



Directorate of
Intelligence

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International Economic & Energy Weekly



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7 January 1983

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

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Comments and queries regarding this publication are welcome. They may be directed to [Redacted] the Office of Global Issues, [Redacted] 25X1

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

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Synopsis

Perspective—*Can OPEC Prevent a Price Decline?* [Redacted]

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Prospects for a continued decline in oil use in 1983 and mounting financial pressures on oil producers to boost exports will keep oil prices weak throughout the year. At a minimum, we expect real oil prices to erode further and in the absence of some concrete measures by OPEC members to restrain output, nominal prices could begin to slide before mid-year. [Redacted]

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Oil Market Outlook [Redacted]

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In the absence of a major supply disruption, we expect continued oil market weakness during 1983 with a further slight decline in oil use and additional erosion in real oil prices. Under these conditions, OPEC members will have difficulty reaching an effective agreement on limiting production and maintaining nominal oil prices. [Redacted]

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Eastern Europe: Growth Prospects [Redacted]

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Recent economic performance has been poor; annual growth of regional GNP slowed to about 1 percent in 1981-82 compared with 4 percent per annum in the late 1970s. Prospects for a rebound are weak and would not improve significantly even if the USSR could satisfy the region's energy requirements over the next few years. [Redacted]

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South Africa: Recession Heightens Prospects for Black Unrest [Redacted]

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The interaction of several economic and political trends in South Africa could make 1983 a difficult and perhaps violent year. A continuing economic slump, rightwing political pressure that is forcing the government to harden its attitude toward blacks, and an increasingly militant and well-organized black labor movement could end five years of relative calm in black-white relations. [Redacted]

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Nuclear Reactor Industry: Looming International Shakeout [Redacted]

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The nuclear reactor industry is in a deep slump. As the decade progresses, we believe at least three nuclear reactor vendors—probably including two US firms—will stop production. [Redacted]

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**International
Economic & Energy
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Perspective

Can OPEC Prevent a Price Decline?



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Prospects for a continued decline in oil use in 1983 and mounting financial pressures on oil producers to boost exports will keep oil prices weak throughout the year. At a minimum, we expect real oil prices to erode further and, in the absence of some concrete measures by OPEC members to restrain output, nominal prices could begin to slide before midyear.

Assuming modest economic growth in the OECD countries of about 2 percent, we believe demand for OPEC oil in 1983 will average about 20.4 million b/d, approximating current levels. This assessment is in line with most recent industry and government forecasts. Based on market trends and industry forecasts we believe that:

- Non-Communist oil consumption will fall slightly to about 44.4 million b/d.
- Non-OPEC supplies will rise by about 500,000 b/d, largely because of increased production from Mexico and the North Sea.
- Inventories will hold fairly steady with a decline in commercial stocks being offset by increased government stockpiles.

Several financially hard-pressed OPEC members, including Nigeria and Indonesia, are likely to try to raise production. Unless other OPEC states, principally Saudi Arabia and the other Arab Gulf producers, are willing to cut output, sharp downward price pressure will result. OPEC's problems could worsen if the Iran-Iraq war ends or if economic recovery fails to materialize as expected. Another year of sharply falling consumption would cause further inventory declines and push demand for OPEC oil down another 1 million b/d below the 20.4-million-b/d level.

OPEC's failure to agree on individual production quotas in December poses little immediate threat to the cartel because of high seasonal oil demand. During the spring and summer, however, demand for OPEC oil could fall by as much as 1 million to 2 million b/d, pressuring OPEC to agree on production quotas or face the prospect of a nominal price decline.

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We cannot be certain that OPEC will be able to maintain nominal prices under these conditions. Most market analysts believe OPEC will take the necessary steps to prevent a price collapse because members are keenly aware of the dangers and impacts of a price cut. Still, there is enough political animosity between Saudi Arabia and Iran and Libya to cloud rational judgment. Indeed, the Saudis themselves have hinted that a \$2- to \$4-per-barrel price cut might in the long run hasten the recovery in oil demand. Riyadh must decide whether the decline would stop at that level or whether other producers, especially Iran, would retaliate with price cuts or even military measures against Saudi oil facilities to dry up the market surplus. Should prices begin to fall, we cannot predict how far they would decline or how long they would stay down.



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Briefs

Energy

Possible Agreement on Development of Canadian Offshore Oil and Gas

Federal and Newfoundland Energy Ministers have agreed on a possible solution to their three-year dispute over development of the province's offshore areas, which may hold as much as 7.4 billion barrels of oil and 2 trillion cubic meters of natural gas. Details of the proposal have not yet been released, and the ministers have expressed concern that the compromise may be difficult to sell, suggesting that the two sides are still far apart on the key issues of control and revenue sharing. The Energy Ministers will present their proposal to their respective cabinets this week to see if an official agreement can be reached.

[Redacted]

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The prolonged dispute has slowed development of the area as companies wait for a settlement; production of the estimated 1.7 billion barrels of oil in Mobil's Hibernia field—originally scheduled to begin in 1986—has been delayed until at least 1990. The broad question of offshore resource ownership is currently before the Newfoundland Supreme Court, which may render a decision before the Canadian Supreme Court begins hearing a similar case on 22 February. Even consistent judicial statements on the issue from both courts, however, may not produce an immediate compromise between St. John's and Ottawa.

[Redacted]

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New Norwegian Oil Find

Preliminary drilling on Norway's block 34/4 revealed substantial recoverable reserves of oil, possibly as much as 2 billion barrels. The field has not yet been completely delineated because additional drilling on adjoining block 34/7 will be required to determine its extent. Saga Petroleum, one of the state-sponsored oil companies and operator of block 34/4, probably will also be named as operator of block 34/7 and could begin drilling some time next spring. The field is in deep water, making potential development costly and difficult. Its proximity to production facilities at Statfjord, however, could enhance development prospects.

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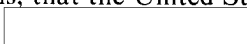
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Several US firms have expressed concern over a recent offer by Japan to greatly increase funding by Japan's Export-Import Bank for the Japanese joint venture already in progress in the Bohai Bay. Beijing has requested, both to US officials and to the firms, that the United States follow suit with government-backed credits. 

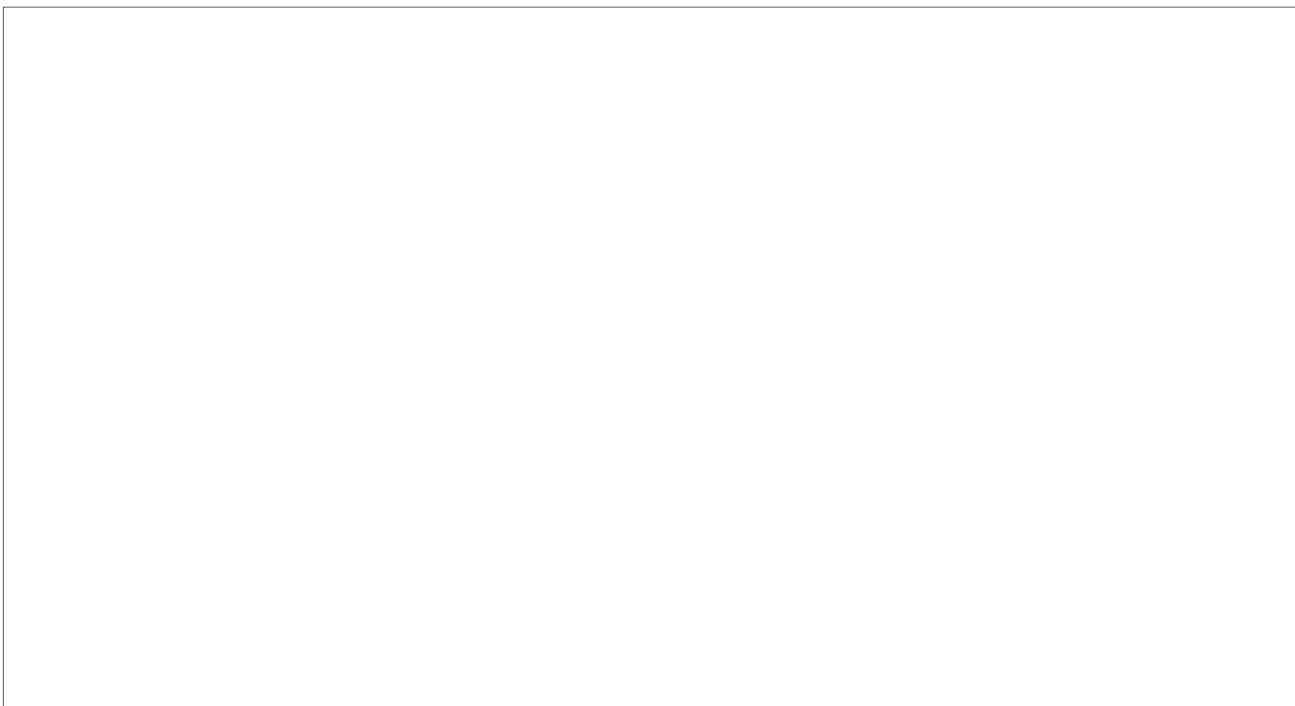
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Egypt Reduces Oil Prices

Egyptian oil prices now are at their lowest level since June 1979, following a \$0.75 per barrel price cut on 1 January. Although oil production reached a historic high of 700,000 barrels per day during the fourth quarter, foreign oil revenues probably will fall \$200 million short—because of the soft oil market—of the \$2.7 billion target set for the fiscal year ending 30 June. To reduce consumption and boost exports, senior petroleum officials, including Deputy Prime Minister Hilal, are reviewing possible changes in Egypt's low domestic energy price policies. Egyptian consumers pay only about 20 percent of world market prices for petroleum, leading to consumption increases of 10 to 12 percent a year since 1975. Hilal plans to propose higher domestic energy prices early this year, but we believe he will face rough sledding in the cabinet. Prime Minister Moheiddin is against policies that raise domestic prices and risk sparking urban discontent. His views will be strongly supported by other cabinet members. 

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International Trade, Technology, and Finance



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OECD Aid to Turkey

The United States, West Germany, Italy, the United Kingdom, and Belgium last month pledged approximately \$670 million in aid at the long-delayed meeting of the OECD Turkish aid consortium for 1982. The consortium early last year had projected that Turkey would need \$800-900 million in official and officially guaranteed credits. Japan, however, has yet to announce its prospective pledge, indicating only that it will not exceed the previous year's \$100 million in aid. Because of growing economic difficulties, France abandoned its role as a major donor but intends to open a line of medium-term financial credits to Turkey of some \$57 million. A number of smaller countries such as the Netherlands, which participated in previous pledging sessions, also did not take part in the latest consortium. The Hague, however, might provide export credits and guarantees at a later date. The overall decrease in aid to Turkey for 1982 appears related largely to reductions in the foreign aid budgets of donor countries and to improvements in Turkey's economy over the past two years.

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New African Trade Area

The Preferential Trade Area for Eastern and Southern Africa formally came into being on 1 January. After a year of preparations, the members met last month in Lusaka to adopt a \$1.7 million budget and approve an ambitious program for 1983. They agreed to reduce trade barriers, establish a clearinghouse for trade payments, and eventually create a trade and development bank. In addition to promoting intraregional trade, the trade area is designed to enhance cooperation in agriculture, industry, transport, and communications. Current members are Burundi, the Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Somalia, Swaziland, Uganda, Zambia, and Zimbabwe.

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The new organization faces formidable obstacles. Only about 5 percent of members' total trade is intraregional because of the similarity of their exports, regional transport problems, and serious foreign exchange shortages. The trade area already is hampered by the failure of most members to pay their budget contributions and probably will seek funding from the UN Economic Commission for Africa, which assisted in the group's formation. Several key states—Tanzania, Angola, and Mozambique—are reluctant to sign the trade area treaty out of fear that the more developed members will benefit most. Moreover, many potential members already belong to the smaller but already functioning and comparatively well-funded Southern African Development Coordination Conference and are concerned about costly duplication of effort.

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*Panama Proposes
Regional Banana
Scheme*

To protect its beleaguered banana industry, Panama is proposing a regional marketing arrangement involving Central American governments and multinational firms. The plan appears to envisage a loose form of market sharing that would allow small production cutbacks and end the banana "price war." The proposal was made in response to an announcement by United Brands, the country's dominant producer, that it intends to cut back its Panamanian operations substantially in early 1983 because of weak world markets and heavy financial losses. By urging Guatemala, Honduras, Costa Rica, and the three leading multinationals—United Brands, Standard Fruit, and Del Monte—to join in its proposed scheme, Panama hopes to achieve more equitable production cuts and firmer prices. Despite some increased producer interest because of the current world banana glut, we believe formation of an effective market-sharing arrangement will be extremely difficult. [REDACTED]

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National Developments*Developed Countries**Japan's New
Defense Budget*

Prime Minister Nakasone and Foreign Minister Abe intervened in the final stage of the budgeting process to raise planned defense spending to \$12.6 billion, a 6.5-percent nominal increase—4.2 percent in real terms according to the Japanese press—over fiscal year 1982. Defense would represent 0.98 percent of estimated GNP in FY 1983. The Defense Agency claims the new budget will enable the government to meet the objectives of the 1983-87 defense plan, even though the Ministry of Finance's decision to limit the rate of increase for future financial commitments forced a cutback in equipment orders. Funds for improvement of facilities used by US forces in Japan will rise by 24.8 percent. [REDACTED]

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Nakasone's willingness to support a defense increase in a year of fiscal austerity reflects a personal commitment to Japan's security as well as a desire to strengthen relations with the United States. Even though the new budget's 6.5-percent increase for defense is less than the 7.8-percent increase of last year, Nakasone's decision is far more daring than that of former Prime Minister Suzuki. The overall budget this fiscal year is rising by only 1.4 percent as compared with 6.2 percent last year. Moreover, 2 percentage points of last year's figure paid for salary increases. This year's 6.5 percent includes none. If salary increases are included in next fall's supplementary budget, as is generally expected, the nominal rate of increase could exceed 8 percent. In that case defense spending will approach and perhaps exceed the traditional 1 percent of GNP ceiling. [REDACTED]

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*Deteriorating Israeli
Credit Rating*

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[Redacted] We estimate that Israel will need at least \$1 billion in new commercial loans this year to avoid drawing down reserves. Foreign exchange reserves—\$3.7 billion at the end of November—can absorb the impact if these loans are not made available for a time. At some point, however, the Israeli Government would be forced by dwindling foreign exchange reserves to implement austerity measures—something Israeli politicians are extremely reluctant to do—if bankers continue to be unwilling to offer new credit. [Redacted]

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*Israeli Public
Sector Wage
Agreement*

A public sector wage agreement was signed last week between the Finance Ministry and the Histadrut, the large labor federation, after the reported intervention of Prime Minister Begin to end strikes, which had left schools closed and garbage on the streets. Because Finance Minister Aridor claimed he had kept his promise to maintain real wages and the agreement is along the lines of Histadrut demands, we believe that, at a minimum, the agreement has allowed public sector wages to catch up with inflation—running at an annual rate of 136 percent—and more likely has resulted in some real wage gains. Under the agreement, the wage scale will be raised an average 12 percent; workers in the lowest grades will receive larger percentage increases. In addition, all workers will receive a one-time payment of 30 percent to compensate for wage erosion since the previous agreement expired on 1 April 1982. [Redacted]

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[Redacted]

Aridor had tried to link agreement on wages to a new cost-of-living adjustment formula, but Begin reportedly ordered Aridor to drop this demand. Instead, government, Histadrut, and private employers' representatives will meet soon to negotiate a new cost-of-living adjustment formula. Aridor wants to index wages monthly to a predetermined, "expected" rate of inflation of 5 percent with compensation at the end of an unspecified period—one Israeli official hinted six months—if prices rise faster. Histadrut officials have demanded catchup compensation quarterly if they agree to this scheme. Under the present cost-of-living formula, wages are raised quarterly to compensate for 80 to 90 percent of the increase in the consumer price index. [Redacted]

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Secret*EC Steel Output Down*

Reacting to the continuing international economic recession and declining world steel demand, EC steel production fell more than 20 percent in the second half of 1982 compared with the first half. Output even dipped below the production quotas imposed by the EC Commission to maintain domestic steel prices. Most of the output reduction was caused by declining domestic consumption—exports remained relatively constant throughout the year. For 1982 as a whole, steel output dipped 11 percent and totaled only 110 million tons—the lowest since 1973. [REDACTED]

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Although reduced production may facilitate EC Commission efforts to cut finished steel capacity, continued soft demand is complicating Commission attempts to prop up sagging domestic steel prices. Moreover, intense competition in the world market is lowering EC export prices. The combined effect of lower output and prices will further reduce EC steel industry revenues and increase pressures on EC governments to step up assistance to their steel-makers. [REDACTED]

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*Less Developed Countries**Mexico Announces
New Minimum Wage
and Bank Legislation*

In two significant economic moves last week, Mexico City announced that the minimum wage increase would be 25 percent for the first half of 1983, and it proposed legislation to sell off 34 percent of the nationalized banks. While the IMF and Mexico's international creditors will be pleased with this low wage hike, they will be unhappy about some other concessions that labor extracted from the administration. The banking legislation, which is vague, apparently will have little effect on the operation of the nationalized banks. [REDACTED]

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In spite of yearend inflation running at an annual rate near 100 percent, labor agreed to a relatively small increase in minimum wages. To obtain labor support, however, Mexico City promised to raise minimum wages another 12.5 percent at midyear, cut or eliminate some taxes, and provide other benefits to ease the economic burden on workers, according to the US Embassy. To further placate the workers, the administration agreed to keep public transport prices at current levels, which constitutes abandonment of the planned fare hikes and undermines efforts to meet IMF spending targets. Even with these concessions, if inflation continues to climb, we believe workers will press for an increase higher than the 12.5 percent promised for midyear and demand an easing of austerity measures. [REDACTED]

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According to press reports, the bank legislation calls for bank shares to be offered to public trust and pension funds, private companies, and individuals, with no single shareholder allowed to acquire more than 1 percent of the shares of a bank. The legislation does not address compensation for the previous owners or disposition of the nonfinancial business shares acquired when the banks were nationalized, but press reports indicate the government has

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consulted with former bank owners and is considering methods of compensation. We do not believe President de la Madrid will make any quick decisions about the private company shares, acquired when the banks were nationalized. Because the proposed legislation provides for government ownership of two-thirds of the banks, the spirit of nationalization will not be violated.

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*Brazil Tightens
Monetary Policy*

Brazilian monetary authorities plan to reduce the growth of the monetary base to 60 percent this year, compared with about 85 percent in 1982; we believe they have an even chance of meeting their target. The slowdown will be achieved by phasing out various subsidies, reducing credit to small businesses, and increasing revenue transfers to monetary authorities. Exporters, however, will receive increased credit while government loans to agriculture will grow 63 percent. Additionally, Brasilia intends to eliminate the overvaluation of the cruzeiro by setting exchange rate adjustments 1 percent above the monthly inflation rate. Although the exchange rate targets probably will be met, Brazilian authorities will encounter technical difficulties in reining in the growth of the monetary base. The failure to increase interest rates for export credits, the lack of a precise timetable for phasing out subsidies, and the small increase in agricultural interest rates probably will translate into stronger-than-anticipated demand for funds. Beyond this, the government is already encountering demands from the powerful Sao Paulo business community for lower interest rates. We anticipate some concessions to industrialists in return for their continued support for the government's austerity program.

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The program has other worrisome aspects. Brasilia's current credit subsidy system:

- Undermines incentives for exporters and rural producers to improve their efficiency.
- Prevents market forces from weeding out unnecessary investments.
- Drains resources away from social welfare programs at a time of major economic retrenchment.

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Additionally, the uneven credit squeeze will increase the prospects for a strong business backlash against the IMF-mandated austerity program.

African Oil Crunch

A number of African states are experiencing or are threatened with oil shortages that could further depress their economies in 1983, increasing the prospect of political instability. Several are deeply debt-ridden and unable to finance petroleum imports. Western banks, concerned about **Liberia's** inability to repay its debts, have refused to continue financing oil purchases. Unless the Doe regime finds new funding soon or imposes drastic rationing, severe oil shortages are likely, possibly sparking domestic unrest. **Tanzania** defaulted on some payments for oil in 1982 and is having difficulty lining up new loans to finance oil imports. **Zaire** says it will have enough foreign exchange to pay for only 70 percent of its oil requirements in 1983.

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South African-supported insurgents in **Mozambique** are responsible for oil shortages in landlocked neighboring countries. Recurring rebel attacks on Mozambican roads and railways have led to a sharp reduction in **Malawi's** oil stocks, adding to its growing economic problems. The insurgents' periodic disruptions of an oil pipeline, and the sabotage last month of a major Mozambican oil depot, have increased **Zimbabwe's** dependence on oil brought in through South Africa. [redacted]

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We expect that several other states in eastern Africa will feel the oil pinch soon. **Kenya** has had to reduce crude oil purchases for refinement and reexport to neighboring countries. Kenyan plans to cut back on such operations will affect **Uganda, Burundi, and Rwanda**. A fire in December that destroyed one of Kenya's main oil depots has aggravated the problem. [redacted]

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The situation is enabling radical oil-producing states in the Middle East to improve relations with a number of African countries. Iran has offered to sell oil on attractive terms to several African states with large Muslim populations as part of a diplomatic campaign to expand its influence in the region. Libya, which last year became **Ghana's** main source of oil, has been expanding its military ties with the Rawlings regime. Algeria last month provided a \$1.3 million oil grant to Zimbabwe and reportedly plans to offer similar assistance to other southern African states. [redacted]

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The dependence of most African countries on Arab oil will continue to be a major obstacle to Israel's efforts to strengthen its position on the continent. No other African state has followed Zaire's lead in restoring diplomatic ties with Tel Aviv. [redacted]

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Moscow has used at least one African country's oil troubles to its advantage. To reinforce its dominant position in financially strapped **Ethiopia**, Moscow for the first time is offering to finance Addis Ababa's \$200 million annual oil import bill. [redacted]

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Because of the oil crunch and other economic difficulties, a number of African states will be asking the United States for increased assistance this year. They undoubtedly will also urge Washington to take the lead in spurring the global recovery that they believe will bolster their faltering economies. [redacted]

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*Jordan Increases
Fuel Subsidies*

Despite King Hussein's concerns about Jordan's worsening foreign exchange shortage and shortfalls in Arab aid, the recently unveiled 1983 budget increases already large subsidies on imported oil. Amman now sells imported oil to the domestic refinery at less than \$2 per barrel. The fuel subsidies were virtually the only budget items to receive real increases; military operating expenses—touted as "high priorities"—are slated to remain constant in real terms, and most other items received cuts. According to the budget, Amman expects to lose at least \$135 million in Arab financial aid in 1983 and envisions

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going to international capital markets for at least \$100 million. Even so, the budget projects a \$100 million funding shortfall, which we believe will rise to at least \$160 million. Without additional outside aid, borrowing will probably rise even more steeply than Amman has projected. [redacted]

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*North Yemeni
Earthquake*

The severe earthquake last week in North Yemen, as well as several aftershocks, left over 3,000 dead, thousands living outdoors, and the economy even more troubled. We believe President Salih will try to use the disaster to pry economic aid from reluctant donors and deflect any blame for growing financial troubles. North Yemen has been squeezed by a decline in worker remittances and foreign aid, with foreign exchange holdings currently at an estimated six-year low. Saudi Arabia, according to press reports, already has sent a mobile hospital and has pledged some \$30 million in medicine, food, and tents; Libya has sent four relief flights; and Western and Soviet Bloc countries have dispatched medical teams and supplies or pledged aid. [redacted]

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*Suriname Attempts
To Replace Dutch Aid*

The recent suspension of Dutch aid already is prompting Suriname to look for new donors. The cutoff by the Netherlands of more than \$90 million in 1983 alone, nearly all of Suriname's anticipated bilateral aid, followed the execution of some 24 leading critics of the Surinamese regime. Army Commander Bouterse told the Brazilian press that he plans to seek immediately about \$30 million from Western nations—including Venezuela and Brazil—and that he will turn to Cuba and other "socialist" countries only if the West fails to provide aid. [redacted]

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Without a substantial pickup in aid by midyear, Suriname—already hit by depressed bauxite exports and growing budget deficits—can expect further import restrictions and budget cuts. The government may be considering tax hikes on businesses and the nationalization of some foreign firms. These measures would lead to disinvestment and add to the emigration of skilled labor. Cutbacks necessary to weather a large decrease in aid would boost unemployment and inflationary pressures. [redacted]

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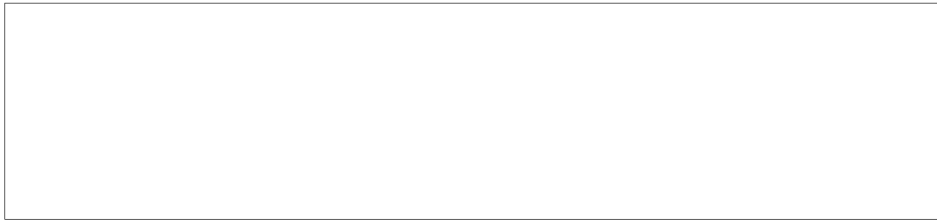
*Romania Requests
More Debt Relief*

Romania has notified the Paris Club that it wants to reschedule its debts for 1983 owed to Western governments and that it intends to open rescheduling negotiations with private banks this month. Although the financing requirement for 1983 is half as large as that for last year, Bucharest needs the debt relief to help cover nearly \$2 billion in scheduled debt service payments. The smaller financing requirement for 1983, Romania's markedly improved trade performance in 1982, and restoration of the IMF standby credit probably will help Bucharest conclude successful rescheduling negotiations sooner than it did in 1982. Bucharest will find it difficult to meet its unrealistic trade targets in 1983, however, because of the impact substantial import cuts have had on growth and exports. [redacted]

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*Slowdown in Chinese
Grain Buying*



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Rising consumer demand for grain and increasing population pressures will cause the Chinese to reenter the grain market and probably will keep imports in 1983 near the current level of 14.5 million tons. The United States will remain China's major supplier. Total US sales may fall below the level of 8.5 million tons in 1982, however, as France and Canada increase their share of the market.

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Oil Market Outlook

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In the absence of a major supply disruption, we expect continued oil market weakness during 1983 with a further slight decline in oil use and additional erosion in real oil prices. Under these conditions, OPEC members will have difficulty reaching an effective agreement on limiting production and maintaining nominal oil prices. We would not rule out the possibility of a price decline if political animosities and financial hardships prevent the cartel from establishing production quotas.

Recent Developments

The oil market remained weak throughout 1982 as a sharp decline in oil consumption combined with industry efforts to reduce inventories depressed oil demand. Weak demand and disagreement within OPEC about production and pricing policies put downward pressure on prices:

- Non-Communist oil consumption in 1982 approximated 44.7 million b/d, 4 percent below 1981 levels and about 13 percent below peak 1979 levels. Heavy and light fuel oil registered the sharpest declines, down an estimated 13 and 4 percent respectively in the major developed countries. Gasoline sales declined slightly reflecting a 1-percent drop in the United States.
- We estimate that non-Communist oil stocks on land fell at a rate of about 1.2 million b/d last year and stood at about 4.1 billion barrels at yearend. Because of the historical relationship between stock levels and consumption, we believe about 100 million barrels were still in excess at yearend.

- Non-Communist oil supplies averaged an estimated 43.4 million b/d last year, 2.6 million b/d below 1981 levels. OPEC production, including natural gas liquids, fell to about 20 million b/d, 3.7 million b/d below year-earlier levels. Within OPEC, Saudi production dropped by about 3.2 million b/d when Riyadh was forced to act as the marginal producer to support the price structure.

- Spot crude prices declined during 1982 and ended the year sharply below official prices. Arab Light crude, for example, fell \$4 to \$30 per barrel at yearend. Price discounting by Iran, Libya, and Nigeria also put downward pressure on prices.

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OPEC Vienna Meeting

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In the face of continued weak oil consumption and flagrant disregard of production quotas by several members, OPEC met in Vienna in December to attempt to hammer out a new agreement that would restore equilibrium to the market and maintain the current pricing structure. While the Ministers agreed in principle to support the \$34 per barrel price and to limit overall crude output to 18.5 million b/d in 1983, no agreement was reached on establishing individual production quotas. According to the official communique issued at the end of the two-day meeting, further consultations will be required before national quotas are set.

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The failure of OPEC to agree to individual output quotas or to deal with price differentials makes the agreement on an overall ceiling essentially meaningless. We expect the members to continue producing at current levels as long as the market permits and to take up the issue again early in the year when they face the prospect of a seasonal downturn in oil demand.

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Non-Communist Primary Oil Stocks on Land, End of Period ^a

	Billion Barrels				Days of Forward Consumption			
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
1978	3.6	3.7	3.9	3.9	74	76	74	69
1979	3.5	3.8	4.2	4.3	72	78	81	82
1980	4.3	4.6	4.8	4.6	91	99	97	93
1981	4.5	4.6	4.7	4.6	101	104	100	97
1982	4.3	4.1	4.2 ^b	4.1 ^b	99	97	93 ^b	89 ^b

^a Estimates include government-owned stocks in Japan and the United States that have increased from 18 million barrels in first-quarter 1978 to about 365 million barrels at yearend 1982. The increase amounts to about eight days of forward consumption.

^b Estimated.

[Redacted]

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Outlook for 1983**Consumption**

The level of Free World energy and oil consumption in 1983 will be influenced by the business cycle, the pace of energy conservation, and inter-fuel substitution. Taken together, we believe these factors will cause energy use in 1983 to increase slightly or remain at year-earlier levels. On the other hand, we expect oil use to remain at or below year-earlier levels, resulting in continued downward price pressures. [Redacted]

accommodate the possibility of a slower rate of growth in the United States that would ripple through the OECD, we have also considered a scenario in which OECD growth is only 1.2 percent in 1983. The OECD recently revised its own 1983 growth forecast to about 1.5 percent. [Redacted]

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Business Cycle

All OECD economies have been under serious strain since 1980. Although most forecasters anticipate a recovery in 1983, it probably will be substantially weaker than previous postrecession upturns. High interest rates, stemming in large part from the combination of expanding budget deficits and restrictive monetary policies, are expected to remain a major obstacle to vigorous economic growth. The availability of substantial excess industrial capacity will further discourage investment. To account for a lackluster recovery, our higher growth case assumes OECD real GNP growth will approximate 2.2 percent in 1983. To

Conservation

Lagged effects of past oil-price increases continue to spur conservation, although falling real oil prices in some countries have begun to dampen efficiency gains. From 1979 to 1982 OECD GNP grew by 2.5 percent while energy demand fell by 7 percent. Following a 4-percent drop in the energy/GNP ratio in the OECD countries in both 1980 and 1981, we estimate the ratio fell by only 2 percent in 1982 as high interest rates and the recession slowed investments in energy-efficient capital stock. [Redacted]

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Still, structural changes in the economies of the major industrialized countries probably will continue to dampen growth in energy requirements in 1983. We expect that the overall energy to GNP ratio in OECD countries in 1983 will fall by about 1 percent. [Redacted]

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Non-Communist Oil Supply ^a*Million b/d*

	1981	1982					March OPEC Production Quota
		1st Qtr	2nd Qtr	3rd Qtr	4th Qtr ^b	Year ^b	
Total	46.0	43.9	42.0	43.3	44.2	43.4	
OPEC	23.5	20.9	18.6	19.4	20.3	19.8	
Natural gas liquids	0.8	1.0	1.0	1.0	1.0	1.0	
OPEC crude	22.7	19.9	17.6	18.4	19.3	18.8	17.5
Algeria	0.8	0.7	0.6	0.7	0.7	0.7	0.6
Ecuador	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Gabon	0.2	0.1	0.2	0.2	0.2	0.2	0.2
Indonesia	1.6	1.4	1.3	1.3	1.3	1.3	1.3
Iran	1.3	1.4	2.3	2.5	2.9	2.3	1.2
Iraq	1.0	1.5	0.8	0.8	0.8	1.0	1.2
Kuwait	1.0	0.7	0.6	0.7	0.7	0.7	0.6
Libya	1.1	0.8	0.8	1.4	1.7	1.2	0.8
Neutral Zone	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Nigeria	1.4	1.4	1.3	1.2	1.4	1.3	1.3
Qatar	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Saudi Arabia	9.6	7.9	6.3	5.8	5.4	6.4	7.0
United Arab Emirates	1.5	1.4	1.2	1.2	1.3	1.3	1.0
Venezuela	2.1	1.9	1.5	2.0	2.2	1.9	1.5
Non-OPEC	22.5	22.9	23.4	23.8	23.9	23.5	
United States	10.2	10.2	10.2	10.2	10.2	10.2	
Canada	1.6	1.5	1.4	1.6	1.6	1.5	
Norway	0.5	0.6	0.6	0.5	0.5	0.6	
United Kingdom	1.9	1.7	2.2	2.2	2.2	2.1	
Other OECD	0.8	0.8	0.7	0.8	0.8	0.8	
Non-OPEC LDCs	6.3	6.6	6.8	7.1	7.1	6.9	
Of which: Mexico	2.5	2.7	3.0	3.0	3.1	3.0	
Net Communist exports	1.3	1.5	1.5	1.5	1.5	1.5	

^a Including net Communist exports.^b Estimated.

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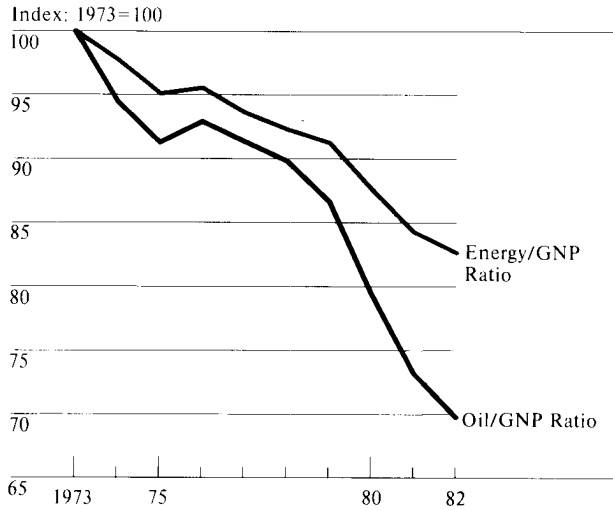
Consumption and conservation trends in major sectors will vary:

- In the transportation sector, we expect consumption will remain fairly flat in the industrialized countries.

- In the residential and commercial sectors, the economic recovery and the expected increase in the housing stock should cause a slight increase in energy use in 1983.

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OECD: Measures of Efficiency



[Redacted]

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- In the industrial sectors of the major developed countries, lower real energy prices will further erode conservation gains in 1983 and the anticipated economic recovery should cause energy use to rise as older, less efficient equipment is brought back into production.
- We expect electricity demand to rebound strongly in response to any economic recovery. [Redacted]

On balance, we expect energy consumption in the OECD countries to grow by about 1 percent or 600,000 b/doe in 1983 under our higher growth case. Under our lower growth case, total energy use would remain at 1982 levels. [Redacted]

Substitution

We believe the anticipated economic recovery this year should boost nonoil energy consumption by about 1 million b/doe—more than enough to cover the expected increase in total energy demand. The bulk of the increase will occur in nuclear power and

coal consumption to meet the expected rebound in electricity demand. The slide in the use of residual fuel oil to generate electricity is expected to continue in most countries, but oil will still supply about 50 percent of electric power generation requirements in Italy and 40 percent in Japan. [Redacted]

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Oil Consumption

Given our conservation and substitution assumptions, oil consumption in the OECD countries should decline by about 500,000 b/d under our higher growth scenario and about 1 million b/d under our lower growth scenario. We believe oil consumption in developing countries will grow only slightly in 1983, perhaps by 200,000 to 300,000 b/d, with most of the increase occurring in oil-producing countries. Most industry forecasters have recently revised downward their short-term projections of LDC demand because of reduced economic prospects and higher domestic oil product prices in many LDCs. Mexico, for example, doubled the retail price of gasoline late last year. Earlier industry forecasts called for LDC demand to increase by about 600,000 b/d in 1983. [Redacted]

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As a result of these factors, we expect total non-Communist oil consumption to fall by about 1 percent to roughly 44.4 million b/d under our higher growth scenario. In the lower growth scenario, total non-Communist oil consumption would fall to about 43.9 million b/d. We expect oil use during the first half of 1983 to remain below year-earlier levels. By the end of 1983, however, consumption should begin to rise above 1982 levels in our higher growth case assuming that the OECD recovery accelerates to an annual rate of 3 percent in the second half. If economic growth were 1 percentage point higher than we assume, oil consumption would increase by up to 600,000 b/d. [Redacted]

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Inventories

[Redacted] oil stocks are near desired levels and assume no net change in inventories in 1983. Some companies, however, believe a further drawdown in 1983 is probable, particularly if consumption and prices weaken significantly or if the fourth-quarter 1982 drawdown proves to be less

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Projected Changes in 1983 Non-Communist Oil Supply and Demand

Million b/d

	Forecasts	Oil Consumption	Non-OPEC Supply	Demand for OPEC Oil	Stock Change ^a
Firm A	November 1982	0.4	0.7	1.0	-0.3
Firm B	October 1982	-0.9	0.5	0.9	0.7
Firm C	November 1982	0.3	0.7	0.6	0
Firm D	November 1982	0	0.1	0.9	0
Firm E	November 1982	0.5	0.6	1.9	0
OPEC Economic Commission Board	November 1982	-0.3	0.7	0.6 to 0.9	-0.2 to -0.4

^a Stock change in 1983.

[redacted]

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than anticipated. [redacted]
 [redacted] Industry estimates of possible commercial drawdowns under a weak market scenario vary from 200,000 b/d to 1 million b/d. [redacted]

Most of the increase will come from Mexico, the North Sea, Canada, and smaller LDCs:

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We have assumed no net change in inventories in our higher growth case and a 500,000-b/d draw-down in our lower growth case. Both cases assume some decline in commercial stocks and a 300,000-b/d increase in government stocks, mainly in the United States. We also expect a dampening of seasonal patterns in inventory swings. [redacted]

- We expect Mexican production, including natural gas liquids, to rise by about 200,000 to 300,000 b/d to 3.2 million b/d. Mexico's ability to raise production above these levels will be constrained by weak oil demand, particularly for the poor-quality crude oil which Mexico could most easily produce.

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[redacted] the combination of high carrying costs, surplus productive capacity, and increased flexibility in the refining system is causing oil companies to carry smaller inventories and shift more of the seasonal pattern of oil consumption to producers. As a result, oil production will probably exhibit significant changes throughout the year in response to the seasonal rise and fall in consumption. [redacted]

- North Sea production will rise in both Norway and the United Kingdom by a combined total of 100,000 b/d.

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- Canadian officials expect domestic production to rise by 100,000 b/d to 1.6 million b/d.

- We expect production in other LDCs including Angola, Brazil, Egypt, India, and Malaysia to rise by a total of about 100,000 to 200,000 b/d.

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- Industry forecasters anticipate small declines in US production and in net Communist exports. [redacted]

Non-OPEC Supplies

We expect non-OPEC supplies to rise by about 500,000 b/d in 1983 to 24.0 million b/d including natural gas liquids and net Communist exports.

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Non-Communist Oil Supply and Demand Scenarios*Million b/d*

	1982	1983				Year
		I	II	III	IV	
Higher growth case						
Consumption	44.7	46.2	43.2	42.5	46.0	44.4
Supply	43.4	44.7	43.7	44.0	45.5	44.4
Non-OPEC	23.5	23.9	24.0	24.2	24.2	24.0
OPEC	19.8	20.8	19.7	19.8	21.3	20.4
Inventory change	-1.3	-1.5	0.5	1.5	-0.5	0
Lower growth case						
Consumption		45.5	42.7	42.0	45.5	43.9
Supply		43.5	42.7	43.0	44.5	43.4
Non-OPEC		23.9	24.0	24.2	24.2	24.0
OPEC		19.6	18.7	18.8	20.3	19.4
Inventory change		-2.0	0	1.0	-1.0	-0.5

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Demand for OPEC Oil

Given our estimates of oil consumption, inventory behavior, and non-OPEC supplies, demand for OPEC oil in 1983 under our higher growth case should approximate 20.4 million b/d (including NGL), up slightly from 1982 levels but 11 million b/d below peak 1979 levels. In the lower growth scenario, demand for OPEC oil would approximate 19.4 million b/d. With inventory changes covering less of the seasonal consumption shifts, demand for OPEC oil could decline as much as 1 to 2 million b/d below present levels during the spring and summer months. [redacted]

needs for development plans far greater than expected oil revenues. In addition major non-OPEC producers like Mexico, Egypt, Norway, and the United Kingdom will keep prices competitive to maximize output. [redacted]

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Prices

In the absence of a substantial supply disruption, we expect the oil market to remain weak throughout 1983. With some 8 million b/d of spare capacity available, OPEC members will remain under substantial pressure to limit output to maintain oil prices. Because most countries would like to increase output, the cartel will have difficulty reaching agreement on limiting production. Several members including Nigeria, Indonesia, and Venezuela face a tight financial outlook with monetary

Most analysts believe, however, that these problems will not lead to a sharp oil-price decline. They argue that OPEC members realize that widespread price discounting could lead to a price collapse resulting in lower revenues for all producers. In addition, OPEC's own analysis has shown that lower prices would not push demand up significantly because oil consumption is relatively unresponsive to price changes in the short run. [redacted]

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Still, there are enough unknowns to make it difficult to predict with certainty that OPEC will be able to maintain prices. Political animosity among Saudi Arabia and Iran and Libya may result in an emotional approach to setting prices. The Saudis and their fellow members of the Gulf Cooperation

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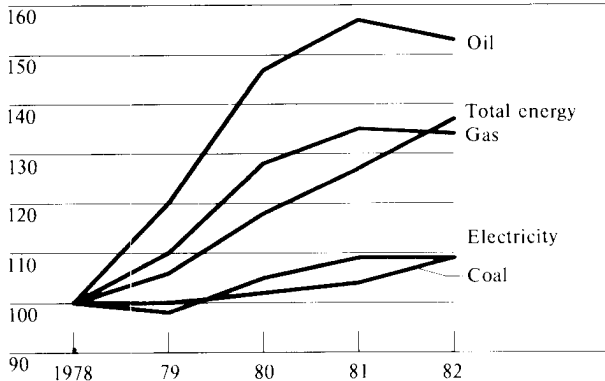
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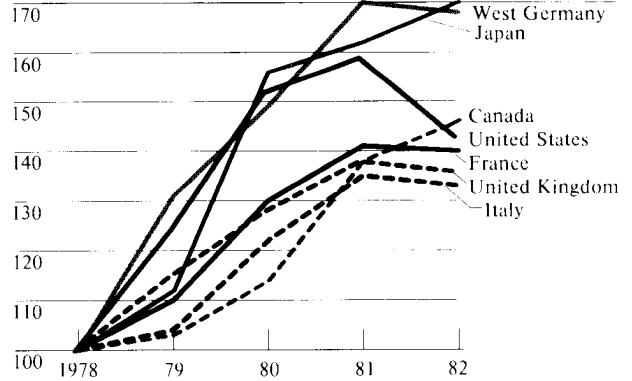
Big Seven: Real Energy Price Trends

Index: 1978=100

Real Energy Prices^a



Real Oil Prices^b



^a Weighted average.

^b Weighted average of real oil prices.

[Redacted]

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Council with huge financial reserves could more easily absorb a drop in revenues resulting from a price cut. Indeed, the Saudis themselves have hinted that a \$2 to \$4 per barrel price cut might in the long run hasten the recovery in oil demand. Riyadh must decide whether prices could be stabilized at that level or whether other producers, especially Iran, would retaliate with price cuts or even military measures against Saudi oil facilities to dry up the market surplus. [Redacted]

Matters could worsen for OPEC if the expected economic recovery fails to materialize and oil consumption continues to slide sharply. Pressures would be further intensified if the Iran-Iraq war were resolved because both belligerents probably would attempt to raise output. Under these circumstances, demand for Saudi oil could fall to as low as 3.5 million b/d, a level which almost certainly would be unacceptable to Riyadh. [Redacted]

If prices begin to slide, we cannot predict how far they might fall or how long they would remain depressed. At some point, we believe OPEC members would probably agree on some rationing scheme to arrest the price slide. Although we cannot quantify the potential impacts of a sharp price decline on the world economies, we believe some of the likely effects would include: ¹

- Lower inflation.
- Higher economic growth.
- Reduced interest rates.
- Lower revenues for oil-exporting countries and severe financial problems for several producers.
- Reduced energy conservation and nonoil substitution.
- Further reductions in the development of alternative energy sources. [Redacted]

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Energy Prices

Led by falling oil prices in the United States, the real energy price to final consumers in the seven major industrialized countries fell by about 1 percent in 1982. The combined Big Seven² oil price fell 2.5 percent while gas and coal prices continued to increase by 8 and 5 percent respectively. The soft oil market should begin to affect other energy prices in 1983, causing real prices of other fuels to begin to decline. [redacted]

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Real oil prices in the United States declined 10 percent last year, but oil prices in some other major industrialized countries rose slightly because of the sharp appreciation of the dollar against foreign currencies. Because oil prices are denominated in dollars, real oil prices in Western Europe as a whole fell by about 1 percent while Canadian and Japanese prices each rose about 5 percent. Barring a continued rise in the dollar against the currencies of the other major industrialized countries, we expect real oil prices for the Big Six will fall in 1983, further dampening conservation efforts and substitution away from oil. [redacted]

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² United States, Japan, West Germany, France, United Kingdom, Canada, and Italy. [redacted]

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**Eastern Europe:
Growth Prospects**

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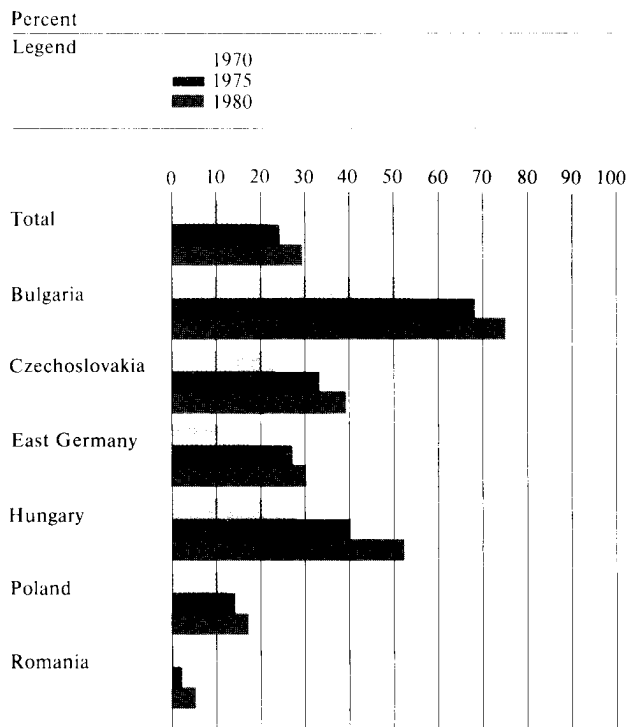
The East European countries¹ are ill equipped to deal with cutbacks in Soviet deliveries of energy over the coming decade. Recent economic performance has been poor; annual growth of regional GNP slowed to less than 1 percent in 1981-82 compared with nearly 4 percent per annum in the 1970s. Prospects for a rebound are weak and would not improve significantly even if the USSR could satisfy the region's energy requirements over the next few years:

- Industrial labor force growth will be sluggish because of demographic trends and depletion of the once-large pools of agricultural labor.
- Labor productivity will improve little because hard currency shortages have forced regimes to slow investment growth—in some cases to cut investment absolutely—and to let living standards stagnate, hurting incentives.
- Hard currency shortages will persist because of debt service obligations, the reluctance of Western bankers and governments to extend credits, Western protectionism, and the continued failure of many East European goods to meet the standards of Western markets.

In 1982 the Soviet Union cut bargain-priced oil deliveries to Czechoslovakia and East Germany by 10 percent and to Hungary by about 5 percent. Soviet price concessions on sales of energy cushioned the East Europeans from the explosion in world prices in the 1970s and saved them scarce hard currency. Current Soviet deliveries of 2.5 million b/doe account for three-fourths of total energy imports and 30 percent of primary energy

¹ CEMA Six: Bulgaria, Czechoslovakia, East Germany, Poland, and Romania.

**Eastern Europe: Energy Imports
From the USSR as a Share of Total
Energy Consumption**



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consumption. Excluding Romania, the Soviet Union provides all the natural gas imports and over 90 percent of crude oil imports to Eastern Europe.

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The East European regimes have few options to offset cutbacks of Soviet energy and other raw

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materials. Domestic energy resources consist largely of coal—mostly low-quality lignite and brown coal—and this is not a ready replacement for oil. Poland is the exception, with ample reserves of bituminous coal. The current soft world oil market offers an alternative to Soviet supplies, but most of Eastern Europe is desperately trying to reduce hard currency imports. It would cost the East Germans, Czechoslovaks, and Hungarians together more than \$1 billion in hard currency just to replace the nearly 100,000 b/d cut by the Soviets in 1982. [redacted]

Eastern Europe is generally coping with its tighter energy situation by imposing greater restraints. The regimes responded to reduced deliveries of Soviet oil by boosting prices and cutting allocations to consumers and industries. The current slowdown in investment in Eastern Europe, however, will hinder efficiency by slowing the replacement of older equipment. [redacted]

Growth Prospects Through 1985

Prospects for economic growth in Eastern Europe—already at the lowest level in the post-World War II period—will remain dismal at least for the next two to three years. To assess Eastern Europe's medium-term growth prospects, we have optimistically assumed that:

- The Soviets will maintain oil supplies at the 1982 level while increasing gas and electricity deliveries slightly.
- Domestic energy production will grow slightly and conservation efforts will achieve some success.
- Investment will not be cut below current levels.
- The productivity trends realized in the 1970s will continue.

Under these generally favorable assumptions, we expect GNP growth to remain at only 1 percent per year through 1985. Slightly less favorable assumptions would lead to declining production in several countries. With population growth averaging nearly 1 percent annually, most countries will find per capita GNP stagnating. [redacted]

We think that prospects are poorest for Poland, Czechoslovakia, and Hungary. Although the political events of the past several years reduce our confidence in forecasting Polish growth, Poland's economy will recover slowly, taking several years to reach even the 1978 level of activity. Czechoslovakia's prospects are also bleak, particularly because of an obsolete industrial plant that is ill suited to adjust to restricted oil deliveries. The Hungarian economy has expanded very little since 1978, and only a slight pickup is likely as Budapest remains committed to austerity. [redacted]

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Growth prospects elsewhere in the region are little better, still well below past performance. Romanian growth may exceed 2 percent per year, far short of the 5 percent rate achieved in the 1970s. Similarly, East Germany can no longer avoid sacrificing traditionally robust growth in the face of tightening constraints. Only Bulgaria will remain relatively immune to the sharp declines seen elsewhere in the region. Sofia should be able to hold growth well above 2 percent, in large part because of its established nuclear energy program and continued heavy subsidization by the Soviet Union. [redacted]

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Prospects to 1990

Assessing Eastern Europe's growth prospects beyond 1985 is difficult given the uncertainty about key factors:

- What will lead to a renewal of banker confidence and to a resumption of lending?
- How will Eastern Europe deal with its debt burden and how seriously will needed stabilization measures stifle growth and reduce living standards?
- What progress—if any—will be made on economic reform programs and will this translate into improved economic performance?
- Will the Soviet Union maintain its deliveries of oil and boost its deliveries of gas and electricity, or will increased gas and electricity deliveries merely offset reduced oil deliveries?

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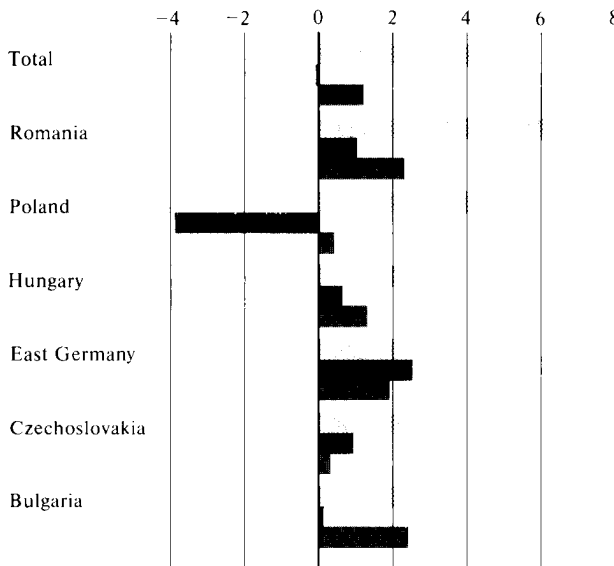
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GNP Growth in Eastern Europe

Average Annual Percent Growth

Legend

- 1970-78
- 1979-81
- 1982-85 projected



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- How far along will domestic energy programs be, especially the construction of nuclear power plants, the development of offshore oil supplies, and efforts to conserve energy?

Positive developments in all of these areas could significantly brighten growth prospects as the decade ends. In our view, however, many shortcomings will persist and will impinge on the East Europeans' ability to revive lagging growth.

Political Implications

Continuing economic difficulties—especially stagnant or even declining living standards—will be a major test for some of the regimes of Eastern Europe. For the most part, the East European populations have quietly tolerated their repressive political climate in exchange for gradual improvements in their economic well-being. Even in the years when material rewards were meager, public reaction was often mild, apparently because of confidence that improved living standards were “just around the corner.” Now the promise of a better future is suspect, and consumers are no longer patient. The Polish story is well known, and the situation there remains quite volatile. Romania has suffered through several sporadic, and at times violent, outbursts recently, with more significant demonstrations quelled largely by the security network. Even the East German regime, although firmly in control, has shown concern for consumer dissatisfaction by their recent efforts to prop up supplies to the populace.

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Growing economic misfortunes are straining relations among the East European states. Several of the regimes vociferously expressed their dissatisfaction with Warsaw's handling of the strikes, especially when they were forced to “contribute” assistance to Poland or accept reduced deliveries of Polish goods. Similar complaints were directed at both Warsaw and Bucharest when their financial predicaments caused Western creditors to limit their exposure to all countries in the region. And more recently, Romanian-Hungarian relations have worsened because of Budapest's growing concern over the economic (and political) well-being of the Hungarian minority in Transylvania. These types of confrontations are likely to intensify as each regime seeks to protect its own interests; none is above promoting nationalistic causes to achieve desired goals.

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The Soviet Union has proposed closer economic cooperation to compensate for reduced aid, but the Soviet proposals are viewed with a skepticism by Eastern Europe. Both Romania and Hungary are shying away from any move that enhances Soviet leverage: Bucharest because of its unwillingness to sacrifice political independence and Budapest because it would not like to back down on economic decentralization. Moreover, Eastern Europe may not be entirely convinced that substantial benefits will flow from closer cooperation. As economic problems mount throughout the region, these countries may wish to avoid increasing their dependence on each other, recognizing that their own situations could deteriorate further should their CEMA partners prove unreliable. The recent cutbacks in Soviet oil and Polish coal already serve as unpleasant reminders of the pitfalls of economic interdependence. [redacted]

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The ability to handle mounting political tensions could be complicated as some of the countries confront their own succession crises. Only Poland has any recent experience in tackling this thorny issue. The leaders of Bulgaria, Czechoslovakia, East Germany, and Hungary are all in their late sixties or early seventies and Bulgarian leader Zhivkov—in particular—may be ill. Continuing financial problems and austerity could serve to frustrate orderly succession within the region. [redacted]

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**South Africa: Recession
Heightens Prospects
for Black Unrest** [redacted]

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The interaction of several economic and political trends in South Africa could make 1983 a difficult and perhaps violent year. A continuing economic slump, rightwing political pressure that is forcing the government to harden its attitude toward blacks, and an increasingly militant and well-organized black labor movement could end five years of relative calm in black-white relations. [redacted]

the price of bread, and the sales tax has been boosted twice during the past year.

- The hard-hit automotive industry already has laid off thousands of workers near Pretoria and in eastern Cape Province, and many plants have been operating on shortened workweeks.
- Two of the country's largest state-run corporations—in transport services and steel production—have cut employment and are warning workers not to expect pay raises next year if further layoffs are to be avoided. [redacted]

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The Troubled Economy

The South African economy was flat in 1982. Low gold prices and a rapidly growing balance-of-payments deficit early in the year resulted in a sharp downward float of the rand. Rising import costs boosted inflation and led to restrictive fiscal and monetary policies. Real government spending was cut, the sales tax was raised, and money supply growth was reduced to push interest rates higher and curb private spending. An import surcharge also was implemented. [redacted]

These setbacks contrast sharply with the economic gains made by blacks during 1979-80, when rapid growth created employment and business opportunities and provided the government with expanded revenues to support increased social spending. The onset of a downturn in 1981 and the deepening recession last year have caused black unemployment to rise rapidly. [redacted]

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Pretoria's Hardening Attitude

Although the current account deficit has responded quickly to these measures and the rand is recovering, Pretoria found it necessary in November to obtain a \$1 billion IMF loan to shore up foreign exchange reserves. Meanwhile, domestic interest rates peaked only recently at 20 percent, private domestic spending is falling, and inflation continues at about 14 percent. We estimate that black unemployment is at 25 percent and rising. [redacted]

The Botha government's concerns about the economic plight of blacks have taken a back seat to political realities, particularly the necessity of pursuing tough economic policies to combat inflation—the key economic issue for white voters.

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Recession Hurts Blacks

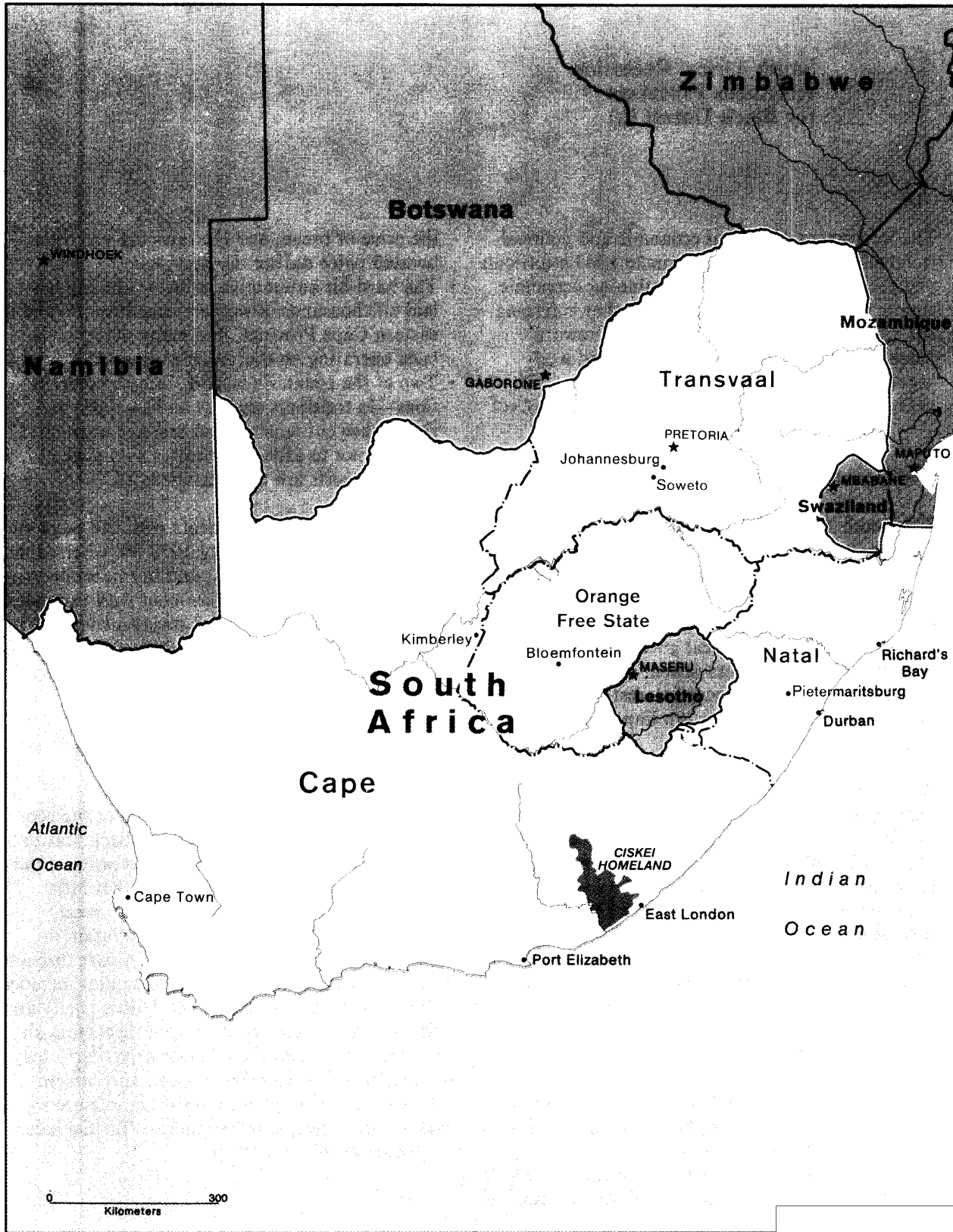
Although whites have felt some of the impact of austerity measures, blacks have been affected most seriously:

- Rents and bus fares in black townships have been hiked, the government has mandated increases in

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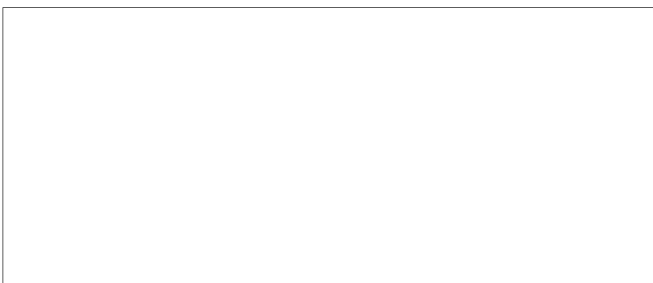


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South Africa's business community, however, is much less sanguine about the likely black response to harsher conditions. Many business leaders fear the social and political consequences of growing black unemployment and believe that growth—widely projected to be negative this year for the first time in about 40 years—should receive a higher priority than combatting inflation; the government itself has acknowledged that 5- or 6-percent growth in output is necessary simply to provide jobs for new black entrants to the work force. Businessmen also fear that, by persisting in its tough attitude, Pretoria may be creating conditions that could become a unifying focus for widespread black protests. [Redacted]

Pretoria has also begun to display a hardened attitude in its policies toward blacks to counter Conservative criticism of the government's plan to grant limited political rights to Coloreds and Asians. Enforcement of laws that control black migration into white areas has been tightened, especially in the Transvaal and in Cape Province. The homes of thousands of black squatters have recently been destroyed, forcing black families back to tribal homelands, and new legislation is being drawn up to limit further the urban residency rights of blacks. [Redacted]

Labor Activism and Government Repression

Strikes and slowdowns have reflected the resistance of black workers to recession-induced belt tightening as well as their continued aggressiveness in seeking new economic concessions:

- In late June thousands of black goldminers near Johannesburg began several days of violent demonstrations over pay and working conditions. The

outburst quickly snowballed into a massive protest involving nearly 30,000 workers, halting production at eight mines, and resulting in several deaths.

- Throughout July and August as many as 10,000 black auto workers in eastern Cape Province struck at various times—at one time closing down simultaneously the Ford, General Motors, and Volkswagen plants—in support of wage demands. [Redacted]

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Rising militancy of the disenfranchised black labor force, for whom unions are one of the few legal vehicles for organized expression, is symptomatic of the tendency of workers to focus much of their frustration on the workplace. The number of strikes and the number of workers participating in 1982 probably ran ahead of the near record pace of 1981, fed in part by enthusiasm for independent black labor unions that have seen their membership more than double since 1979 to more than 300,000. Prospects for further rapid membership growth received a boost late last year when the nearly 500,000 black mineworkers were for the first time allowed to unionize. [Redacted]

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Pretoria, meanwhile, has shown little tolerance for those black unions whose demands extend beyond the workplace and has routinely arrested or detained union leaders suspected of supporting "political" aims. Convinced that the African National Congress and its allies in the South African Communist Party have infiltrated labor organizations to foment unrest, Pretoria sees such union activism as evidence of militant influence and therefore as a pretext for cracking down on labor leaders. The manpower minister also has publicly urged businesses to get tough with unions and not to give in to "the dictates of militants and outsiders." [Redacted]

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Pretoria has even been hard-nosed in dealing with those unions that focus on traditional labor issues:

- Last September Pretoria announced the creation of a fund to compensate auto workers who refused to strike—a move to benefit skilled white workers idled in a strike by a black union.

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- Over 2,000 black workers in Natal Province were fired for failing to return to work in a dispute over pensions.
- Black dockworkers employed in Port Elizabeth by the state-run transport services corporation—the country’s largest employer—were fired and exiled to their homelands when they engaged in a work slowdown over their demand to join an independent black union. [redacted]

Outlook

In the near term, rapidly rising unemployment and continued high inflation will create additional economic difficulties for blacks. In our view, however, the South African Government will continue to tailor both its short- and long-term economic policies to the immediate interests of whites. Because of Pretoria’s failure to take adequate account of their plight and the severity of the recession, blacks can expect little economic relief this year. [redacted]

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Economic Issues Also Trigger Black Community Unrest

In recent months manifestations of black discontent have spread from the workplace to the community as the backlash to unpopular economic measures has deepened:

- Government-mandated increases in the price of bread, closely following an increase in September in the general sales tax from 5 to 6 percent, have provoked a number of local boycotts by black consumers in Cape and Natal Provinces.
- The October announcement of rent hikes for a black township near Pietermaritzburg, provoked violent protests in which a schoolboy was shot by police. The bread price increase was also an issue in demonstrations at the boy’s funeral, while the rent issue contributed to an outburst of arson and looting in the township later that month.
- A 1 December, 12-percent fare increase for black buses in Durban prompted riots in which buses and police cars were destroyed, and has spurred a prolonged and effective boycott. In mid-December the boosting of fares in two nearby black townships by about 13 percent provoked even more serious rioting and looting in which over 150 buses and eight police vehicles were destroyed. [redacted]

As the economic slump continues, blacks may become more restive. They probably will continue to demonstrate their discontent in frequent, but usually small-scale, protests triggered by specific grievances such as layoffs, tax and price increases, or further crackdowns on urban dwellers. Although Pretoria reportedly has plans to relax economic policy later this year, we believe that the imposition of additional austerity measures in the intervening months may lower the flashpoint for such outbursts. [redacted]

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Government repression coupled with the growing caution that some black workers are beginning to feel as a result of the deepening recession may restrain the more aggressive tendencies of some union leaders, but the more militant among these may simply be driven temporarily underground, adding to the volatility and unpredictability of the labor scene. South Africa’s mines may again become a focal point for labor unrest because of the newly allowed black unions. We believe eastern Cape Province also is likely to become a major trouble spot because of its already highly politicized and unionized black population. Moreover, South African officials reportedly are particularly worried about prospects for black unrest in the adjacent Ciskei homeland, with its extreme unemployment and poverty. A major outburst in Soweto also cannot be ruled out; substantial rent hikes along the lines the government may announce this month are a potential spark. [redacted]

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Pretoria, however, will remain vigilant and will move forcefully to quell any serious disturbances. Harsher repressive measures and a further slowing of racial reforms would then be likely as the National Party attempted to project an image of strength to Afrikaners being wooed by rightwing parties. While prospects for plans to grant limited political rights to Coloreds and Asians probably would not be seriously affected, Pretoria might feel compelled to strengthen further its assurances that no significant political accommodation for blacks is envisioned. [redacted]

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Weakness in the South African economy will extend well into this year, with a strong upturn unlikely before 1984. Even an economic recovery, however, may not signal a reduction in black unrest. As blacks come away virtually empty handed from political reforms aimed at benefiting Coloreds and Asians, they probably will focus even more intensely on economic conditions. If expectations rise faster than the ability of the economy to satisfy them, the perception that Pretoria is not doing enough for blacks will create a climate for continued protest. [redacted]

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**Nuclear Reactor Industry:
Looming International
Shakeout**

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The nuclear reactor industry is in a deep slump. Slack demand has caused severe overcapacity with little prospect for improvement in the next several years. As the decade progresses, we believe at least three nuclear reactor vendors—probably including two US firms—will stop production. Those companies remaining in business will be operating at greatly reduced capacity and will be forced to concentrate more on the nuclear service business. As a result, critical technical, engineering, and managerial skills will be lost.

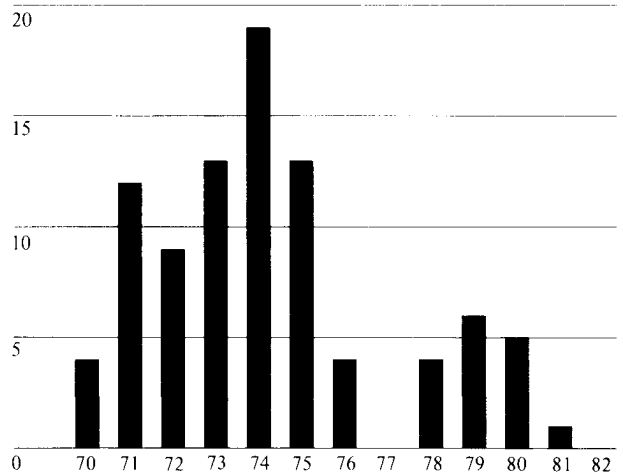
Programs Cut Back

Six countries currently manufacture nuclear reactors for export: Canada, France, Sweden, West Germany, the USSR, and the United States. Almost across the board, domestic nuclear power programs in these countries are being cut back. Industry analysts report that lower growth rates for electricity demand, high capital costs, high interest rates, and regulatory uncertainties have forced utilities to delay or cancel nuclear power reactor construction programs.

Despite recent cutbacks, the French nuclear power program is large and continues to grow. Framatome, the French nuclear reactor vendor is the sole reactor supplier for the French nuclear program, and the French Government has made nuclear-generated electricity a cornerstone of its program to improve the security of energy supply. According to recent press reports, however, Paris plans to cut back on construction of new nuclear power plants by as much as 50 percent beginning in 1984 because of greatly reduced growth in electricity demand.

Worldwide Nuclear Reactor Exports

Number of Reactors



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As a result of a referendum conducted in 1980, Sweden's domestic nuclear power program has been limited to 12 nuclear power plants totaling 9,500 megawatts. All of these plants are in operation or under construction; thus, ASEA-Atom, the Swedish firm, must depend on export sales for survival as a vendor of nuclear power plants.

Near-term orders for Canadian reactors have slowed, according to industry reports, and Atomic Energy of Canada, Ltd. (AECL) is experiencing commercial difficulties. A Canadian Government study reports that no new reactor orders are needed to meet electricity requirements for the next several years.

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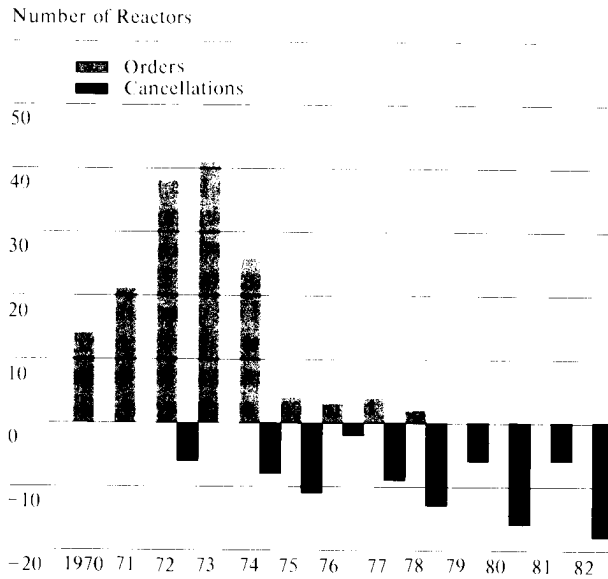
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We believe that Kraftwerk Union (KWU) in West Germany has already weathered its worst crisis. Since the mid-1970s KWU has not received a single domestic order for a nuclear power plant. Existing orders were tied up when the West German Government announced that no new reactors would be licensed until the utilities could demonstrate satisfactory arrangements for disposing of radioactive wastes. Industry assessments indicate that facilities to handle these tasks should be in place by the end of the decade. Also, the government has instituted a streamlined licensing system, ending years of procedural delays. As a result, the West German nuclear power program is progressing for the first time in years. [redacted]

The Soviet nuclear power program continues to grow. The Soviet nuclear reactor vendor serves as sole supplier to the domestic nuclear power program. Atomenergoexport, the export arm of the Soviet reactor vendor, enjoys strong government support. [redacted]

US Domestic Nuclear Reactor Orders and Cancellations



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Major Export Potential for US Firms

Mexico

The first phase of Mexico's nuclear power program consists of two General Electric boiling water reactors with a total generating capacity of 1,308 megawatts-electric (MWe). These two reactors are in the mid-to-late stages of construction at Laguna Verde. In early June, President Portillo's Economic Council decided to suspend the second phase of the Mexican nuclear power program as a result of Mexico's financial crisis. This phase of the program called for an additional 2,400 MWe at the Laguna Verde Nuclear Power Station. Further government plans calling for the installation of some 20,000 MWe of nuclear generating capacity have been abandoned. [redacted]

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Although the US nuclear industry is the world's largest, it has been going through a lengthy period of stagnation. An industry trade group reported that US reactor vendors have not received a single domestic reactor order since 1978 and have not sold a reactor on the international market since 1979. A total of 95 nuclear power reactor orders have been canceled in the United States, and additional reactor plans have been delayed. Many experts project no new orders for nuclear reactors for the remainder of this decade. Reactor manufacturers will face increasingly severe problems as they work off their construction backlogs. In this decade, industry observers expect Babcock & Wilcox and Combustion Engineering to drop out of the nuclear reactor business unless either foreign or domestic orders can be found. [redacted]

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Potential Reactor Exports, 1983-85

Purchaser	Reactor Name	Capacity (MWe)	Likely Suppliers
Argentina	Atucha-3	690	Kraftwerk Union
Brazil	Iquape-1	1,245	Kraftwerk Union
	Iquape-2	1,245	Kraftwerk Union
China	Guangdong-1	950	Framatome or US supplier
	Guangdong-2	950	Framatome or US supplier
Egypt	El Daba-1	900	Framatome
	El Daba-2	900	Framatome
Finland	Loviisa-3	1,000	Framatome or Atomenergoexport
Libya	Surt-1	420 ^a	Atomenergoexport
	Surt-2	420 ^a	Atomenergoexport
Mexico	Laguna Verde-3	1,200	Framatome or US supplier
	Laguna Verde-4	1,200	Framatome or US supplier
South Korea	Undetermined	950	US supplier
	Undetermined	950	US supplier
Taiwan	Yenliao-1	950	Framatome
	Yenliao-2	950	Framatome
Yugoslavia	Prevlaka-1	1,000	US supplier

^a This is the rated capacity for this reactor; however, the plant will be derated to provide process steam for desalination facilities.

[redacted]

At the time of the suspension, France and the United States appeared to be the leading candidates for the sales contract, according to Mexican officials. Mexican Government officials have indicated that they believe US nuclear equipment and technology are superior to that offered by France but are put off by a perception of the United States as an unreliable supplier. If the Mexicans can be persuaded that future administrations will honor commitments made by the Reagan administration, we believe that US vendors would be virtually assured of winning the nuclear reactor export orders from Mexico if and when its nuclear program resumes. [redacted]

[redacted] the program could be approved within a year, we believe it is unlikely that new contracts would be signed before 1985. [redacted]

South Korea

Seoul already has a 564 MWe Westinghouse pressurized water reactor in operation and eight reactors totaling more than 6,800 MWe under construction. Government plans indicate that as many as 10 additional reactors are scheduled to be in operation by the year 2000. Despite recent delays in the nuclear program, South Korea will remain a strong market for nuclear reactor sales. [redacted]

With the exception of the sale of a single Canadian CANDU reactor in the early 1970s, US vendors maintained a solid grip on reactor exports to South Korea until 1980 when Framatome's bid to construct the two-unit power project near Ulchin was accepted. Framatome won the contract in part by offering the Korea Electric Co. (KECO) extremely favorable financing. The US Embassy in Seoul reports that under the terms of the loan agreement, French banks loaned Korea \$1.25 billion at 7.5 percent interest. No payments are due for eight years; thereafter repayment is to be made in 15 equal annual payments. [redacted]

As of 1981, KECO had planned to order four more nuclear reactors, two in 1982 and two in 1984. Recent Korean press reports indicate that bidding for the two reactors scheduled for 1982 has been officially postponed until 1983. The units originally scheduled for 1984 will be delayed by at least one and perhaps two or more years. Financial strains and reduced growth rates for electricity demand were cited as reasons for the delay. We expect only two Korean reactor orders by 1985. [redacted]

France now has a solid foothold in the Korean nuclear reactor market. Nevertheless, we believe US vendors are in a strong position to win these contracts unless France once again offers generous financing terms. French adoption of a proposed common line on credit terms for nuclear power

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plant financing would improve the competitive position of US nuclear vendors, but political considerations will remain a factor. If South Korea concludes that continued US military and political support is something that needs to be purchased periodically, we expect US nuclear reactor sales prospects would be enhanced. [redacted]



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Other Potential Sales

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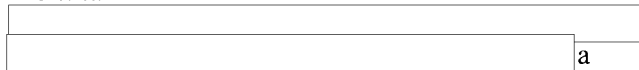
Taiwan

Like South Korea, Taiwan has an aggressive nuclear power program. Three nuclear power reactors are in operation, and three more are under construction. Government plans call for 14 additional nuclear power plants to be in operation by the year 2000, bringing total installed nuclear-electric generating capacity to more than 20,000 MWe. France has emerged as the most aggressive competitor to the US nuclear industry, and Taiwan has reportedly decided to reduce its dependence on US nuclear technology and equipment. [redacted]

Argentina, Brazil, Egypt, Finland, and Libya are considering placing orders for a total of eight nuclear power plants in the next few years. We believe US nuclear vendors stand little or no chance of securing any of these reactor sales. Brazil has previously selected Kraftwerk Union as its reactor supplier, and our analysis indicates that Argentina also favors the West German firm. Although contracts have not yet been signed, Egypt and Libya apparently have already selected non-US reactor suppliers. Finland is known to be evaluating French and Soviet technology. According to the press, Pakistan is seeking to purchase a nuclear power plant, but we expect Pakistan to be rebuffed by most suppliers because of its poor nuclear nonproliferation credentials and strong US pressure to prevent such a sale. [redacted]

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China



[redacted] a feasibility study conducted in 1980, which recommended the purchase of two 950 MWe nuclear power reactors to provide electricity for Guangdong Province and neighboring Hong Kong. The State Council's recent decision to build a 1,200 MWe coal-fired electricity generating plant in Guangdong may further delay approval of the nuclear project according to the American Consulate in Hong Kong. The lack of a Sino-US nuclear cooperation agreement may inhibit Chinese acquisition of a US plant. [redacted]

Implications for US Vendors

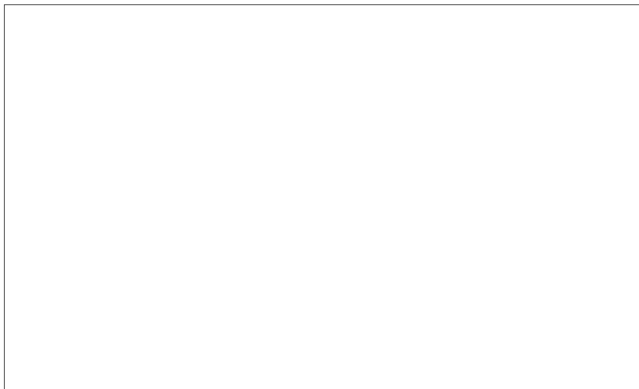
Until the late 1970s, US manufacturers dominated the nuclear reactor export market. As a result of increased competition, concessional financing packages, and negative reactions to the Nuclear Non-Proliferation Act of 1978, the US share of the world market for nuclear reactor exports has fallen steadily. We believe US reactor vendors may secure upcoming orders from South Korea. China, Mexico, and Taiwan are other candidates for US sales in the next three or four years. Yugoslavia may also purchase a reactor of US manufacture, but probably not before the latter part of the decade. Competition will be fierce, but we believe US manufacturers may be able to capture as many as four reactor orders for export in the next few years. Unless these potential sales go to the weaker

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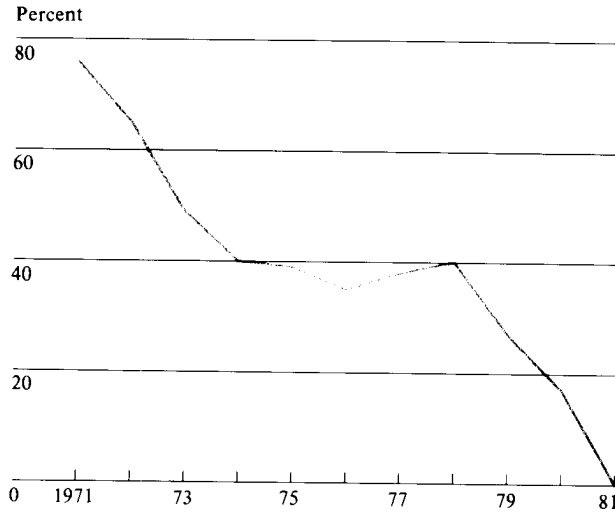
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United States: Share of Nuclear Reactor Export Market^a



^a Three-year moving average

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US nuclear reactor vendors, for instance Combustion Engineering or Babcock & Wilcox, export sales will have little effect on the health of the US nuclear industry. [redacted]

Industry Shakeout Looms Ahead

The bleak nuclear reactor export market has combined with a prolonged stagnation in most domestic nuclear power programs to threaten the vitality of the nuclear reactor vendors. Indeed, the industry now suffers from severe overcapacity and we expect an industry-wide shakeout. [redacted]

We expect the international nuclear reactor market to contract substantially, with the greatest losses accruing to vendors in Sweden and the United States:

- ASEA-Atom may be the first casualty in the industry shakeout. With limits on Sweden's

domestic nuclear power program and weakness in the current export market, we believe ASEA-Atom's chances for nuclear reactor sales are slight.

- Combustion Engineering and Babcock & Wilcox have somewhat larger construction backlogs; nevertheless, industry observers expect both of these firms to drop out of the nuclear reactor business unless foreign or domestic orders can be found.

[redacted]

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Other reactor vendors will probably survive the shakeout, although they too will be hurt:

- Framatome, has emerged as the strongest and most aggressive US competitor for nuclear power plant exports. Recent plans to cut back the French domestic nuclear power program make it likely that Paris will continue to offer subsidized financing to increase export sales and to maintain employment levels in the French nuclear industry.

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- Near-term prospects for Atomic Energy of Canada Ltd. are not favorable and a significant cutback in production capacity is expected. Direct government intervention may be necessary to preserve the nuclear power option.

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- We expect Kraftwerk Union to remain in the nuclear reactor business without direct government subsidy. Nevertheless, KWU will continue to limp along at well below capacity.

- We do not expect Atomenergoexport to be much of a factor in the Western reactor market, except in Finland, where we believe the USSR will use heavy diplomatic and economic pressure to sell Soviet nuclear power plants.

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- General Electric and Westinghouse have sizable construction backlogs to help sustain them through the decade. [redacted]

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Consequently, the industry will lose critical technical, engineering, and managerial skills as the nuclear reactor vendors work off their construction backlog. Although this loss of skilled personnel should pose no problem for the nuclear reactor vendors for the next several years, a sharp resurgence in orders in the late 1980s or early 1990s could find the industry with insufficient trained manpower.

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