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Paper Prepared for the Senior Review Group by the Ad Hoc Interagency Working Group on Chile

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Nota de Archivo: *Summary: This paper prepared for the Senior Review Group examined the political and economic developments in Chile during Allende's term in office. It highlighted the deteriorating economic situation and the international Communist stake in seeing Allende's socialist revolution succeed. The final third of the paper outlined the various U.S. policy options available. Source: National Archives, Nixon Presidential Materials, NSC Files, NSC Institutional Files (H-Files), Box H–64, SRG Meetings, Chile 4/11/72. Secret, Sensitive; Nodis. Annexes A and B are attached but not published.*

NEXT STEPSOPTIONS ON CHILE

[Omitted here is the Table of Contents.]

I. Introduction

Our basic policy objectives in our relations with Chile are to prevent the consolidation of the Allende regime and to limit the ability of the Allende regime to carry out policies contrary to United States and hemisphere interests. To achieve these objectives, we seek to maximize pressure on the Allende Government while maintaining a correct but cool posture. Thus, pressure is to be balanced by a restrained posture so that measures intended to prevent consolidation of the Allende regime do not in fact contribute to its consolidation of power or its ability to rally support. Our policy on Chile has proven reasonably successful to date and has been so acknowledged by our friends in Chile and elsewhere in the world. The unvarying advice we continue to receive from Allende's opponents and those who wish us well is to continue on the course we have taken. The publication of the Anderson–ITT documents has been, however, a setback to the policy and a corresponding gain for Allende.

Though hard-pressed, the basic elements of democratic choice are still intact in Chile. The outcome of the political struggle is still uncertain and Allende's revolution has not reached the point of irreversibility.

The following sections discuss current and projected developments, internal and external, and conclude with a discussion of questions relating to debt rescheduling which require most immediate decision. With respect to other aspects of our relations with Chile, the options as stated in the paper submitted to the Senior Review Group on Next Steps in Chile on November 23, 1971 continue to stand.

II. Internal Developments in Chile

Political—In the first few months following his accession to power, Allende enjoyed the "honeymoon" traditionally accorded a new administration in Chile. The opposition managed to block or divert certain governmental legislative initiatives, but for the most part the administration built up considerable momentum as it went about implementing its

program at a rapid rate. The April 1971 municipal elections, which showed a sharp rise in the vote polled by Allende's Socialist Party (12% to 22%), was the culmination of that period.

The opposition, nevertheless, held the Popular Unity government just short of a majority in those elections, and since then the government's popularity has steadily slipped. Anti-government manifestations accompanied worsening economic problems, particularly shortages of food and other consumer items, and by last September political polarization began to acquire a momentum of its own. As measured by the results in congressional by-elections, the opposition margin over the government coalition increased from a slight majority in Valparaiso Province in July 1971 to a substantial one in three other provinces in January 1972.

It is far from certain that the pattern will hold through the future. Allende as Chief Executive enjoys a broad range of constitutional powers which he is clearly prepared to utilize to the utmost. His political support has receded measurably from its inflated display of last April, but he has not lost his political skill. The coalition which supports him has been strained by the internal recriminations which have followed the January electoral setback, but it shows no sign of coming apart prior to the March 1973 congressional elections. Were it to gain a majority in the Congress in those elections, there would be virtually no impediment to the definitive restructuring of Chile sought by Allende and his supporters, for they would be able to accomplish it legally. By the time of the presidential election in 1976, the opposition parties would most likely have found organization, financing, and mass communications so difficult as to make their chances of winning that election, no matter how honestly held, virtually nil.

Up to now, however, it has been more probable that the opposition would retain its control of the Congress in the March 1973 elections. The political polarization already occurring, the poor economic prospects, the continued independence of the military, and the disposition to cooperate of the two major opposition parties, the Christian Democrats and the Nationals, formed the basis for this judgment. The publication of the Anderson–ITT papers has been, however, a windfall for Allende at a critical moment for him. This development is certain to assist him politically to a degree not yet possible to assess. It will serve to heighten credence among moderates in habitual leftist charges of foreign plotting against Chile. It will leave a taint on some oppositionists, thus undercutting their effectiveness. It can drive the Chilean military further into its constitutionalist shell. (See Annex A for Santiago telegram 1536, April 1, 1972, giving Ambassador Davis' current assessment on debt renegotiation and the Anderson–ITT papers.)

Economic—During 1971 the GOC increased the purchasing power of lower-income sectors by about 40%, stimulating consumer-goods industries and reducing unemployment. While it claimed to hold price inflation at around 22%, moderate for Chile, and to have increased GNP for the year by 8% with unemployment at only about 3.5%, these momentary accomplishments will exact a severe economic and political price in 1972. The doubling of the money supply and stimulation of demand for consumption items has produced pent-up inflationary forces of major proportions. The anti-private enterprise policies of the regime resulted in net disinvestment in 1971 in this sector. Bad management and worker performance in much of the public sector, especially copper, left foreign exchange earnings well below goals. Accelerated expropriation of farms, much of it carried out by extreme leftist factions out of the government's control, dislocated agricultural production and left requirements for heavy food imports this year. All together, the outlook for the Chilean economy in 1972 is so bleak that no likely combination of debt relief, new credits or default will avert serious economic problems. (See Annex B for Embassy Santiago telegram 1466, March 28, 1972, Review of Chilean Economy.)

The implications in the economic sphere for U.S. strategy with regard to Chile are virtually the same as, and intimately connected with, those in the political sphere. As Embassy Santiago pointed out in a recent telegram—transmitted, it should be noted, before the publication of the Anderson–ITT memoranda—"Economics will largely determine politics during months to come," and "The odds in favor of an opposition victory in 1973 are steadily improving, and will probably continue to do so as long as the process unfolds normally and Allende remains unable to unify Chile against a credible and

emotionally overwhelming foreign threat."

III. Chile's International Relations

Allende's primary concerns are the survival of his regime and accomplishment of a socialist revolution in Chile. His foreign policy is designed to serve these objectives.

The USSR and the PRC have an ideological stake in the success of the Allende Government and have begun to make available some economic assistance. The USSR has raised to $97 million a vague and unused offer of $57 million in credits left over from the Frei Government, and is reportedly developing with the GOC plans for their utilization in industrial development projects. It has, in addition, opened a $37 million line of bank credit to the GOC, said to be freely convertible and without strings. There are unconfirmed intelligence reports that the USSR is dangling a $300 million offer of credits to the Chilean military for arms and equipment.

The PRC has furnished a five-year $65 million credit to Chile, $13 million of which is reportedly available in 1972; no further details are available. GOC officials have claimed a total of nearly $400 million in new credits from the socialist countries (our own count is closer to $250 million), but it is clear that a large part of this is in supplier credits of doubtful economic value or in project financing for which plans are still in drawing-board stages at best.

We believe, however, that if the Allende regime were in extremis economically, the Communist nations (principally the USSR) would attempt to save it. On the other hand Allende probably does not want to become completely dependent on these nations. Except in an emergency, new involvement in Chilean affairs on a large scale by the USSR and/or the PRC would contribute to Allende's domestic political problems. In any event, it would complicate his relations with neighboring countries, which the USSR, PRC, and GOC would all prefer to avoid. We estimate that the USSR and PRC would also prefer to limit Chilean demands on their resources to the minimum needed, and for this reason as well would be cautious about increasing their involvement and presence unless Allende became hard pressed. The PRC's relatively limited resources make this consideration even more important in its case. Both the Soviets and even more so the Chinese accordingly have up to now carefully kept a fairly low silhouette on the Chilean scene, both in the numbers of representatives in the country and in the prominence given them in national life.

During his first 16 months in power Allende has not moved to disrupt relations between the Chilean military and the United States, and apart from not compensating for expropriated property has not chosen to open up a confrontation with us in other respects.

Allende's most notable initiative in foreign relations, apart from his efforts to draw Chile away from the United States, has been to improve his relations with the socialist countries and with other Latin American countries. Under his leadership Chile has become a new seat for international leftist organizations and he is trying to become a leader of the Third World. A number of forthcoming international conferences, including UNCTAD III in Santiago in April, will provide him with a platform and setting suited to his aims. He can be expected to make a major effort to win international sympathy and support in the Third World and beyond for Chile as a leader of underdeveloped countries in their struggle to obtain better treatment by the developed countries, led by the United States. As a part of this effort, he will undoubtedly exploit the ITT memoranda and our current position in the Paris talks.

While so far there has been no known direct GOC support for subversives against other neighboring countries, some extra-legal support, principally from the Socialist Party, has already been given, and aid to subversives from Fidel Castro or other sources will almost certainly transit through Chile.

The Chilean experiment, combining independence from U.S. influence with sweeping social change carried out with a show of legalistic deference to pluralism, has inherent appeal in Latin America. The extent to which this appeal is

manifested in political developments in other countries will depend on the evident success or failure of the Allende regime, and whether Allende can persuasively attribute his difficulties to external factors. The implications for U.S. strategy are clear.

In sum, the course of political and economic developments in Chile has been in the direction we desire in dealing with the Chilean problem. Allende has problems, but so far he has remained unable to escape the political and economic damage of these problems by credibly transferring the blame for them from himself to us. The ITT memoranda represent the first significant opportunity for him to rally support by using the United States as an alibi.

These trends confirm the general correctness of our established policy, namely maximizing pressure on the Allende government within a cool but correct framework which ensures that measures intended to prevent the consolidation of the Allende regime do not in fact contribute to that consolidation or the regime's ability to rally support.

IV. Basic Debt Renegotiation Issues

The basic issue in our relations with Chile on which SRG guidance is required now is the question of whether it is in our interest to sign a multilateral debt rescheduling agreement for Chile this year. The principal determinants of this decision are:

(1) its effects on Allende's political and economic prospects; and

(2) certain basic tenets of U.S. foreign economic policy.

With regard to (1), our principal political objectives are:

a) to assure that the effects of a debt renegotiation will be of minimum assistance to Allende in solving his economic problems, both with respect to the amount of debt relief and the flow of new credits;

b) to avoid being made a scapegoat for Allende's current economic difficulties in a manner which would help consolidate his regime.

We need to determine whether these objectives can best be achieved by a) signing a multilateral debt rescheduling agreement or b) not signing and having other creditors reach agreement without us. We do not believe other creditors can be prevented from eventually proceeding to a separate agreement if we decide not to sign.

With regard to (2), the economic issues of fundamental importance to the US are: 1) that debts not be repudiated, selectively or otherwise; 2) that provision be made for prompt, adequate and effective compensation for expropriated investment; and 3) that immediate USG interests represented by Chilean obligations affecting ExImBank, AID, OPIC, and other USG agencies, (totaling over $1.1 billion) be protected.

The political and economic determinants are, of course, interrelated. The outcome of the debt rescheduling negotiations which would probably be of most political and economic benefit to Allende would be one in which the U.S. refuses to reschedule while all other creditors agree to reschedule. This outcome would be credible evidence of U.S. "persecution" of the Allende government which he could use (1) to rally domestic and international support, and (2) to explain away the economic problems he has created for himself. This outcome could also leave Allende better off economically if the damage to Chile's credit-worthiness resulting from continuing default on obligations to the United States were mitigated. This could result from a readiness by some of the other creditors (and possibly United States banks) to provide enough new credits in addition to the relief obtained by continued default on the U.S. Government debt (an average of $80 million per year in the next three years), so that net capital inflows would be maintained at 1970 levels.

This outcome would be most damaging to U.S. interests. Allende's hold on Chile would be strengthened. There would be great sympathy for him both in Chile and in the rest of the world. Economic pressures on him would be somewhat lessened. Closer relationships between Chile and the socialist countries would be encouraged. And U.S. public institutions could lose $1.1 billion.

If a multilateral agreement is reached on a basis acceptable to the U.S., we would still not be bound to implement the agreement by signing a bilateral accord with the Chileans. This decision could be taken later in bilateral negotiations with the Chileans.

The extent to which we achieve our objectives depends in part upon the willingness of other creditors to support us. After three meetings of the Paris Club, it has been increasingly clear that other creditors are anxious to terminate the debt default and encourage resumption of payments by Chile. Some of them are concerned that inflexibility on key issues may lead to a break in the talks, continuing default, and Chilean dependence upon Socialist countries.

The other creditors are therefore more prone to accommodate Chile being less concerned with the establishment of undesirable precedents. We believe there is a serious danger that the other creditors may be prepared to settle with Chile at the next meeting (April 17–18) provided that Chile accepts harder terms than it has offered to date, but without giving the U.S. meaningful support on debt and compensation clauses.

We expect the other creditors will be willing to insert clauses in the multilateral agreement relating to debt repudiation and compensation for expropriated copper interests of U.S. companies, but these clauses are not likely to provide firm assurance that GOC-guaranteed debt or adequate compensation will be paid.

If properly drafted, however, such clauses could support the principles we are concerned about, calling upon Chile to engage in a meaningful process, e.g., negotiation or arbitration, looking towards discharge of its obligations and opening the way for further consideration of Chile's performance in future debt rescheduling negotiations. A properly drafted clause could also provide a basis for U.S. refusal to sign a bilateral debt rescheduling agreement, and for a U.S. position in the I.F.I.'s, if Chile does not perform.

With regard to terms, we expect the creditors may move further toward the Chileans in the interest of reaching agreement. The creditors at present want a one year consolidation period with relief limited to 70–75% of principal, a grace period of two years and repayment over 5–6 additional years with interest at commercial rates. The Chileans want a three year consolidation period with relief covering 85% of principal and interest, a grace period of three years and repayment over seven additional years with interest at four per cent.

The United States has strong tactical interest in holding the consolidation period to a single year, so that any subsequent consideration of additional debt relief can be made contingent upon adequate performance under the debt and compensation clauses.

There is no further hope that an IMF standby can be obtained. The creditors have pressed for alternative commitments which are more demanding than the Chileans have offered. While the Chileans, with IMF technical assistance, are considering ways to strengthen the measures they offered as an alternative, it is unlikely that the next version will be significantly closer to a standby, particularly with respect to internal policies. However, after three meetings, the creditors are becoming impatient to reach a conclusion, and will probably concede this issue but may use that concession to bargain on terms.

The basic decision before us is whether we will sign a multilateral agreement which falls short of our aspirations with respect to the copper debt and equity issues. Based on trends in the Paris meetings to date, there is a high probability that the other creditors would proceed to sign such an agreement without us. Our negotiators would in any event make every

effort to secure agreement on the options most beneficial to our interests. Decisions on two specific issues are needed at this time:

1. Repayment of the debts of nationalized American companies.

2. Provision for just compensation for the value of expropriated United States companies.

During the negotiations in Paris we are almost certain to encounter suggestions that we accept relative success on one of these issues in exchange for our ceding on the other or on the terms of rescheduling.

1. The Debt Issue

The issue here relates to the unilateral repudiation of contractual obligations undertaken by a sovereign government to its creditors. The Chileans have passed a constitutional amendment which—

a) allows the President of Chile to determine that the copper loans will not be repaid if a finding is made that they were not "usefully invested." (Allende has ruled that $8.1 million of the $92.9 million Braden debts should not be repaid on this ground); and

b) provides that Chilean Government promissory notes to Anaconda arising from the 1969 partial nationalization will be paid only to the extent that a positive compensation award is made to the company. (Allende has made an excess profits determination which would appear to cancel out any compensation.)

The Chilean repudiation of debt is one issue on which most other creditors share much of our concern. This issue is complicated, however, by the different manner in which the Chileans are treating the debts owed to the two American companies: the constitutional process is completed in the case of the Braden debt but not for the Anaconda debt. Both of these debts should receive equal treatment.

There are basically three options:

1. Require the GOC to acknowledge its obligation to pay in full all its debts, specifically including the $8.1 million debt to Braden and the outstanding promissory notes to Anaconda.

2. Require the GOC to acknowledge its obligation to pay in full all its debts; however, in the event that differences exist after the internal process in Chile has been finished, both parties agree to submit immediately to binding arbitration under international law, to be completed within a reasonable time period.

3. Require that the agreement include a clause clearly recognizing the obligation under international law to honor debts, and a clause calling upon Chile to meet these obligations through bilateral negotiation or arbitration.

4. There is very little likelihood of obtaining Option 1. There could be some possibility of obtaining Options 2 or 3.

Issue: Do we refuse to sign the agreement if we do not achieve satisfaction under

Option 1? Yes_____ No_____

Option 2? Yes_____ No_____

Option 3? Yes_____ No_____

The remaining alternative would be to sign a multilateral agreement containing the best language we can obtain to preserve our position on this issue.

2. The Compensation Issue

It will be virtually impossible to achieve prompt solution of the compensation issue. Moreover, there is solid evidence that the other creditors will not support a tough compensation position. While any language on compensation agreed upon with the other creditors would be useful to us in bilateral negotiations and in any future multilateral negotiations with the Chileans, we still must insist on a wording which closely reflects the international legal principle of prompt, adequate and effective compensation.

Options:

1. Require that the Chileans agree to pay prompt, adequate and effective compensation for expropriated property, and if differences exist that they agree to submit the case to binding arbitration under international law after a reasonable period of time for the completion of the Chilean judicial process.

2. Require that the agreement include a clause clearly recognizing the obligation under international law to pay just compensation for expropriated property, and a clause calling upon Chile to meet these obligations through bilateral negotiations or arbitration.

Option 1 has some chance of success, although it is possible that the Chileans will refuse to accept it. Option 2 has better chance of success.

Issue: Do we refuse to sign the agreement if we do not achieve satisfaction under

Option 1? Yes_____ No _____

Option 2? Yes_____ No _____

The remaining alternative would be to sign a multilateral agreement containing the best language we can obtain to preserve our position on this issue.

Footnotes on Treasury views.

1) Treasury believes that “This result is unlikely as shown by Chile’s tenacity in seeking a debt settlement.”

2) It is Treasury’s judgement that the other creditors as a group “are probably almost as serious and as inflexible as the U.S. on keeping the Chileans on hard terms.”

3) Treasury believes that the other creditors are only unlikely to accept a clause which makes it a precondition for the Chilean Government to agree to repay its public debt or guaranteed debt to U.S. companies.