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Memorandum From the Executive Secretary of the Department of State (Pickering) to the President's Deputy Assistant for National Security Affairs (Scowcroft)

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Nota de Archivo: *Summary: This memorandum transmitted a Department of State paper, titled "Economic Assistance Needs of the New Chilean Government and Possible Responses," that was prepared for the Washington Special Actions Group. It discussed the difficult economic problems Chile faced in light of the socialist programs instituted by the recently overthrown President, Salvador Allende. It then outlined the different types of assistance that could help the new junta stimulate economic growth. Source: National Archives, Nixon Presidential Materials, NSC Files, Box 777, Country Files, Latin America, Chile, Vol. VIII. Secret; Exdis.*

Economic Assistance Needs of the New Government of Chile and Possible Responses

Attached is a paper for the Washington Special Actions Group which outlines the general magnitude of economic needs of the new Chilean Government; examines resources available within the U.S. Government, the international institutions, and other governments to meet Chile's needs; and recommends that we send a team composed of representatives of A.I.D., the Departments of Agriculture and Treasury, and the Export-Import Bank to Santiago as soon as conditions permit to develop programs which will help meet the new Government's immediate needs. It also recommends that we encourage the GOC to make early contact with the international financial institutions, particularly the IMF, and that we be prepared, through special congressional action if necessary, to provide substantial additional resources.

ECONOMIC ASSISTANCE NEEDS OF THE NEW CHILEAN GOVERNMENT AND POSSIBLE RESPONSES

I. Nature and Dimensions of Need

A. The Chilean Economy at the Time of the Coup d'État

The September 11 coup in Chile occurred at a time of deepening economic crisis and chaos. Inflation, which had reached levels of 22 percent in 1971 and 163 percent in 1972, was pointing toward a 200 percent or greater surge in 1973. During 1971 and 1972, the Allende government lost more than $600 million; it inherited $340 million in foreign exchange reserves from the Frei government (and is now in a negative reserve position) and this notwithstanding virtual 100 percent relief (through default) from payments to USG creditors and very substantial relief from payment to other creditors. There have been widespread and increasingly serious shortages of foodstuffs and consumer goods. At the root of these phenomena was an economic policy designed to effect rapid income redistribution, resulting in a spiraling fiscal deficit. The GOC's price, income and exchange rate policies have also contributed to the disequilibrium.

As the economy has gotten further and further out of kilter, circumstances have become increasingly propitious for strikes. Particularly disruptive and costly strikes have occurred in the copper and transportation sectors; the coup occurred on the

47th day of a paralyzing truckers' strike.

Consequently, the new government confronts enormous problems in putting the economy back together and cannot possibly succeed without very substantial external help. It has effectively exhausted its international reserves, yet faces another whopping balance of payments deficit, compounded by extraordinary food import requirements attributable largely to the disruption of the agriculture sector by Allende policies. About the only bright spot is the rapid rise of world copper prices in recent months (from 46 cents per pound at the end of 1972 to about 85 cents currently). However, nationalization of the mines and labor strife have resulted in drastically reduced—and higher cost—production.

Particularly urgent is the shortage of foodstuffs, wheat foremost among them. We have one unverified report that 300,000 tons will be needed for the balance of 1973. Complicating the wheat problems may be the inability of Chilean ports to handle the quantities needed.

Also in acute shortage are spare parts, particularly for vehicles. We also have a report that pharmaceuticals are in short supply. Of course, should widespread fighting break out, additional requirements for emergency feeding, shelter, and medical supplies could develop.

B. Stages of Economic Effort

The new government confronts three stages of economic effort. The first is a consolidation stage during which the government must try to create economic conditions which will facilitate a degree of normalization of national life which will, in turn, facilitate its consolidation of power. Priority goals during this stage, which can be expected to last for several months, will be the normalization of public services and the increased availability of foodstuffs and other critical commodities.

The second stage can be called the economic stabilization stage; it will overlap both the first and third stages. The new GOC inherits a bankrupt and contorted economy. Much will depend on the policies it chooses and the external support, both technical and financial, that it receives. The stabilization program is likely to take several months to develop; because of the severity of the disequilibrium, the execution of the program is likely to be both drawn out and difficult.

The stabilization program will have better prospects and be easier to bear if the third, or development, stage moves ahead promptly and effectively. The rehabilitation and expansion of the copper industry can be thought of as one of the keystones of this stage; also of great importance is agricultural rehabilitation and development.

II. Available External Resources

A. Assumptions Concerning Future External Assistance to Chile

Despite the present uncertainties in Chile, for planning purposes we make the assumption that the new Chilean government will urgently seek external assistance, both short- and long-term, in order to consolidate its position and to restore the economy of Chile. We make the further assumption, for planning purposes, that the United States will determine it to be in its national interest to respond positively to such a request. In such a circumstance, however, we believe that, for financial and technical as well as political reasons, the United States effort should be part of a larger effort of various international and other sources of assistance, and that the role of the U.S. should not be the leading one. That function is probably most appropriate for the IMF, which may well be in the best position to respond rapidly and substantially.

B. United States

In the consolidation stage, the U.S. Government faces serious constraints on its ability to help the new GOC. A.I.D. has two kinds of resources that are relevant: supporting assistance, for which the rationale is the promotion of economic or

political stability; and development loans, where a development need is being met. First quarter FY 1974 availabilities of the former under the congressional Continuing Resolution are already committed for on-going needs in Southeast Asia and Pakistan flood relief. Amounts made available in the new Continuing Resolution that will be necessary on October 1 are likely to be required for other high priority needs, principally in Southeast Asia.

Development loan funds under the Continuing Resolution, covering the first quarter, are committed with the exception of $10 million. Our ability to respond from this account will depend on the duration and size of the Continuing Resolution that will be required on October 1.

The needs for external resources during the consolidation stage may not be all that great, however—particularly by comparison with the stabilization stage—and may be manageable for the U.S. within immediately-available resources, even assuming an important USG role, through either or both of these A.I.D. accounts, PL–480, and Export-Import Bank lines of credit. This assumes that several legislative problems, discussed below, can be overcome.

As was mentioned above, wheat is likely to be a high priority requirement during the consolidation stage, and PL–480 Title I is an appropriate vehicle with which to meet the need. (For the foreseeable future, every effort should be made to assure the most concessional possible financing for Chile, given the enormity of the balance of payments problems facing it.) Unfortunately, the world food shortage has led to unprecedented rigidities in PL–480 programs. There are only two Title I wheat programs planned in FY 1974 for Latin America: 38,500 tons for Bolivia, 1,500 tons for Jamaica. Allocations for other parts of the world have also been most rigorously screened. Consequently, there are unlikely to be any easy choices should a decision be taken to program Title I wheat for Chile; we would require cutbacks in such programs as Southeast Asia, the Sahel, Bangladesh and Pakistan.

Before either A.I.D. supporting or development assistance or PL–480 Title I could be made available, certain legislative restrictions or procedures would have to be considered. The Allende government’s uncompensated expropriation of U.S. investments poses one problem. The Hickenlooper Amendment to the Foreign Assistance Act prohibits assistance to an expropriating government which fails to take “appropriate steps” to discharge its obligations under international law. Hickenlooper has not been invoked in Chile, but there have been no significant new programs since the first Allende expropriations, and significant new assistance could bring Hickenlooper concerns back into play. This might not be an insuperable problem, particularly if the new GOC approaches the disputes in a constructive way or if Hickenlooper is made more flexible in pending legislation.

Assistance under the Foreign Assistance Act is proscribed to countries which fail to take appropriate steps to prevent their flag carriers from engaging in the Cuba trade. PL–480 contains a similar proscription and also proscribes assistance to countries whose governments make matériel assistance available to Cuba. (Both the PL–480 prohibitions under certain circumstances can be waived by a national interest determination.) Presumably the attitude of the new GOC toward Cuba will obviate problems on this score.

There is also a prohibition of assistance to countries in default on Foreign Assistance Act loan payments. Chile is currently one such country. This prohibition can, however, be waived by a national interest determination (which has already been done for technical assistance by the Secretary of State).

The law requires justification to the Congress for supporting assistance programs not included in the Congressional Presentation.

Finally, under an agreement between A.I.D. and the Subcommittee on Foreign Operations of the Senate Appropriations Committee, the Subcommittee Chairman must be notified of proposed loans which have not been presented to Congress.

The foregoing legislative problems do not in any event apply in the case of the Export-Import Bank, which might be an appropriate source for the kind of financing Chile needs, given its economic woes, for spare parts, pharmaceuticals, and perhaps other key commodities the availability of which will contribute to achievement of consolidation objectives. A line of credit arrangement might provide a convenient device. Ex-Im would want to reach some understandings on its future relationships with the GOC, particularly with respect to debts, before establishing such lines.

If a clear-cut emergency situation existed in Chile which warranted the provision of humanitarian disaster relief assistance, the U.S. would be able to respond almost immediately to an official request. For example, if an outbreak of fighting in Chile left large numbers of people homeless, we could supply tents, blankets and other emergency equipment from A.I.D. Disaster Relief stockpiles. All cases involving Disaster Relief assistance must be reported to the U.S. Congress. Similarly, if there were an immediate need for food assistance, the food already in Chile for our small on-going PL–480 Title II program (which is programmed in FY 1974 at a level of $2.4 million) could be used for emergency feeding.

We may wish to consider expansion of the Title II program even in the absence of conditions which would qualify for disaster relief. This would be particularly true if there were widespread unemployment and hunger. We would, however, want to do this only in the case of very clear need because of the difficulty of reducing or terminating such programs after the emergency passes and because of the extreme tightness of PL–480 availabilities.

All of the foregoing program tools could play a role during the stabilization and development stages. However, the magnitude of requirements during these stages may be so great, particularly in the light of substantial recent reductions in A.I.D. and PL–480, that it may be necessary to seek special authority for Chile, even assuming that other institutions take leadership roles. As an example, the entire proposed A.I.D. lending level for Latin America in FY 1974 totals $185 million; actual appropriations are likely to be substantially below this level. Similarly, the total PL–480 Title I wheat allocation in FY 1974 for Latin America is 40,000 tons, an amount which could be dwarfed by Chile’s needs. Cost must also be considered: 100,000 tons of wheat would have a value of about $18,500,000.

C. Other Sources

Particularly in the stabilization and development stages, the IMF, IBRD, and IDB can make major financial and technical contributions to the Chilean economy. The dimensions of needed external resources are likely to be so great that indeed without the involvement of these institutions, as well as other developed countries, major gaps are likely to remain uncovered.

The role of the IMF is critical. Because of its staff work for the Paris Club, it has a better appreciation of the condition of the Chilean economy than any other institution. It has a natural leadership role among external financial institutions in both the design of and financial assistance to stabilization programs. It is possible that Chile could draw $43 million very rapidly. Moreover, a serious stabilization effort by the GOC could qualify Chile for a standby agreement which could yield it substantially more. The IMF could also be extremely helpful to Chile in its negotiations with its Paris Club creditors. (For comparison purposes, the IMF recently projected a 1973 balance of payments deficit of more than $300 million, after substantial debt rescheduling.)

While the IBRD would probably be more interested in the development than the stabilization stage (as would the IDB), it should be encouraged to consider program lending, a kind of quick-disbursing assistance which can have important balance of payments as well as development consequences. Aggressive project lending by the IBRD and IDB (and A.I.D.), while primarily aimed at development objectives, could also contribute to the financing of the gap during the stabilization stage, but probably not before a year has passed.

U.S. votes on IBRD and IDB loans are governed by the Gonzalez Amendment, which requires that good faith negotiations be in progress in expropriation cases to avoid a negative vote by the U.S. Executive Director. The possible applicability of the Gonzalez Amendment will have to be considered carefully in the light of the policies and actions of the new GOC with respect to the expropriation disputes. Our ability to be helpful to the new GOC in terms of our influence in the IBRD and IDB would be clearly enhanced were a Presidential waiver authority added to the amendment.

The GOC will want to work closely with its creditors in Europe, Japan and North America (with the IMF's help) toward new debt rescheduling arrangements. However, until at least the basic outlines of a stabilization program are established, it may be premature to begin such discussions. It may consequently be desirable to postpone the Paris Club meeting scheduled for next month. Beyond debt rescheduling matters, the GOC will also want to discuss with these countries the possibilities for new credits related to stabilization and development.

Finally, other Latin American countries and especially Brazil may be disposed to help in all these stages. Brazil may be particularly important because of its likely ideological identification with the new GOC and its substantial and growing economic strength.

III. Recommendations

That, upon a request from the new government and a U.S. determination to respond positively:

A. We encourage the GOC to make early contact with the international financial institutions, particularly the IMF which should take the lead in working with the GOC toward the design of a stabilization program which would presumably involve the IFI's, the USG, and other members of the Paris Club, in addition to a drastically different set of GOC economic policies.

B. Immediate efforts be made to develop more complete information on the dimensions of the short-term need, and that we be prepared to send on short notice a team composed of senior A.I.D., USDA, Treasury and Export-Import Bank representatives to work with the Embassy, as well as the GOC and other institutions, to this end and to initiate the action necessary to get such assistance flowing at the earliest possible time. To the extent feasible without prejudicing these primary objectives, the team would also attempt to develop an appreciation of the possible dimensions of required stabilization assistance and some ideas as to an appropriate U.S. role during the stabilization stage.

C. We be prepared, through special congressional action if necessary, to provide substantial additional resources in support of Chile's stabilization and development programs.