plan to submit bids in the planned privatization of the Argentine national telephone company ENTel, to be awarded 28 June [redacted]
An IMF official in Egypt reports no breakthroughs last week in discussions with Cairo. The fund is in no rush to reach agreement with the Egyptian Government, according to US Embassy reports.	An Egyptian industrial delegation held talks with Moscow earlier this month, resulting in an agreement on Soviet loan (b)(3) and participation in a paper production plant to be established in Egypt.
[redacted]	Caracas issued a public invitation to domestic and international consulting firms and investment banks to apply to prequalify as advisers for its privatization program. (b)(3) (b)(1)
Education Ministry and World Bank sources announced a $100 million loan for the development of the primary education sector will be released to Lagos next year, according to US Embassy reports.	Lagos's program to privatize or commercialize approximately 130 public-sector enterprises appears to be on schedule for completion before the transition to civilian rule in 1992, according to US Embassy reports.
Because the IMF and Manila are at odds over the budget deficit, the IMF withheld the last $300 million installment of the $900 million extended fund facility, originally scheduled for release this month.	President Aquino approved a comprehensive tax reform package featuring 16 new tax proposals, the first of which is a tax on "sin" products such as tobacco and alcohol.
The African Development Bank is considering a $20 million loan to Rabat for a road rehabilitation and maintenance project, according to US Embassy reports.	Rabat is delaying implementation of its privatization plans as Cabinet officials debate the amount of control that foreign investors will be allowed to have over Moroccan companies. [redacted] (b)(3)
Tokyo promised Santiago a $300 million credit that will be channeled through Japan's Foreign Cooperation Fund, according to press reports.	President Aylwin announced the adoption of measures to assist people in debt with housing, taxes, utility, and in paying back government loans for university students.
President-elect Fujimori announced he would resume repayments on Peru's foreign debt under an economic plan aimed at restoring the country's international creditworthiness.	Alberto Fujimori, former president of the National Agrarian University and agricultural engineer, won the 10 June presidential runoff against novelist Mario Vargas Llosa, according to press reports.

Egyptian Brooke Amendment
Payment Obligations to the United States
June - September 1990

Million US $

Total	**286.6**
June	75.6
July	71.5
August	0
September	139.5

[redacted] (b)(3)

- ***G-15: Emerging Cautiously from Inaugural Summit.*** External debt dominated discussions at the G-15 inaugural summit in Kuala Lumpur in early June, but no agreement on a united position was reached. The delegates—whose countries' $600 billion external debt accounts for nearly half of the Third World's total—want developed nations to lower interest rates, stabilize exchange rates, and provide better access to their domestic markets for developing countries exports, according to press reports. The G-15 also proposed that financial institutions link debt servicing capacity to economic performance. While some Latin Aamerican countries wanted a strong position on debt relief, others such as Indonesia, Malaysia, and India, were more moderate. G-15 representatives have publicly announced they will meet during the coming months to draft a compromise strategy for dealing with creditors. [redacted] (b)(3)

  Three initiatives emerged from the summit that are designed to facilitate economic growth in the Third World. According to US Embassy and press reporting, the group agreed to create a data exchange center to distribute information on trade, investment, and technology-transfer opportunities among developing nations. An initiative to boost South-South trade by utilizing Central Banks to guarantee payment to domestic exporters and one establishing a forum of businessmen, investors, and government officials to boost trade and investment between LDCs were also approved. The group failed, however, to establish a permanent Secretariat—a move that would have capped its commitment to become a formal organization representing Third World interests. Instead, the group established a steering committee of Foreign Ministers from Malaysia, Venezuela, and Senegal to coordinate the group's activities until next year's summit in Caracas, where the Secretariat issue is likely to re-emerge. Malaysia was appointed to present G-15 positions to the G-77, but the group elected not to approach G-7 countries before the Houston Summit, according to US Embassy and press reports. [redacted] (b)(3)

[redacted] (b)(3)

Briefs

Energy

Italian Nuclear Plant Closure Ratified

The Italian Parliament last week ratified the decommissioning of Italy's two nuclear power plants, according to the US Embassy in Rome. The two reactors, with a combined capacity of 1,150 megawatts, were shut down shortly after the Chernobyl' incident but had been kept ready for use pending the expiration of a five-year moratorium on nuclear power enacted after a 1987 referendum. Although the parliamentary action is the death knell for the nuclear operation of the two plants—they might still be converted to traditional fuels—the Parliament refused to support environmentalists' calls to ban any future development of nuclear power in Italy. Rather, it recommended that the National Agency for Nuclear and Renewable Energies and the National Agency for Electricity undertake research for safe reactors that might be built after 1992. Embassy reporting suggests that the compromise seems to have satisfied the Italian Green parties—which believe that such safe reactors will be unavailable for at least 15 years—and Italian energy and industry officials. These officials reportedly worry that, without the possibility of nuclear expansion, Italy will be unable to meet carbon dioxide emission targets being promoted by EC partners such as West Germany and France to help combat climate change. (b)(3)

International Finance

Western Banks Requiring Higher Margins on Loans to USSR

Western banks have reacted to increasing Soviet indebtedness and delayed payments with tougher credit terms, including higher interest rate margins. Short-term loan arrangements completed in the first quarter of this year show that Western banks increased their margins to 0.5- to 1.25-percentage points over LIBOR, the London Interbank Offered Rate, with long-term loans priced even higher. Some Western banks made offers with margins as high as 3.0- to 4.0-percentage points over LIBOR. The Soviet Union, considered an impeccable credit risk until recently, had enjoyed interest rates averaging just 0.125- to 0.25-percentage points over LIBOR on short-term loans since the mid-1980s, with slightly higher margins as debt exposure crept up at the end of the decade. The loss of such favorable terms will aggravate Moscow's foreign payments problem, with additional debt servicing from the increased margins alone likely to amount to over $100 million next year. Even if the Soviets were to clear up the arrearage problem in the near term, margins will remain high because of banker concerns about the poor performance of the domestic economy and continued ethnic tensions.

(b)(3)

Global and Regional Developments

India Welcomes US Decision on Super 301

Indian officials were pleased with the US announcement postponing a decision involving retaliation under the Super 301 provision of the 1988 Trade Act until after the Uruguay Round ends in December. According to the US Embassy in New Delhi, they view the move as part of a broader improvement in US-Indian relations. In our view, New Delhi now will try to address some of Washington's insurance and investment concerns in the Uruguay Round to avoid possible US action against India after the Round ends. In addition, New Delhi may even negotiate bilaterally with the United States if it can avoid appearing to bow to US pressure. [redacted] (b)(3) [redacted] (b)(3) New Delhi may push some elite Indian businessmen to personally call for the government to negotiate with the United States, after which Prime Minister Singh would agree to talk— claiming that he is only trying to protect important business interests from possible US retaliation. Some Indian exporters have already stated that they fear the United States will impose sanctions after the Uruguay Round and hope that New Delhi will move faster to open up the economy, according to the US Consulate in Bombay. [redacted] (b)(3)

Highlight–Global and Regional Developments

The release of new data on AIDS at the International AIDS meeting that began on 20 June in San Francisco is likely to further hurt tourism in a number of countries . . . tourism in Haiti, for example, dropped 80 percent the year its AIDS prevalence was publicized, according to the US Embassy . . . tourism in parts of the Caribbean, East Africa, and Thailand—because of strong links between local prostitution and tourism—are likely to be adversely affected by data presented at the conference . . . more countries may also require HIV tests for foreign visitors; some 41 countries, including some OECD members, and a few corporations already require such tests, which cost between $40 to $330 per person. [redacted] (b)(3)

National Developments

Americas

Costa Rica Announces New Economic Stabilization Measures

In an effort to ease pressure on interest rates and inflation, President Calderon late last month unveiled a plan to slash Costa Rica's domestic budget deficit, which has risen steadily from 2 percent of GDP in 1988 to a projected 7 percent this year. Calderon plans to cut the projected deficit by more than 60 percent with a 25- to 30-percent cut in government spending and substantial hikes in utility rates, according to US Embassy reporting. Over the longer term, San Jose hopes to hold the deficit down by boosting revenues through higher consumption and business taxes, by broadening the sales tax base, and by reducing exemptions. The President's proposal enabled Costa Rica to sign a letter of intent with the IMF earlier this month for a new standby agreement. San Jose sought to soften the package by allocating more money for social programs, but businessmen, farmers, labor groups, and the main opposition political party are protesting the new measures. Calderon probably will go ahead with the increase in public-sector prices, but securing legislative approval for the proposed spending cuts and tax changes may be difficult. [redacted] (b)(3)

Low-Level Cuban-Nicaraguan Shipping Activity Despite Ban

Although Cuba suspended all commerical shipments to Nicaragua in mid-March following President Chamorro's inauguration, Havana is quietly arranging for other shippers to transport Nicaraguan-bound cargoes, and limited shipping activity between the two countries is continuing aboard flag-of-convenience ships. Havana probably wants to keep the door open for future economic trade with Managua, and its decision to pick up cargo in Nicaragua suggests that the Cuban economy needed those goods. If the economic situation in Cuba continues to deteriorate, Havana may rescind its self-imposed ban against trading with the new Chamorro government. Nicaragua—bolstered by the suspension of US sanctions and the ability to trade freely with US firms—no longer needs Cuban maritime assistance. Now that the conflict between the Sandinistas and Contras is winding down, the Nicaraguans probably see no need to dedicate two ships to a liner service with Cuba, and they are hoping to lease these ships to earn hard currency. [redacted]

(b)(3)

Europe

EC Makes Progress on Single-Market Corporate Tax Policy

EC Finance Ministers last week broke a 20-year deadlock on tax problems encountered in cross-border business within the EC, giving a significant boost to completion of the single internal market by the end of 1992. The measures, strongly supported by EC firms, will abolish withholding taxes on dividends paid by a subsidiary to a parent firm in another member state, abolish capital gains taxes arising from cross-border mergers, and establish the use of arbitration in cross-border tax disputes. West Germany cleared the way for agreement—perhaps in an attempt to show its commitment to the Community—by dropping its longstanding opposition to the withholding tax measure after the other members agreed to give Bonn until 1996 to comply fully. Agreement on these tax issues may signal increased member-state willingness to resolve other deadlocked tax issues that threaten timely completion of the single market. Italy, which takes over the EC Council's rotating presidency in July, has said agreement on harmonizing value-added tax rates will be a top priority. [redacted] (b)(3)

Italy Strengthens Antistrike Law

Threats of wildcat rail strikes, which would have disrupted the World Cup soccer championship, spurred the Italian Parliament to pass legislation making it easier for Rome to issue back-to-work orders. Informal unions have disrupted rail transportation this spring, pushing for higher wages than Italy's three major labor confederations have sought. The three confederations—affiliated with the Christian Democrats, Socialists, and the Communists—have often agreed to lower wage rates in exchange for concessions that further their political agendas. The specter of strikes during the World Cup united Italy's normally fractious political class behind antistrike legislation covering essential public services. Under the new law, Rome can broadcast back-to-work orders on television; previously, such orders had to be hand delivered to each striker. The law will allow Rome to reduce Italy's notorious disruptions to public services, thereby cutting the cost of doing business and generally making the country more competitive in international trade. [redacted] (b)(3)

Paris Proceeding Cautiously on Income Redistribution Proposals

The French Government will proceed cautiously in efforts to alleviate a growing income disparity between rich and poor in France. President Mitterrand views redistribution as a way of bolstering his sagging popularity and of fulfilling promises made when he first took power in 1981. He and other Socialists are pushing Prime Minister Rocard to devise plans to spread the fruits of prosperity more evenly, although the government recently had to back away from a Socialist parliamentary proposal to raise the corporate capital gains tax from 19 to 25 percent when the stock market reacted negatively. Rocard warned fellow Socialists that the proposal would discourage investment from other EC countries, and Mitterrand and Finance Minister Beregovoy subsequently tried to reassure financial markets by promising to consider other ways of narrowing the income gap. Paris also is threatening to supplement the annual minimum wage hike if private industry does not come up with suggestions to help low-wage workers. [redacted] (b)(3)

East German Uranium Industry's Bleak Future

West German officials are almost certainly planning to shut down East Germany's uranium mining industry, although the fact that it is a joint GDR-USSR project will increase the political and economic costs for Bonn. The GDR's uranium mining operation—one of the largest in the world with over 40,000 employees—is causing major environmental and health damage in the southern GDR; mining at the site was initiated by the Soviets in 1946, and their contracts do not expire until 2000. West German authorities normally would have no compunction in shutting down this environmentally unsound industry, but the Kohl government is committed to ensuring that Soviet economic interests are not damaged by unification—and Soviet officials already have explicitly raised the issue of uranium mining in bilateral talks. West German negotiators, for their part, probably believe that the Soviets are merely looking for compensation. Since production costs are five times that of world market prices, the Germans doubt the Soviets are serious about wanting to continue operating the plant, particularly after 1 July when GDR trade is to be on a hard currency basis. One compromise solution under active consideration in Bonn is an agreement to replace the uranium the Soviets receive from the GDR through German purchases on the world market. [redacted] (b)(3)

Africa/Middle East

Kenya Presents Optimistic Budget

Kenya's budget for FY 1990/91—starting 1 July—is based on improved revenue performance, tighter controls on government borrowing, increased debt service capability, and stronger export achievement, according to the US Embassy in Nairobi. The government projects total expenditures to increase 10 percent and revenues to grow by 24 percent. As a result, Nairobi hopes to reduce the budget deficit to 3.8 percent of GDP, down from 4.2 percent in FY 1980/90, and to cut the country's debt service ratio to 20 percent of export earnings by 1995 from the present level of 27.5 percent. Kenya also is emphasizing export promotion in its economic policy for FY 1990/91 to sustain the country's fairly strong 5-percent average annual economic growth rate since 1980. Toward this end, the government introduced a duty exemption scheme for horticultural exports—a growing product line—and plans to step up its initiatives on the operation of Export Processing Zones (EPZs). [redacted] (b)(3)

We believe some of Nairobi's budget assumptions are too optimistic. For example, we concur with the US Embassy's view that the debt service projections are unrealistic because exports continue to stagnate, while imports—partly paid for with increased foreign borrowing—continue to rise sharply. In addition, foreign investors have shown little interest in Nairobi's EPZ promotions because of an unfavorable investment climate highlighted by bureaucratic redtape and corruption, according to diplomatic and press reporting. Moreover, Nairobi has on several occasions in the past been unable to hold projected government expenditures within targeted limits. [redacted] (b)(3)

Asia/Pacific

Tokyo Trying To Revitalize Technopolis Program

Japanese officials are offering new incentives to try to revitalize the Technopolis program—a plan designed to encourage regional development and the decentralization of frontier technology industries by creating high-technology centers throughout Japan. Existing incentives—corporate investments in technology centers have been tax deductible since the plan's inception—have not spurred large-scale industry involvement. The project—officially launched in the early 1980s—has not attracted much industry participation because many firms are reluctant to locate new research and manufacturing ventures far from established company facilities and trading centers. To get the program back on track, Tokyo has committed itself to match any Technopolis-related funds set aside by prefectural governments and provide marketing assistance for small and medium-sized companies. The Trade Ministry will also extend government support for the program through 2000, rather than the early-to-middle 1990s as originally scheduled. [redacted] (b)(3)

Japanese Setting Carbon Dioxide Target

Japanese officials agreed in principle to adopt an as yet unspecified carbon dioxide emission target at an 18 June cabinet-level meeting, according to Japanese press reports. The target reportedly would be part of a new 20-year "master plan" to be finalized this fall that would stress reducing emissions of several greenhouse gases through technological innovation. The plan would supplement the 100-year plan to combat climate change currently being promoted by the Ministry of International Trade and Industry (MITI). One report suggested that the target would likely permit at least some emissions growth before, and possibly after, 2000. As such, it would not be nearly as strict as the targets being promoted by several West European countries. Nonetheless, the reports suggest proponents of the target believe that by demonstrating some flexibility on the target issue—where it had shown little before— Tokyo can reduce its isolation at the Houston G-7 Summit and upcoming climate change conferences, and possibly reach a compromise with the West Europeans. [redacted] (b)(3) (b)(1)

South Korea Threatens to "Discipline" Foreign Banks

In a notice sent in early June to all foreign banks with branches in South Korea, the Bank of Korea (BOK) warned they will face stiff penalties unless BOK regulations are followed, according to the US Embassy in Seoul. Disciplinary action could include the expulsion of the bank's general manager from the country. The South Korean press observed that in the past the BOK has taken strong measures against Korean employees who have ignored regulations, but this is the first warning to foreign bankers. As Seoul prepares for the complete liberalization of its financial markets in 1992, authorities want to ensure compliance by both domestic and foreign banks of remaining regulations. For example, Seoul is especially concerned about the foreign exchange speculation that has occurred since government officials partially liberalized the market earlier this year. Although US branches will be affected by this tougher policy, Seoul is probably most concerned about the potential for illegal behavior by the powerful Japanese banks. [redacted] (b)(3)

South Korea Likely To Adopt US HDTV Standard

(b)(3)

The South Korean Ministry of Trade and Industry (MTI)—striving to establish high-definition television as a major export market—is likely to adopt the US HDTV standard, which is scheduled to be established in 1993. [redacted] MTI ruled out the adoption of the Japanese standard because it felt Tokyo would not allow South Korean manufacturers access to the Japanese HDTV market. South Korean concerns over access to the European market will also probably encourage MTI to adopt the US standard. Not only is the United States the largest potential HDTV market but also South Korean television manufacturers are already established here. In addition, adoption of the US HDTV standard would assist South Korean firms in their efforts to establish HDTV joint ventures with US companies. Waiting for the establishment of the US standard, however, means the South Korean HDTV effort—whose government funding was put on hold in late 1989—is not likely to make substantial progress until 1993. [redacted] (b)(3)

(b)(3)

Hong Kong Unions Protest Foreign Labor

About 1,000 members of the Federation of Trade Unions recently demonstrated against a government plan to import about 15,000 more craftsmen, supervisors, and construction workers from China, the Philippines, and Thailand. The trade unionists fear losing their bargaining power with employers and slower wage increases in Hong Kong's inflationary economy; retail prices rose about 10 percent last year. According to government statistics, job vacancies rose to about 85,000 in 1989, in part because of emigration driven by fear of the territory's return to Chinese control in 1997. By allowing more foreign workers, the government hopes to ease the chronic labor shortage and sluggish economic growth; GDP grew only 2.5 percent last year. Staffing difficulties and rising wages have fueled inflation, lowering the competitiveness of Hong Kong's exports and causing firms to move production facilities to other countries. We believe the government will probably face increasingly strong opposition to foreign workers after the legislative election next year; unions are politicizing the issue by joining with Hong Kong's first political party, which supported the rally. [redacted] (b)(3)

Punjab Province Pressuring Islamabad for More Funds

The Punjab provincial government, which is headed by Prime Minister Bhutto's main political rival, Nawaz Sharif, recently announced its budget for FY 1991 and is pressuring Prime Minister Bhutto to fund the province's deficit—projected to be over $88 million. Islamabad, however, is facing IMF pressure to cut its own federal budget deficit and will be unable to bail out the Punjab government, in our view. According to US Embassy reports, the province plans to increase operational expenditures by about 15 percent over last year's level, but, as in past years, will not tax politically powerful landowners. Instead, the Punjab government reportedly hopes to get more federal funds for its Annual Development Program, but the federal government has already increased the province's ADP allocation by 15 percent over last year. If additional federal funds are not forthcoming, we believe the Punjab's government almost certainly will blame the federal government for cuts in provincial spending in an attempt to garner political support. [redacted] (b)(3)

USSR

Soviets Improving Enterprise Taxation

The enterprise tax bill the Supreme Soviet passed yesterday establishes a maximum 45-percent tax on the profits of most state enterprises. Currently, ministries often arbitrarily tax the most efficient firms at much higher rates. Foreign enterprises will pay a 30-percent rate; joint ventures, except for those engaged in services, will continue to be exempt from taxes for their first two years of profitability. The tax receipts will flow about equally into union and republic budgets, providing needed resources for republic autonomy. Profits in excess of a 30-percent return on capital will be confiscated. The law is an important step in giving the government fiscal tools to regulate the economy and to pursue social goals as it dismantles administrative controls. It is also a victory for reformers, who lobbied against the government-proposed 55-percent rate. Nonetheless, a rate of 45 percent and the confiscation of "excess" profits are still likely to discourage entrepreneurial activity. [redacted] (b)(3)

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