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International Economic & Energy Weekly

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28 January 1983

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Synopsis

Perspective—*OPEC Fails To Bite the Bullet* 25X1

OPEC's latest failure to agree on oil prices and production quotas will intensify downward pressure on prices. We would expect some further efforts to forge an agreement with OPEC before the Saudis cut prices as threatened. 25X1

Mexico: Fast Start but Long Way To Go 25X1

President Miguel de la Madrid has made a fast start in addressing Mexico's financial and economic crisis, but we expect increasing pressures on him to backslide and we see no letup in persisting financial problems. We believe that concessions to maintain what he views as minimum consumption and to preserve the ruling party's traditional social and economic programs will cause Mexico to miss—perhaps by wide margins—some of its quarterly IMF stabilization targets. Economic recovery and expansion in consumption are likely to be postponed until 1985 at the earliest. 25X1

Saudi Oil Capacity: Impact of the Weak Market 25X1

Saudi Arabia has decided to reduce oil production capacity to 8.5 million b/d over the next several months. Anticipated reductions in Saudi capacity should not by themselves affect the market. 25X1

USSR: The Astrakhan' Natural Gas Project 25X1

Having secured Western assistance in developing the Siberia–to–Western Europe gas pipeline, Moscow is again turning to the West for equipment to develop its natural gas reserves at Astrakhan'. The Western countries involved in the bidding are considering ways of accommodating Soviet demands for highly concessionary interest rates. 25X1

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International Economic & Energy Weekly

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28 January 1983

Perspective

OPEC Fails To Bite the Bullet

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OPEC's latest failure to agree on oil prices and production quotas will intensify downward pressure on prices. Buyers will further delay purchases and draw upon inventories in anticipation of lower prices and a seasonal downturn in consumption this spring. Unless an agreement on production quotas or price cuts is reached soon, Saudi Arabia and the other Arab producers in the Persian Gulf could bear the brunt of the 1-million-b/d or more decline in demand that we project for the second quarter. Rather than accept this outcome, we believe that Gulf producers will carry out their threat to cut prices, risking retaliatory cuts by other producers.

OPEC ministers reached tentative agreement on the first day of their Geneva meeting on an allocation scheme to restrict overall crude output to about 17.5 million b/d. According to the Venezuelan Oil Minister, under this scheme Saudi Arabia would be limited to production of 4.5 million b/d, Iran would be allowed 2.5 million b/d, and Libya would produce 1.2 million b/d. These quotas represent significant concessions from demands that earlier had obstructed a pact. OPEC production has fallen sharply this month, however, and it is questionable whether the 17.5-million-b/d ceiling would be sufficient to absorb the market surplus in the months ahead.

Arab Gulf states foresaw difficulty in marketing their allotted production without some realignment of prices and made their support for new quotas conditional on an increase in the prices of Iranian and high-quality African and Iranian crudes. The agreement broke down when these producers refused to accede. After the meeting, OPEC President Dikko from Nigeria claimed that a consensus on the 17.5-million-b/d ceiling still stood, but Saudi Oil Minister Yamani labeled the session a complete failure.

Saudi Arabia now faces a difficult decision. Early this month its largest customers told Riyadh that they would reduce purchases drastically unless the Saudis cut prices. Saudi output already has fallen under 5 million b/d this month and could drop well below 4 million b/d early this spring. The Saudis had hoped to improve their situation through the OPEC forum and took the lead in calling for the special session. Evidence has been mounting that the Saudis are considering discounts or price cuts to buoy sales in the absence of an OPEC agreement, but any move along these lines probably would be taken in concert with other Arab Gulf producers. Kuwait's Oil Minister has been

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among the most vociferous in threatening to cut prices, and the UAE Oil Minister said after the Geneva meeting that the Emirates will increase their output by several hundred thousand b/d.

Any Saudi move to cut prices unilaterally would be a major change in policy by Riyadh. In addition, the risks of a price war may cause the Saudis to delay any unilateral price moves until further efforts to forge an agreement within the cartel are attempted. The Saudis did achieve significant progress toward an acceptable production sharing arrangement at Geneva, and Nigeria's delegate indicated afterward that the African states would be willing to meet next month to address the issue of price differentials. The Saudis, moreover, recognize that further weakening of the market will probably increase the willingness of other OPEC members to bargain, particularly if North Sea producers or Mexico yield to buyer pressure to reduce prices. In our judgment, the Saudis still see substantial benefits in operating within OPEC.

If OPEC cannot reach an agreement on realigning prices, we believe the likelihood of independent action by the Arab Gulf states will grow. The Saudis then might attempt a price cut of about $2 per barrel, which they believe would restore the proper price differential with African crudes. Riyadh could argue that a cut of this magnitude would not warrant competitive price cuts by Iran or producers outside the Persian Gulf. If these producers held the line on prices, a cut of this size probably would lead to a more even sharing within OPEC of the further decline in oil sales that we expect next quarter.

An unmatched Saudi price cut on the order of $4 per barrel, the maximum the Saudis reportedly are considering, probably would be required to head off further erosion in Saudi sales. We would expect other producers—both within and outside of OPEC—to match a cut of this magnitude. Should the Saudis adopt this course, we believe that they would try to defend prices at about $30 a barrel to avert a major price collapse.

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Briefs

Energy

Spot Oil Market Trends

Spot crude oil prices plunged following the OPEC meeting last weekend when members failed to reach agreement on new production quotas. Arab Light fell by about $2 per barrel to $29.25, the lowest level in over nine months. North Sea and light North African crudes also declined sharply. North Sea Brent crude dropped to $29.10 per barrel, more than $4 below its official price. While underlying demand for both crude and products remains weak, many analysts attribute most of the recent price decline to speculative trading. We expect spot prices to weaken further in the coming weeks unless OPEC can agree on production quotas. [redacted] 25X1

International Trade, Technology, and Finance

Japanese–European Community Steel Cartel

Japanese and EC producers of steel are collaborating to divide markets and set prices in Western European and in the Third World. [redacted] 25X1
[redacted] both European and Japanese steel companies were bidding on a 25X1
Malaysian contract but that the Japanese consortium would get the sale under the terms of the marketing arrangement with the EC steel firms. Negotiations for another deal revealed Pakistan was in the territory assigned to Western Europe. [redacted] 25X1
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A major Japanese steel producer recently said, however, it had lost confidence in the collaboration between Japan and Western Europe. It complained that price and marketing agreements were being broken by some European mills. [redacted] 25X1
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All the available evidence concerning this cartel activity refers to non-EC West European or Third World markets. The arrangement probably does not apply to the US market, perhaps because of Japan's sensitivity to US antitrust laws. [redacted] 25X1
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New Banking Institute

Representatives of 35 international banks from nine countries have founded the Institute of International Finance, which will have its headquarters in Washington. The Institute will provide economic information on debtor countries to member banks, particularly to assist smaller US and foreign banks in their decisions on the creditworthiness of borrowers. It will review economic conditions and plans in debtor countries, consult with international agencies and banks, provide information to its members, and give financial advice to

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borrowers. The directors will meet in March in Zurich to receive working committee recommendations on senior permanent staff, recruitment of new member banks, and the details of how the Institute should function. [redacted] 25X1 25X1

Major international banks that have lent heavily to developing countries are concerned that smaller banks are jeopardizing repayment by reducing their lending to these countries. The Institute is intended to help persuade the smaller banks to maintain their lending levels by giving them more adequate financial data. It may have difficulty, however, getting data because banks may be reluctant to report the amount loaned to individual countries, and the IMF probably will be reluctant to share confidential information. [redacted] 25X1 25X1

Soviets Ease Terms of Weapons Sales to Syria

The USSR has reversed its earlier demand for immediate payment for at least $2 billion worth of weapons it has delivered to Syria since last summer's war in Lebanon, [redacted] Moscow now has agreed to defer any repayment at least through 1983. The USSR also has dropped its usual requirement that Syria use hard currency to pay salaries of Soviet advisory personnel. The concessions should help ease Syria's foreign exchange crunch, lessening the need for President Assad to accede to Gulf state pressure to reopen the Syria-Iraq oil pipeline in exchange for financial aid. [redacted] 25X1 25X1

National Developments

Developed Countries

Portugal's Balance-of-Payment Deficit Worsens

Portugal's current account deficit widened to $2.6 billion for the first three quarters of 1982, 30 percent above a year earlier. The US Embassy estimates that the deficit for the full year will total $3.2-3.4 billion, equal to 14 percent of GDP. The deterioration during the first three quarters was attributable entirely to net tourism receipts and worker remittances, which were both down significantly, and to sharply higher interest payments. Official reserves of $8 billion—most in the form of gold—are adequate to forestall a near-term crisis. The problem is severe enough, however, that Lisbon will have little choice but to implement an austerity program similar to the one proposed in December by now acting Premier Balsemao. The Portuguese probably will also need assistance from the IMF, but no progress is likely on that front until the 1983 budget is passed. At this point, it is far from certain that Balsemao's caretaker government will pass even emergency economic legislation before President Eanes follows through on his recent pledge to dissolve parliament and schedule an early election. [redacted] 25X1

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Australia To Allow Entry of Foreign Banks

The Fraser government has approved plans to allow foreign banks to set up business in Australia—thus removing an embargo on foreign banking that has been in force since the 1940s. Entry will be limited by several regulations—including a domestic equity requirement that will limit foreign participation to 50 percent unless the bank can prove a clear benefit to the Australian economy. Canberra expects to approve the entry of about 10 banks in 1983; several banks already have expressed an interest in doing business in Australia. The opposition Labor and Democratic Parties have made it clear that they oppose the plan, and Labor Party leaders are suggesting that a Labor victory in the 1983 elections will result in a review of the terms and conditions of entry. [redacted] 25X1

Major French Investment in Quebec

The nationalized French aluminum company Pechiney and the government of Quebec last week announced a joint venture in which Pechiney will invest $890 million for the construction of a smelting-manufacturing complex near Trois Rivieres. The project would be the largest single investment in the province's industrial sector and Quebec's first major deal with France. Quebec's commitment to invest $81 million in the project and Hydro-Quebec's promise to provide electrical power at half price for at least the first five years of the facilities' operations apparently persuaded Pechiney to proceed. The project will boost employment in Quebec by 1,200 jobs during the construction phase, and 800 permanent jobs are expected when production begins; it also will provide Hydro-Quebec with a market for a portion of its surplus electricity. [redacted]

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Less Developed Countries

Iraq Seeking Financial Relief

Deputy Prime Minister Aziz visited Paris this month to request payment deferments from France for arms purchased earlier, according to the US Embassy in Paris. Aziz last month also visited Moscow, in part to arrange easier terms on weapons contracts. To minimize reductions of civilian imports, Iraq has delayed payments on a wide variety of economic projects already under way. Iraq now requires firms bidding on contracts to offer credit as a prerequisite for new orders. Most exporters probably will go along with Iraq's payment deferrals in the hope that Iraq's economic situation eventually will improve and because there is not much they can do to force payment. [redacted]

Iraq can do little now to augment its foreign exchange earnings. Because of the closure of the pipeline through Syria last April, oil revenues will be even lower this year than last. Iraq's foreign exchange reserves have plummeted from

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$21 billion at the beginning of 1982 to about $5 billion—the equivalent of less than three months' worth of imports. The Persian Gulf states so far have not responded to Iraq's pleas for more financial aid. They will find it more difficult to provide Iraq with the $5.5 billion they gave last year because of their own financial situation. A weak world oil market also will prevent them from selling much oil for Iraq. [redacted] 25X1

Increasing Saudi Outlays For Military Imports

Although Saudi Arabia hopes to cut spending in the next year or two because of greatly reduced oil revenues, significant cuts in outlays for imports of military equipment, services, and construction will be difficult. Saudi payments for deliveries are scheduled to increase by more than 40 percent in FY 1983 and remain high for at least three years. We estimate between $22-25 billion will be due over the next three years if estimated payments for non-US deliveries are included. The largest payments will be for construction of military facilities, an air defense system, combat and transport aircraft, and for the AWACS program. [redacted] 25X1

These programs are unlikely to be canceled or delayed because of Riyadh's commitment to the gradual creation of a complete, modern defense establishment by the early 1990s. New contracts to modernize Saudi weapons are expected over the next three years, and significant future savings could be effected through selective delays for high cost programs like the M-1 Abrams tank or a replacement fighter for the F-5E. [redacted] 25X1 25X1

Venezuela's Deteriorating Reserve Position

According to US Embassy reports, Venezuela's foreign exchange reserves—the combined holdings of the Central Bank, the national oil company, and the Venezuelan Investment Fund, excluding gold—fell to about $8.4 billion by the end of December, nearly 50 percent below the holdings of $16.1 billion at the end of May of last year. Caracas has been forced to draw down reserves because of:

- Difficulty in obtaining longer term loans necessary to cover the current account deficit.
- Growing demands by bankers since September for repayment of maturing short-term loans in lieu of rolling over existing obligations.
- A sharp escalation of capital flight in the face of ebbing business confidence in government economic policies and persistent rumors of a large devaluation.

Caracas is moving to bolster its external accounts in an effort to stem the reserve drawdown. Oil exports have been increased by 50 percent since the second quarter of last year. Tight import restrictions—licensing requirements, tariff hikes, outright prohibitions—became effective in late November. [redacted] 25X1

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Despite political costs, Caracas may be forced to impose exchange controls or a major devaluation to stop capital flight that drained some $5 billion in reserves last year, according to Central Bank estimates. Growing banker anxiety about dwindling reserve levels also could increase Venezuela's difficulties in refinancing maturing obligations, restructuring short-term debt, and raising new loans. [redacted] 25X1

Chilean Debt Rescheduling Talks

Chilean officials earlier this week met with foreign creditors to discuss rescheduling on $4.8 billion in medium- and short-term debt due in 1983 and to secure some $1 billion in new loans. Chile's debt crisis was precipitated by Santiago's decision to liquidate three financial institutions, intervene in the operation of five banks, and appoint inspectors for two others, which together have a combined foreign debt of $3.5 billion. The interventions—aimed at boosting domestic confidence in the country's weak financial system—upset foreign bankers and caused them to cut off Chile's access to new credits. In an effort to restore confidence, the government has assured foreign creditors that it will guarantee the loans of the 10 banks. Moreover, Chile's excellent past debt servicing record, its willingness to implement austerity measures, and the prospect of a rebound in copper exports probably assure a successful outcome to the rescheduling negotiations. [redacted] 25X1

Soviet-Grenadian Ties Expanding

[redacted] 25X1

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Over the last six months, the USSR has expanded political and economic ties with the Bishop regime. Moscow established a diplomatic mission on the island last fall, and during Bishop's first visit to Moscow last summer agreed to provide $10.5 million in credits for a satellite receiving station, a feasibility survey for a deepwater port, and other aid projects. [redacted] 25X1

Suriname Seeking Economic Ties With USSR and Cuba

Surinamese attempts to expand trade relations with the USSR and Cuba have become more important in the wake of the execution of regime opponents and subsequent suspension of Dutch and US aid last month. Army Commander Bouterse is hoping that increased trade with these countries will lead to offers of economic aid. [redacted] 25X1

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[redacted]

Early last month—on a trip to Havana scheduled prior to the executions—the Surinamese Minister of Industry, Trade and Transportation discussed potential trade agreements with Cuban officials. (S NF NC) 25X1

Malawi Miffed by US Bank Pullout

Senior Malawian officials are bitter about a recent decision by the Bank of America to withdraw its $12 million equity from Malawi by the end of 1983, according to the US Embassy in Lilongwe. They blame Washington for failing to dissuade Bank of America and see the move as another indication that Malawi ranks low on the list of US priorities in Africa. Despite Lilongwe's unhappiness about the bank's decision, the economic impact on Malawi is likely to be slight. We believe that Barclays Bank and Standard Bank, British institutions that are the principal shareholders of Malawi's only other commercial bank, will be strongly tempted to take over Bank of America's equity. Barclays and Standard already own and operate the largest commercial banks in South Africa, Zimbabwe, Zambia, and Kenya. [redacted] 25X1

Communist

Yugoslav Hard Currency Restriction Lifted

The Yugoslav press reports that banks in Yugoslavia have lifted the $250 limit on withdrawals from hard currency accounts. The restriction had been imposed last October in conjunction with other foreign exchange controls. According to the US Embassy, however, only a few banks thus far have carried out the relaxation. [redacted] 25X1

The federal government probably hopes the removal of the restriction on the approximately $7 billion worth of deposits will lead to an increase in remittances from Yugoslav workers living in Western Europe. Remittances, which are a key source of hard currency, apparently fell off substantially following the imposition of the restriction. Yugoslav bankers probably believe depositors will have more confidence, now that a $1.3 billion financial package with Western governments has been announced. [redacted] 25X1

Soviet Nongrain Crops Below Plan

Agricultural performance figures for 1982 have been released by the Soviet Central Statistical Administration, and for the second consecutive year, data on grain production were not included. These figures indicate that with the exception of cotton, the 1982 output of the principal nongrain crops—sugar beets, potatoes, vegetables, sunflowers—increased over last year. Even so, production for all of these crops, except for vegetables and cotton, was well below plan, and the production of sugar beets and potatoes was below the 1976-80 average. [redacted] 25X1

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Weather conditions, poor seed quality, improper handling, and the lack of transportation equipment all contributed to this year's shortfall in nongrain crops. Soviet admission of disappointing harvests of sugar beets and potatoes, which are extensively grown in and on the perimeters of some of the major grain-producing areas, also lends credence to our previous estimate that the Soviets suffered another poor grain harvest last year. [redacted] 25X1

Beijing Hikes Prices of Cotton Textiles

In a bold move certain to spark consumer protests, the Chinese Government has ordered a 20-percent increase in retail prices of cotton textiles. The action comes after increases in prices paid cotton growers and is intended to cut down on massive subsidies that have contributed to a string of deficits in the state budget. At the same time, Beijing is cutting by 20 to 30 percent consumer prices of synthetic fabrics in order to dislodge inventories and help soak up excess purchasing power. The government is attempting to put the best face on a politically sensitive issue by arguing that the growth of its synthetic garment industry has reached the point where the average Chinese should now be able to dress better. Although the price changes may be less unpopular in the cities, the rural poor will be hit hard, which the government has acknowledged by authorizing subsidies for certain areas. Chinese media are billing the price changes—which also involve a number of slow-selling consumer durables—as a major step in reforming the country's highly irrational price system. [redacted] 25X1

China has cut back sharply on imports of synthetic fibers over the past year because of increased production and stockpiles of synthetics and because of record cotton crops. Although Beijing last week restricted future purchases of US-origin fibers to protest controls on textile trade, China probably will reenter the market—but buy less than in past years—after the domestic supply situation stabilizes. [redacted] 25X1

Abolition of Communes in China

China's rural communes—the centerpiece of China's rural development strategy for 25 years—will be abolished and replaced by village cooperatives and village governments. The change, which is mandated by China's new state constitution, is now being implemented experimentally in 60 localities. The new administative system will be similar to that of the 1950s. The communes, which combined both governmental and economic functions, were viewed as too large and inefficient to play a useful role under Beijing's increasingly market-oriented agrarian policies. [redacted] 25X1

The abolition of communes is important mainly as a political symbol of Beijing's willingness to reject Maoist institutions. The commune system had been closely associated with Mao Zedong since its inception in 1958 during the Great Leap Forward, and its egalitarian ideological basis is at odds with the

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current leadership's emphasis on rewarding individual productivity. The communes' cadres, most of whom will lose their jobs, have frequently been accused of blocking reforms and interfering with decisionmaking at lower levels to protect their own power. 25X1

In the short run, the new rural institutions are unlikely to have much effect on agricultural production. Agricultural responsibility systems—under which individuals or groups can exercise greater control over production outside state plans—are already in place in most communes. They are given credit for the rapid gains in production over the past few years, which have given Beijing confidence that the communes are no longer needed. Joint economic and trading companies will take over some of the communes' economic functions, but individual households and cooperatives will be the basic economic units. 25X1

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Mexico: Fast Start but Long Way To Go 25X1

President Miguel de la Madrid has made a fast start in addressing Mexico's financial and economic crisis, but we expect increasing pressures on him to backslide and we see no letup in persisting financial problems. For 1983 we project a steep drop in economic activity, high inflation, and a sharp falloff in consumption compared with the previous year. As a result, keeping the cooperation of labor and the middle class for austerity will become progressively harder. We expect to see increasing consumer demonstrations, growing dissension among factions within the ruling party, and perhaps violent antigovernment protests.

In these circumstances, we think that de la Madrid's dedication to economic stabilization will wane in favor of maintaining domestic stability. He already has eased projected austerity by reversing commitments to cut food and public transport subsidies and by offering a huge new public works program. We believe that concessions to maintain what he views as minimum consumption and to preserve the ruling party's traditional social and economic programs will cause Mexico to miss—perhaps by wide margins—some of its quarterly IMF stabilization targets. This will cause periodic gaps in foreign financing as Mexico seeks to extract more lenient conditions from the IMF. These setbacks will add to problems in restoring public confidence and reversing capital flight, while undermining business recovery. Economic recovery and expansion in consumption are likely to be postponed until 1985 at the earliest.

Austerity and a New Beginning

De la Madrid's quick fleshing out of the emergency economic program announced in his 1 December inaugural speech and his ending of antibusiness rhetoric have reassured the international financial community, gained Mexico access to $9 billion in new IMF and commercial bank credits, and set the stage for a $21 billion public-sector debt rescheduling. Meanwhile, his seizure of economic initiative and establishment of a new "clean" presidential image have earned him cautious public approval. His strong support for the IMF program—he publicly stated that the loan was essential to avoid even worse austerity—helped end the acrimonious debate in the Mexican press over loan conditions that had persisted since the last months of the Lopez Portillo administration. 25X1

Most Mexicans give de la Madrid high marks for his vigorous attack on inefficient policies and his measures to attack official abuses of power. Legislation pushed through Congress in December establishes a cabinet-level Comptroller General to monitor government spending procedures and strictly limits outside income for officials. It also better defines categories of illegal activities—including influence peddling, unjust use of power, and illegal enrichment—sets punishments, and closes loopholes in existing anticorruption laws. Additionally, in an unprecedented move, de la Madrid publicized public salaries—including his own. 25X1

To implement the IMF program of tight limits on public spending, domestic credit expansion, and foreign borrowing and purchases, Mexico City slashed the projected 1983 budget. The new budget mandates a 20-percent real cut in non-debt-related spending and a 30-percent real increase in revenues in order to reduce the public-sector deficit from 17 percent of GDP in 1982 to 8.5 percent in 1983. Government ministries are slated to cut expenditures an average of 25 percent. Increased revenues

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are projected largely from a boost in the value-added tax and gasoline prices while nonfuel subsidies are projected to grow. [redacted]

In a step to lessen market distortions, Mexico City removed most price and foreign exchange controls and sharply raised interest rates. The Commerce Ministry removed price restrictions on 4,700 of the 5,000 controlled items, leaving controls on basic—largely public-sector supplied—commodities. In mid-December Mexico City devalued the peso for the third time in 1982, boosted the controlled rate from 70 to 95 pesos to the US dollar, and reestablished a free market rate. The controlled rate is being adjusted downward 13 centavos a day, with an eventual goal of unifying it with the free market rate, presently at 148 pesos to the dollar or 82 percent below the value a year ago. Interest rates—although they remain negative in real terms—have been raised substantially to reduce the disincentive for domestic savings. [redacted]

Crucial Labor Support

De la Madrid's most successful move thus far—in our view—has been that of gaining union leaders' support for only moderate wage hikes. At the end of 1982, the government announced a labor, government, and management solidarity pact designed to keep wages in line, maintain subsidies, and control food prices while assuring supplies. As a part of this deal, labor accepted an increase in minimum wages of 25 percent, with an additional 12.5 percent promised this summer. We believe labor's willingness to accept pay well below projected rates of inflation reflects de la Madrid's success in convincing Mexicans of the need for belt tightening. Moreover, we believe the early acceptance of the modest wage hike will help persuade international lenders and business leaders that de la Madrid is committed to austerity and that he can control major domestic interest groups [redacted]

As an indication of the importance that de la Madrid attaches to successful worker relations, he appointed Arsenio Farrell—described by the US Embassy as a decisive leader and totally familiar with labor issues—as Secretary of Labor. In exchange for labor's support of moderate wage hikes, de la Madrid made important concessions. Taxes on low-cost housing and medicines were reduced and plans to raise public transport fares postponed. The National Minimum Wage Commission—composed of government, private-sector, and labor representatives—is now allowed to meet more than once a year to discuss raising wage rates. [redacted] 25X1

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Debt Refinancing Exercises

Against this backdrop, Mexico City is pulling together a series of huge financial deals totaling more than $30 billion over the next three years. These arrangements involve the IMF, more than 1,400 foreign commercial banks, and numerous foreign governments. Successful completion of these deals is needed if Mexico is to avoid default on a portion of its $82.5 billion foreign debt and maintain essential imports. Although the IMF will provide only a fraction of the funds, its support is needed to gain other financing. In early January, Mexico drew its first quarterly installment of $330 million from the three-year, $4 billion IMF package. [redacted] 25X1 25X1

Quantitatively more important is the $7 billion in new credits that commercial banks and foreign governments are reluctantly committing. We believe most of the requested amount will be forthcoming by next week. Foreign governments and international organizations have committed $2 billion for 1983, a sizable increase from their support in recent months. Through last week, $4.7 billion of the $5 billion requested from commercial banks had been subscribed. To assure participation of other institutions that had made their subscriptions contingent on full syndication of the loan, we expect some large banks to make additional pledges. Payments from this credit are to be made in four equal installments, contingent on and immediately following the quarterly IMF tranches. [redacted] 25X1 25X1

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Labor-Government Links

Labor leaders—long an integral part of the governing process—are willing to go along with austerity measures, mainly because they consider themselves equal partners with the government in running the nation. Labor officials—representing the ruling party's biggest and best organized sector—hold the largest share of national, state, and local government offices. Union members traditionally have gained numerous benefits from close labor-government ties and are relatively immune to opposition party blandishments to alter the relationship. The major trade union leader, Fidel Velazquez, recently told US Embassy officials that he recognizes the gravity of the situation and the necessity for austerity. He indicated that union leaders will attempt to educate their members on the seriousness of Mexico's problems.

In addition to the recent tax and price concessions, wage gains late in the Lopez Portillo administration helped union leaders keep the rank and file in line. Moreover, the recent emphasis on job preservation rather than large wage hikes has served the best interest of skilled workers, the bulk of unionized labor. Few skilled laborers have lost their jobs, despite the 1 million added to the unemployment rolls since August. 25X1

Unions not affiliated with the ruling party represent a small minority of laborers and have yet to display the strength or inclination to force changes in the government's labor policies. High wages, more fringe benefits, and better working conditions make challenges by affiliates of the Independent Federation of Workers—the nation's largest independent union organization—unlikely despite the country's economic problems. Although leftist-dominated unions and labor organizations have increased their efforts to expand links with labor since economic problems intensified last August, their influence is limited to electrical, telephone, and teachers' unions. 25X1 25X1

Mexico's bank advisory group would like to turn to the even more complex debt rescheduling package, which needs attention before the moratorium on principal payments expires at the end of March. At yearend 1982 Mexico's public-sector foreign debt totaled $68.5 billion. Mexico has proposed rescheduling $21 billion in arrearages and principal obligations due on this debt through 1984. We expect most of Mexico's creditors to accept public-sector debt rescheduling, although they are likely to press for higher interest, new collateral, and some longer term stabilization agreement that would restrict Mexican economic policy initiatives throughout most of the seven-year rescheduling period.

Mexico City has proposed a new scheme for private-sector debt relief, according to US Embassy reporting. Since August, private firms have built up arrears of $2 billion, nearly equally divided between interest and principal payments on the $14 billion privately held debt. If a foreign creditor is willing to reschedule principal payments on a firm's debt, the government has announced that foreign exchange will be available for purchase by the firm to pay its debt. Although details of the scheme are not yet worked out, we believe foreign creditors will jump at the chance to clear up private-sector principal arrears. 25X1

Miguel Mancera, director of the Bank of Mexico, stated that this mechanism will not apply to interest payments. To meet interest obligations, the private sector will have to deposit pesos with the Bank of Mexico at the controlled exchange rate. Mancera said Mexico will pay 10 percent of the outstanding balances of these accounts at the end of January. Thereafter, the Bank will make monthly payments on private-sector interest as foreign exchange becomes available. 25X1 25X1

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Continued Economic Deterioration

In our assessment, planned financial inflows will slow, but not reverse, the steep decline in economic activity that began in late 1982. Economic performance during early 1983 will be particularly weak. Imports are running 50 percent below last year, and businessmen report that capacity utilization has dropped to 50 to 70 percent compared with 90 percent between 1980 and mid-1982. Because of these trends, we largely agree with the forecast of Data Resources Incorporated (DRI); they project that economic activity will fall at a 6-percent rate for first-quarter 1983 and that inflation will rise to a 100-percent annualized rate during the time period.

Shortages of foreign exchange and domestic credit will intensify the private-sector slowdown at least until debt arrears are reduced. Business leaders claim that few dollars are available outside the free market because of the critical foreign exchange needs of the government. They indicate that even firms earning foreign exchange from exports are having trouble maintaining production levels. Moreover, drastically reduced inventories of spare parts and raw materials are reported by business leaders. Industrialists interviewed by US officials in Guadalajara say that productivity is falling and that they are relying on the free foreign exchange market for necessary imports despite government guarantees of subsidized exchange for those purchases. As a result, they are cannibalizing machines for parts to maintain production.

Inflation in January-March 1983 will almost surely stay at triple digits. Floating the peso and removing price controls boosted the cost of living by 10.7 percent in December alone, a 240-percent annualized rate. The soaring peso cost of imports will continue to be a large component of price increases, while the boost in the value-added tax will give another fillip to inflation. Decontrol of prices on many consumer goods and the government's 15-percent hike in prices of controlled items in mid-January will add more fuel to inflationary fires.

Austerity Challenged

Accumulating Social Pressures. Continuing economic deterioration could generate a prolonged crisis that would put Mexican institutions under stress unprecedented in several generations. Pressures on de la Madrid to weaken the program will mount as the austerity program intensifies economic problems of important interest groups:

- Further reductions in food and transport subsidies will especially hurt the lower classes.
- Additional devaluations—which policymakers indicate will be an important instrument to force a more export-oriented economy—will undercut middle class consumption as imports become even more expensive. 25X1
- Job losses will increase as the government cuts public spending and falling sales force business to cut production. 25X1

Union leaders may push for new concessions if they believe government policies or private-sector unwillingness to limit price increases are putting a disproportionate share of the burden on labor. Victories by dissidents in local union elections would send a clear message to national leaders that policy changes were in order. Strikes by unions affiliated with the ruling party would be an indicator that the difficulties plaguing the system were too complex to handle in traditional, behind-the-scenes negotiations. 25X1 Disorganization within labor's hierarchy would also complicate continued union-government cooperation. Fidel Velazquez remains in undisputed control of Mexican labor, but at age 82 his health is uncertain. His death could bring union disarray because potential successors lack his influence. 25X1

Weak International Demand

External economic factors could also throw de la Madrid's efforts off course. 25X1 Despite the devaluations that have undervalued the peso for trade

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Mexico: Foreign Financing Gap *Million US $*

	1975	1980	1981 [a]	1982 [b]	1983 Best Case [c]	1983 Deepening Crisis [d]
Trade balance	−3,119	−1,647	−3,520	7,000	8,700	12,700
Exports, f.o.b.	3,461	16,925	20,880	22,000	23,200	22,700
Oil and gas	460	10,306	14,400	15,500	15,700	15,200
Manufactures	1,763	3,725	3,750	4,000	4,600	4,600
Agriculture	815	1,544	1,530	1,500	1,700	1,700
Minerals	423	1,350	1,200	1,000	1,200	1,200
Imports, f.o.b.	6,580	18,572	24,400	15,000	15,000	10,000
Net services and transfers	−574	−4,950	−9,480	−12,500	−12,000	−11,000
Interest	−1,437	−5,380	−8,217	−11,900	−12,000	−12,000
Current account balance	−3,693	−6,597	−13,000	−5,500	−3,800	1,700
Debt amortization	1,058	5,984	6,310	7,000	7,500	7,500
Financial gap	**−4,751**	**−12,581**	**−19,810**	**−12,500**	**−11,300**	**−5,800**
Medium- and long-term capital inflows	5,629	12,460	18,514	13,000	11,300 [e]	7,000 [e]
Net short-term capital (terrors and omissons)	−740	1,009	2,396	−2,500	NEGL	−1,2000
Changes in reserves	138	888	1,100	−2,000	NEGL	NEGL
Other financial items						
External debt (at yearend)	17,600	48,800	74,900	82,500	85,000	80,000
Short term	5,200	16,900	21,900	24,000	23,000	21,000
Debt service ratio (percent)	35.0	45.4	47.5	57.7	54.9	56.5

[a] Estimated.
[b] Projected
[c] Assumes Mexico maintains IMF program.
[d] Assumes Mexico loses IMF and international banking support.
[e] Includes 7 billion in debt relief on medium- and long-term debt principal due.

25X1

purposes, we project only a small increase in export revenues. We expect nonoil sales to improve only slightly because of weak world commodity demand and continuing economic policy uncertainties. To boost nonoil exports more would require major long-term investment to reorganize Mexican industry, which for years has concentrated on the local market because of domestic incentives and an overvalued peso. On the other hand, tourism and border trade should be a small plus, adding up to $1.5 billion to service receipts.

The greatest shortfall from Mexican projections will reflect lower oil revenues, which represent 70 percent of all merchandise exports. While we assess that Mexico could boost oil production and export capacity by 200,000 b/d on average this year as Pemex had earlier planned, the US Embassy reports that Pemex has scaled back its production and sales targets because of budget constraints, the weak world oil market, and concern over alienating OPEC. Largely for budget reasons, Pemex exploration and development spending was slashed 25X1

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Mexico: IMF Quarterly Performance Targets

	September 1982	December 1982 (estimate)	Targets and Limits for 1983			
			January-March	April-June	July-September	October-December
	Billion Mexican pesos					
Net credits to the public-sector by the Bank of Mexico [a]	1,763	2,310	2,525	2,689	2,791	3,097
Cumulative overall public-sector deficit [b]		1,605	360	690	1,005	1,500
Cumulative change in net domestic assets of the Bank of Mexico	319 [a c]	635 [a c]	21	44	44	104
	Million US $					
Cumulative net foreign borrowing by the public sector [b]			1,250	2,500	3,750	5,000
Cumulative change in net international reserves of the Bank of Mexico [b]	734 [a]	−585 [a]		500	1,000	2,000
Cumulative reductions in arrears [b]						600

[a] End of period.
[b] Limit tested at the end of each period.
[c] Amount subject to ceiling is defined as the difference between note issue and net foreign assets.

[redacted] 25X1

75 percent in 1982 and is projected to be cut another 50 percent this year. Current Pemex projections call for export revenues of $15.8 billion this year, compared with an estimated $15.5 billion in 1982. This forecast assumes constant nominal oil prices and a slight increase to 1.5 million b/d in export sales. For each $1 change in world oil prices, Pemex receipts change $550 million annually. [redacted] 25X1

Missing IMF Targets

We believe the odds of de la Madrid's further backsliding on austerity are better than even and that, as a result, Mexico will fail to meet some IMF targets this year. The requirement to lower the public-sector budget deficit from 17 percent to 8.5 percent of GDP is probably the most unlikely target to be met. Even so, noncompliance with this goal could remain hidden by the slow process of budget reporting at least until the end of the year. We think that strong government ministries will not accept slashed budgets without a fight. Firing the hundreds of thousands of public employees it would take to meet the goal is unrealistic both because of Mexican job security laws and because we believe key government ministries such as Interior (cut 50 percent), Defense (cut 30 percent), and Health and Education (cut 25 percent) will resist. [redacted] 25X1

At the same time, we project government income will fall short of budgeted revenue levels because of a deteriorating tax base and a weakening of the receipts of government enterprises. Price controls on basic goods will keep revenues substantially below inflation in many government-owned businesses. Moreover, we expect tax remittances by

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Pemex to the central government to be at least $1 billion below the $11 billion the budget projects. We calculate that receipts from the higher value-added tax probably will fall 20 percent below projected revenues because of a falloff in economic activity. [redacted]

Other targets likely to be missed—and much easier to detect—are net credit to the public sector by the Bank of Mexico and the change in net domestic assets of the Bank of Mexico. Recent monetary policy has been designed to meet the financing needs of the public sector. Between September and December, net credit to the public sector increased by 31 percent and net domestic assets soared by almost 100 percent. The IMF program, however, limits the increase in both to just 34 percent for all 1983. A 9-percent increase in net domestic credit to the public sector in the first quarter seems particularly difficult in light of triple-digit inflation. With a large part of its new foreign credits already committed to interest obligations, Mexico City will have to depend on domestic credit to finance continuing subsidies and its new public works program. Moreover, we expect Mexico City to be faced with unanticipated wage hikes and financing requirements for business transactions that will boost public and private domestic credit because its goal of cutting inflation to 50 percent in 1983 is unrealistic. [redacted]

In our assessment, Mexico City could meet the other three of its six quantitative IMF targets. The probable successes, in our view, will be the reduction of foreign borrowing, the $2 billion increase in net foreign reserves, and the reduction of debt arrears by $600 million. On the other hand, if devaluation begins to substantially lag inflation and other economic shocks drive a skittish public into another round of capital flight, even these targets could be missed. [redacted]

Implications of Backsliding

Even though we foresee economic deterioration and backsliding, we believe that the international financial community will allow a fair amount of flexibility if they perceive the thrust of de la Madrid's economic policies as positive. Then the IMF and world bankers will allow Mexico to readjust austerity criteria based on the administration's six-year economic plan now scheduled to be 25X1
released by de la Madrid in May. [redacted] 25X1

In this case, we see only temporary delays in financial disbursements, with a gradual increase in the foreign exchange availability by the end of 1983. Even so, the bulk of the improvement will be swallowed up by the need to stay current on government interest obligations, reduce private-sector debt arrears, and rebuild inventories. Thus the volume of imports in 1983 will be lower than in 1982. [redacted] 25X1

Under these circumstances, we project that 1983 economic performance will be substantially worse than in 1982. Construction, manufacturing, and commerce will be the hardest hit by import shortages. Domestic budget cuts will, in a similar fashion, slice government and other service activities. Even the mineral sector—which paced by oil development has been the engine of dynamic Mexican economic growth for the past eight years—will not avoid the slump. For 1983, at best, we assess that GDP will fall 3 to 5 percent and that inflation will run between 70 and 90 percent. [redacted] 25X1

If Mexico misses its IMF targets by wide margins and international bankers perceive that de la Madrid's policies are off base, we believe that the risks of losing international financing are significant. In this case, Mexico could lose IMF support and additional commercial bank credit; imports would then plummet, private-sector debt arrears would expand, and many Mexicans, particularly intellectuals and leftwing politicians, would call for an interest moratorium. To remain current on interest, 25X1
Mexico would be forced to cut imports by as much as one-third in 1983. In this situation, the economic activity would fall by 10 percent and inflation would stay at triple digits. [redacted] 25X1

[redacted] 25X1

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Saudi Oil Capacity: Impact of the Weak Market [1] [redacted]

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Saudi Arabia has decided to reduce oil production capacity from 10 million b/d to 8.5 million b/d over the next several months. They plan to mothball 1.5 million b/d of capacity, which, according to Saudi directives, should be capable of being returned to operation within 90 days. Recent budget reductions, however, may adversely affect upkeep and maintenance of the mothballed equipment and lead to further postponements of new capacity development projects. [redacted]

Anticipated reductions in Saudi capacity should not by themselves affect the market. [redacted] Saudi output of 8.5 million b/d will not be required before the end of the decade. The reductions, however, will substantially reduce the world's cushion of spare productive capacity to offset supply disruptions in the short term. [redacted]

Saudi Oil Capacity Policy

With proved and probable reserves estimated by Aramco at 178 billion barrels, Saudi oil capacity is dictated by policy considerations rather than resource availability. The Saudis maintain some spare productive capacity to use as leverage in OPEC pricing decisions and to protect Saudi political, economic, and security interests in response to supply disruptions. In 1976 the Saudis, at US urging, reluctantly agreed to raise sustainable capacity to 12 million b/d. For several years Saudi oil officials cited the 12-million-b/d figure as existing capacity, although actual sustainable capacity was only about 10 million b/d. We believe that the Saudis made this claim to enhance their leverage over OPEC oil prices during a period of peak OPEC production and substantial upward price pressures. [redacted] 25X1

Now, however, with the current weak oil market, many Saudis feel that existing underutilized capacity—4.5 million b/d or more in recent months—is too expensive to maintain merely as an emergency cushion to protect the industrial nations. Moreover, the foreign manpower requirements to build and maintain capacity exceed what many Saudis consider prudent to avoid social and cultural disruptions. [redacted] 25X1 25X1 25X1 25X1

Current Capacity

In November 1982 the Saudis instructed Aramco to adopt an 8.5-million-b/d-capacity level as a cost-saving measure. This 1.5-million reduction in capacity will be achieved by shutting in several marginal oilfields and mothballing the associated processing facilities. In some cases, facilities shut down are to be available to be returned to service within 90 days. Regular maintenance and periodic testing will be required to prevent deterioration of these facilities. Given likely spending cuts, we believe that proper maintenance will not be carried out, leading to a loss of part or all of mothballed capacity. [redacted] 25X1 25X1

Evolving Aramco Plans

Aramco plans call for the maintenance of 8.5-million-b/d operating capacity during the next five years. The plan, however, is currently under revision, and we believe that cuts in productive capacity are likely. [redacted] 25X1

[1] [redacted]

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Saudi Arabia: Selected Oilfields

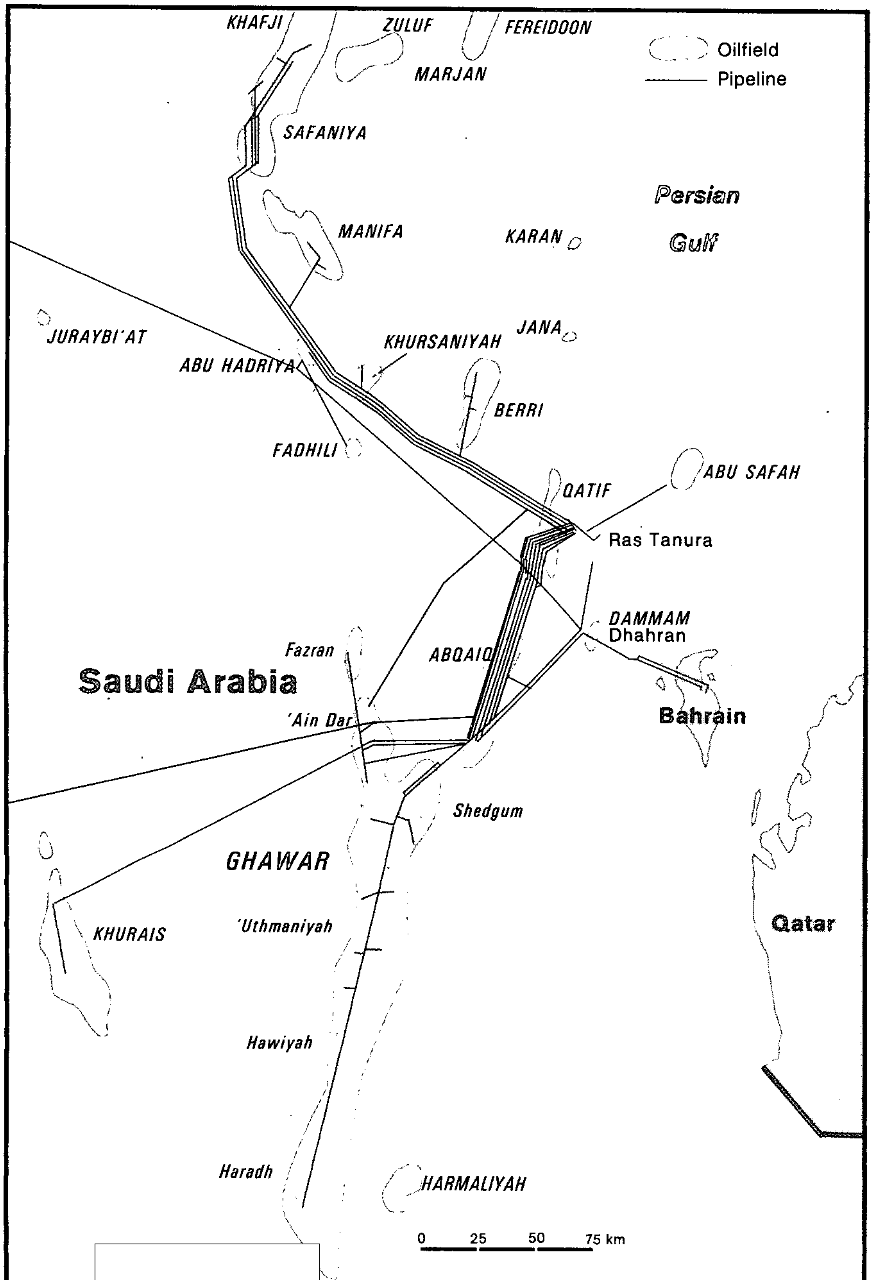

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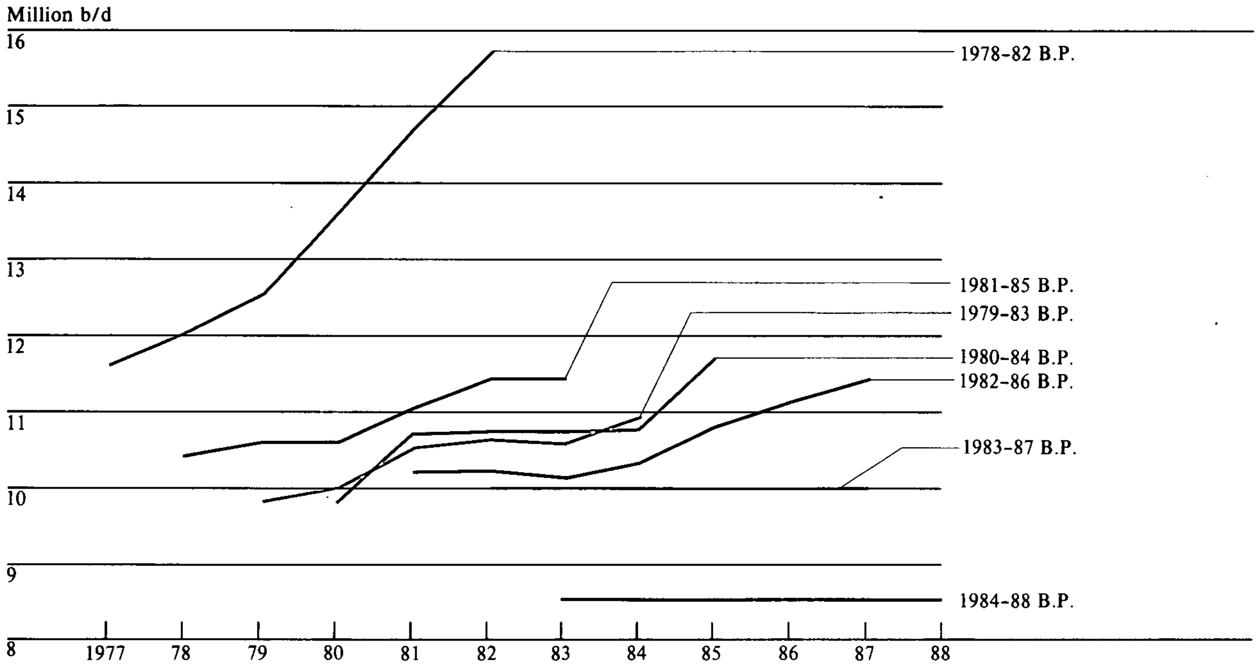
Figure 1
Aramco Business Plans: Projected Productive Capacity



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Aramco capital spending targets—which must be self-financed under Saudi regulations—have been sharply reduced in recent months. As of November 1982, total Aramco capital spending for the 1983-87 period was already down about 40 percent from the amount targeted in mid-1981. Since then, the government has directed Aramco to recalculate the budget based on lower production projections. Thus far, most cuts have come in heavy crude development. We expect this trend to continue because the Saudis can meet capacity targets less expensively by emphasizing maintenance of light crude capacity.

A major victim of the Saudi budget cuts is Riyadh's long-term goal of matching the composition of production by crude type with the composition of reserves. The existing physical crude production system remains heavily geared toward producing Arab Light. To balance production among the crudes, it would be necessary to either reduce light crude production or to develop medium and heavy crudes. While recent planning emphasizes development of medium and heavy crudes, these projects have been delayed because of the greater marketability of lighter crudes and Sandi need for the gas associated with the Arab Light production. Recent production figures indicate that Arab Light again comprises over 70 percent of total production.

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The Saudi Government's goal of balancing production of the light, medium, and heavy crudes in accordance with their reserves could conflict with domestic requirements for associated natural gas. Most of the existing gas-collection facilities are designed to gather gas produced at onshore Arab Light crude fields. These oilfields have a higher gas-oil ratio than the medium and heavy crude fields, and the volume of gas collected per barrel of oil produced is considerably higher if Arab Light crude output is emphasized. The Saudis now want to develop gas facilities at medium and heavy crude fields and nonassociated gas deposits. Over the longer run, the Saudis are planning to advance development of the Khuff gas formation and possibly the Abqaiq and Aindar gas caps to eliminate gas requirements as a constraint on oil production.

[redacted] 25X1

Further Cuts Ahead?

Aramco's financial limitations might force further delays in expansion of Saudi oilfields. The Khurais, Manifa, and Qatif oilfields, for example, would require expensive pressure maintenance systems to boost capacity. Expansion at the Marjan oilfield also may be delayed; the impetus to increase capacity here has been Saudi concern that Iranian production in the extension of this offshore field in Iranian waters would deplete its reserves. Iran, however, has not produced from the field in two years. Postponement of these projects alone would reduce projected Aramco capacity in 1987 by more than 500,000 b/d in the absence of other less expensive development programs. [redacted] 25X1

[redacted] 25X1

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USSR: The Astrakhan' Natural Gas Project [redacted] 25X1

Having secured Western assistance in developing the Siberia–to–Western Europe gas pipeline, Moscow is again turning to the West for equipment to develop its natural gas reserves at Astrakhan'. Astrakhan' gas, however, will be used primarily for domestic purposes rather than export. A revitalized Soviet interest in developing the Astrakhan' deposit reflects the USSR's need to restore gas supply to the Caucasus region following the cutoff of Iranian gas in 1979, to increase chemical fertilizer production, and to activate backup capacity for the Soyuz export pipeline. [redacted]

Negotiations with potential Western suppliers for $1.5 billion worth of pipe and equipment needed to develop the gasfields have accelerated since the summer of 1982; the Soviets—perhaps optimistically—hope to conclude most if not all of the contracts early this year. The Western countries involved in the bidding are considering ways of accommodating Soviet demands for highly concessionary interest rates. [redacted]

Dimensions of the Project

Soviet geologists estimate that the Astrakhan' gasfield may contain up to 6 trillion cubic meters of gas, making it nearly as large as the one at Urengoy. When brought on stream, the project could eventually produce 30-60 billion cubic meters of gas, nearly 3 million tons of sulfur, and 1.8 million tons of stable condensate annually. The sulfur and condensate will be used as feedstock for chemical plants. The Soviets were forced to halt deep exploratory drilling at Astrakhan' in the late 1970s because they lacked sulfur-resistant tubing, casing, and drill pipe. [redacted]

Development of the Astrakhan' gas reservoirs will be extremely difficult and time consuming. Over one-third of the gas consists of noxious, noncombustible contaminants—about 25 percent hydrogen sulfide and 12 percent carbon dioxide—which are highly corrosive and hazardous. Moreover, the gas reservoirs are located at depths of more than 4,100 meters—twice as deep as those at Urengoy—with extremely high reservoir pressures of 630 atmospheres (9,300 psi) and temperatures of up to 150 degrees Celsius. [redacted] 25X1

The Need for Western Technology 25X1

The Soviets will require substantial Western equipment and technology to ultimately drill and equip some 2,000 wells, construct gathering systems, and build gas-processing and sulfur recovery plants to develop the Astrakhan' deposits. We expect the hard currency cost to be about $1.5 billion, of which as much as $650 million may be needed for special corrosion-resistant seamless tubular steel and large-diameter pipe. About $100 million is to 25X1 be spent on well equipment, $250-300 million on the gathering system, and perhaps $550-650 million on the gas and sulfur processing plants. An additional $350-450 million could be spent on pipeline construction. Maintenance of the gas complex will be tied to the procurement of Western equipment and technology. [redacted] 25X1

The Western Players

Negotiations for Western equipment began in 1977 and continued sporadically over the next four years. Field development that had been scheduled for the 1981-85 Plan was canceled but has since been reinstated. [redacted] 25X1
[redacted] the Soviets were delaying the 25X1

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bidding process for the new Tengiz field in order to proceed with development of Astrakhan'.[1] The tempo of the talks, however, did not pick up much until the summer of 1982, when Moscow stationed a negotiating team in Cologne. [redacted]

At least 15 major Western firms reportedly are vying for Astrakhan' contracts. A French consortium led by Technip signed a $400 million contract for the gas plant and related pipe and tubes on 21 December 1982. [redacted]

In their negotiations with the West European and Japanese firms, the Soviets have stipulated that equipment is to be purchased from the United States only if it is unavailable elsewhere. Some US equipment and special corrosion resistant seamless tubular steel are likely to be needed. [redacted]

Financing the Project

The Soviets are pressing hard to obtain concessionary Western loans. They would probably balk at interest rates over the 7.8 percent obtained on Western government–backed credits for equipment for the new Siberia–to–Western Europe natural gas pipeline. [redacted]

The Western governments are complaining that they are being whipsawed between a desire for their firms to win contracts and the wish to at least appear not to be straying too far from the OECD interest rate consensus. In July 1982 the OECD countries agreed to fix minimum interest rates to be charged on official lending to the USSR at 12.4 percent for high interest rate countries and at 0.3 percentage point above the long-term domestic market rate for low-interest-rate countries. [redacted]

[1] With the momentum of the Astrakhan' negotiations well under way, Soviet negotiators reportedly are now moving ahead with discussions on other sour gas projects—at Karashaganak roughly 120 kilometers southwest of Orenburg and at Tengiz some 500 kilometers east of Astrakhan'. [redacted]

The Astrakhan' Natural Gas Project in Brief

Development Stage	Requirements for Western Goods
Up to 66 producing wells in the two stages, including 10 observation wells (eventually up to 2,000 wells); well maintenance equipment. *Cost: $100 million*	Special drill pipe; corrosion-resistant, high-pressure blowout preventers; casing and tubing; wellheads, Christmas trees, and valves. Well maintenance equipment includes workover rigs, snubbing equipment, and replacement casing and tubing with leakproof joints; special equipment tools and supplies to break out hydrate and sand plugs, and to prevent formation of same in producing gas wells. [redacted] Some US investment is likely.
500-kilometer gas-gathering system. *Cost: $250-300 million*	Corrosion-resistant linepipe for the collection manifolds and gathering lines along with associated computer systems and valves. In late November, three competing firms were in the bidding: Mannesmann (West Germany), Technip (France), and Partec-Lavalin (Canada) with the Canadian firm favored. [redacted]
Natural gas plant. *Cost: $550-650 million*	Equipment for removal and recovery of natural gas liquids, sulfur, and carbon dioxide from natural gas streams. The cost of the sulfur recovery plant alone may be as high $300 million, and the cost of related pipe and tubes could be $250-350 million. Technip of France signed a $400 million contract in late December. Western firms competing for the contracts include Mannesmann, Sumitomo, Nippon Steel, Nissho IWAI, Marubeni, Nichimen, ENI, Lurgi, and Creusot-Loire.
Production pipelines: A 360-kilometer gas pipeline (Astrakhan'-Kamush-Burun) to the North Caucasus. A 580-kilometer condensate pipeline to transport natural gas liquids to petrochemical plants. A 630-kilometer carbon dioxide pipeline to the Gur'yev oilfields for use in enhanced oil recovery. *Cost: $350-450 million*	Major bidders for pipe are Mannesmann (West Germany), four Japanese steel companies, and Voest-Alpine (Austria).

[redacted]

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In an attempt to get around the new OECD consensus guidelines, the Western countries have been considering "grandfathering" offered rates to earlier periods and—in some cases—raising equipment prices to compensate for reduced interest rates. Although there apparently is as yet no agreement on credits for the French contract, the press reported that earlier in December French banks offered financing at 7.8 percent. [redacted] Canada (a high-interest-rate country) was considering offering a stated loan rate below the consensus by "grandfathering" the rate to 1977, when negotiations on Astrakhan' began. Japan (a low-interest-country) could come close to the Soviet interest rate requirement by offering 8.7 percent and still be within the OECD consensus. The Japanese long-term prime rate was 8.4 percent when negotiations got under way in earnest last summer. [redacted]

We have little information on the repayment terms for the Astrakhan' credits, but Moscow probably will attempt to procure terms of eight years or more with an initial grace period. The OECD consensus agreed to in July stipulated that no East European country would be eligible for credits of more than eight and a half years. Financing of machinery and equipment for the Siberia–to–Western Europe pipeline included credits with repayment periods over eight years after an initial three-year grace period on repayment of principal. In the case of financing for pipe, it is likely that the Western lenders will insist on annual negotiations and will not offer repayment periods of more than five years. [redacted]

Benefits to the USSR

The Astrakhan' project is important to the USSR as a source of additional gas and sulfur and natural gas liquids needed for expanding production of fertilizers and petrochemicals. Kremlin leaders want to use Astrakhan' natural gas to compensate for depleted gas-producing capacity at the vast Orenburg field and to replenish nearly exhausted supplies in the Transcaucasus and North Caucasus. Iranian gas was being imported at the rate of 10 billion cubic meters a year when shipments were halted in 1979. Natural gas from Astrakhan' could flow at a rate of 3 billion cubic meters a year by 1985 and perhaps 30 billion to 60 billion cubic meters a year by 1990. Present Soviet output of natural gas is about 495 billion cubic meters a year. [redacted]

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Although intended primarily to fill domestic gas requirements, the Astrakhan' fields will help maintain Soviet gas exports to both Eastern and Western Europe via the Orenburg pipeline by making up for any production decline elsewhere. At present, the Orenburg line carries some 16 billion cubic meters a year to Eastern Europe, and it could carry another 13 billion cubic meters to Western Europe. In 1981, hard currency receipts from sales of gas totaled $4 billion, or about 15 percent of total Soviet commodity export earnings. [redacted]

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When the new Siberia–to–Western Europe pipeline is completed, the Astrakhan' project will give the Soviets even greater flexibility to maintain or—as has been hinted—to increase gas exports to Eastern and Western Europe. An offer of stepped-up gas deliveries would help offset the impact of cutbacks in oil shipments to Czechoslovakia, East Germany, and Hungary. [redacted]

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The Astrakhan' project includes ambitious plans for sulfur production of about 3 million tons a year, larger than any sulfur complex in the world. Although the USSR, with an output in excess of 11 million tons, is second only to the United States in production, sulfur is in tight supply in the USSR. Because there are few large reserves of sulfur suitable for mining, the Soviets are turning increasingly to recovery of byproduct sulfur from sour gas, oil, metal smelters, and possibly coal. Moreover,

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Poland—which in 1980 provided about 7 percent of Soviet sulfur consumption—cannot be counted on for large increases in deliveries. Thus, the USSR has had to turn to Western countries to help meet its domestic needs. [redacted] 25X1

Finally, the project is expected to make available 1.8 million tons of stable condensate for feedstocks at petrochemical plants. In addition, the carbon dioxide recovered from the gas will be transported via a 630-kilometer pipeline for injection into the Gur'yev oilfields to enhance oil recovery. [redacted] 25X1

[redacted] 25X1

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