DECLASSIFIED // SECRET; NODIS

Paper Prepared by the Ad Hoc Interagency Working Group on Chile

Identificador Archival:	frus:frus1969-76ve16/d81
Agencia Emisora:	NSC / Casa Blanca
Fecha del Documento:	1971-09-07
Colección / Serie:	FRUS 1969–1976, vol. E-16: Documentos sobre Chile, 1969–1973

Nota de Archivo: *Summary: This paper outlined a strategy to avoid a confrontation with Chile on compensation for U.S. investments and argued that if the U.S. Government could signal a relaxation of restrictions on aid, that would reduce the risk of confrontation. Source: National Archives, Nixon Presidential Materials, NSC Files, NSC Institutional Files (H-Files), Box H–220, NSDM 93. Secret; Nodis. Drafted by Fisher and Gird-ler. It was sent by Meyer to Kissinger under cover of a September 8 transmittal memorandum.*

CHILE: Strategy Review

The Problem:

What immediate adjustments should we be prepared to make in our policy on Chile as the question of compensation for expropriated U.S. investments comes to a head?

I. Situation

Our policy toward Chile as established last November sets forth two basic purposes: To avoid giving the Allende government a basis on which to rally domestic and international support; but to maximize pressures on that government to prevent its consolidation and limit its ability to implement policies contrary to U.S. and hemispheric interests.

We have had fairly good success in carrying out this policy in both respects, up to now. The credibility of our correct but cool public posture has occasionally been attacked, principally by those who from the outset viewed skeptically our assertions in this regard, but in general, both in Chile and elsewhere, our posture has been considered correct in both senses of the word. Until the recent advent of the Eximbank-Boeing matter, Allende could find in our actions and policies no effective basis for rallying support.

At the same time, economic pressures began to take effect. The caution of financial sources around the world was by no means due exclusively to our efforts, and many of the economic problems confronting the Allende government are visibly of its own making.

Within the broad scope of strategic choices lying before us in determining our relations with Chile is an interest in protecting legitimate rights of U.S. investors and of protecting direct U.S. Treasury interests in about $1 billion in debt to USG entities and over $312 million exposure of the Overseas Private Investment Corporation (OPIC).

Through our good offices we have assisted over the past several months in the consummation of several buy-out agreements between smaller U.S. investors and the GOC.

The outlook for a satisfactory outcome on compensation for the major U.S. investors, Anaconda, Kennecott, ITT and possibly Cerro, has never been encouraging and has worsened in recent weeks. The GOC has chosen to make a public

issue of Eximbank's hesitation to finance Boeing aircraft until it is satisfied concerning various aspects of the GOC's creditworthiness, including its intentions on compensation. Allende's increasingly strong and critical declarations against "economic coercion," picking up the Eximbank loan question and on the eve of his compensation decisions, suggest that the GOC is embarked on the course of attempting to justify limited or no compensation, and to pin the blame on the U.S. both for Chile's economic problems and for any deterioration in U.S.-Chilean relations.

Allende has also publicly stated that the U.S.G.'s new economic measures, by "changing the rules", in effect strengthen Chile's case for not paying compensation and underscore her right, no less than that of large nations, to take steps to protect her economy.

Chilean Ambassador Letelier has requested an appointment with Secretary Rogers to present him with a letter from Foreign Minister Almeyda and with a letter from Allende to President Nixon. While both letters are virtually certain to touch on the expropriation question, nothing more is known about their contents. (On September 7 he asked for postponement of his appointment with the Secretary on the same day, stating that he had instructions that some changes in the texts of the communications will be made.)

The GOC's copper expropriation bill (since July 16 part of the Chilean Constitution) basically calls for compensation to be set at depreciated book value (to be calculated by Chile's autonomous Comptroller General), including deductions for equipment either obsolete or in poor condition, plans or spare parts withheld, etc. In addition, the President may calculate a further deduction for "excess profits" taken by the companies since 1955. The terms of payment (i.e. number of years and interest rate) are also to be established by the President within the limits of a 30-year maximum and a 3% minimum.

Thus, as the U.S. copper companies have pointed out, there is no possibility that compensation will be "adequate" in the sense of representing a true "going concern" value. In that it would be politically extremely difficult for Allende to take the position that no excess profits had been taken by the companies, the prospect is that Chile will provide something even less than book value.

Within the limits imposed by the constitutional amendment, both Allende and the Comptroller General retain the capacity to come up with a settlement that could range from zero (or worse) to something approaching book value. According to our calculations, the maximum that could be awarded under the law would be in the area of $85 million for Kennecott and some $205 million for Anaconda. Cerro has been promised $56 million.

Current indications are that the GOC intends to complete the process by October 14. The companies would then have 15 days in which to lodge their only possible appeal, to the special tribunal provided for in the law. Three of the tribunal's five members are presidential appointees. There are no time limits on its deliberations. See Attachment 1 for the time schedule under the copper amendment.

The GOC's final decisions on copper compensation, to be made in the next 2–3 weeks, will reflect its appreciation of its political and economic needs, both domestic and international. Strengthening its hand are the propaganda successes of Allende's recent tour and the appeal of economic nationalism both in Chile and elsewhere in Latin America. Suggesting caution to the GOC are its growing economic problems and its evident awareness that its international creditworthiness, its access to its traditional financial sources, stands to be adversely affected by its position on compensation.

Ambassador Korry has been active in drawing the attention of the GOC to the advantages of pragmatic solutions on compensation, and in suggesting practical ways of moving toward them. To date, the GOC has displayed no interest in pursuing any of these possibilities.

Meanwhile, Anaconda has suggested to the USG the possible utility of giving a positive signal conveyed through official channels or a third party intermediary, on the economic benefit to Chile of achieving an acceptable outcome on

compensation. The company expressed the hope that the GOC could be induced to invoke the 90-day extension provision in the copper amendment to lengthen the timetable beyond its currently established October deadline, to provide time for moderating influences to take effect. The other US companies concerned oppose such extension.

The question for the U.S. at this stage is whether it wishes, however slim the chances of success, to take a further initiative to attempt to induce acceptable compensation in time to affect the final GOC decision, now scheduled to be made on October 14. The economic background together with the factors at play for both governments, are reviewed below.

II. The Economic Outlook for Chile

The GOC has had some short term success in seeking four basic economic objectives: Containment of inflation through price controls; reduced unemployment; increased production supported by rising popular consumption; and a more equitable income distribution. Production increases were achieved only by using idle capacity, however, and the rate of increase is now sinking for lack of new investment. To meet demand the GOC has had to increase imports, especially of food. While substantial foreign exchange reserves were still available early in 1971 for this purpose, they have declined sharply in recent months due primarily to large shortfalls in copper earnings. By the end of this year reserves are expected to fall to around $110 million, roughly one month's import level. The balance of payments outlook for 1972 indicates some degree of further deterioration, although it cannot be precisely quantified. The principal problems of 1971, dissappointing copper output and capital inflows, and high imports, cannot be substantially improved under foreseen conditions.

As shown in the following tabulation, the GOC will carry heavy public debt service burden through the next several years:

Total Chilean external public debt as of December 31, 1969 was $2,227,000, of which $960 million, or 43.1%, was owed to the USG and $64 million, or 2.9%, owed to U.S. private creditors. The debt service for 1972 of $251 million is 26% of projected total exports, or 6% over the traditional 20% "danger point." $85 million of the $251 million is pay-able to U.S. creditors ($72 million to the USG and $9 million to private sources).

The foreign exchange problem is compounded by a shortage of short-term credits. U.S. banks alone report that their short-term credits to Chile fell from $199 million to $158 million in the first five months of 1971. The GOC has been unwilling to accept the kind of conditions IMF applies to standby agreements, which leaves the IMF an unlikely source of relief under current circumstances. Use of the IMF program for compensatory financing of export shortfalls also appears unlikely and limited in possible results.

Long-term investment offers no solution, as it does not provide large amounts of free exchange rapidly and disbursements on development loans normally stretch out over several years. Medium-term project loans, such as the Eximbank aircraft loan, also fail to meet the balance of payments problem.

Substantial credits and investments from the Eastern bloc have been advertised by the GOC, but previous experience in Chile and elsewhere suggests that it is unlikely that large inputs will occur soon. Supporting assistance from Russia on the Cuban scale might meet Chile's exchange needs, but we have no indications that this is in prospect.

While the Chilean copper industry is an important foreign exchange earner and barring a price fall will increase its gross earnings in the next few years from the just completed expansion investment of the former owners, these earnings cannot come soon enough to avert the foreign exchange crisis looming up for next year.

Thus, unless the GOC receives unforeseen new large inputs of foreign exchange by early 1972, it will be forced to make drastic and politically costly curtailments in imports, or to seek rescheduling of debt payments, or to default.

The U.S. is the dominant factor in the Chile debt picture, and compensation to expropriated investors would increase its dominance. It would have the leading influence in any consideration of debt relief for Chile and the Eximbank, with 83% of the payments due the USG from Chile in FY 1972–1973, would have the largest creditor position within the USG. If attempted, a debt renegotiation, which would have to be multilateral, could meet the Chilean exchange problem and avert defaults only if it were combined with stabilization assistance through means such as an IMF standby agreement and/or stabilization loans from Eximbank or AID. Any such measures would require major GOC policy concessions, of kinds it has already shown unwillingness to make.

III. Discussion

The radical elements of the Chilean Socialist Party favor and are pressing for a confrontation with the U.S. earlier rather than later, in the belief that radicalization is essential to the establishment of socialism in the country. In addition to the political attraction, there is in the prospect of confrontation the more immediate economic temptation to the GOC of the benefit it would derive from a repudiation of debt to the U.S. Government and private U.S. creditors. As noted above, this would wipe out about $1 billion of indebtedness and an average of some $77 million in annual debt service to the US over the next four years. The adverse effect of debt repudiation on the GOC's credit-worthiness would be conclusive, the internal shock would be considerable, and Allende would probably take the step only if he felt he could successfully blame it on U.S. coercion.

The preference of Allende, the Communists and other less radical forces for avoiding a confrontation is based on the tactical consideration that for a time Chile can squeeze sufficient benefits from normal relations with the West to make it worthwhile to retain them, while not compromising on ultimate objectives which are adverse to U.S. interests. Thus, while the GOC seeks to minimize the relationship between copper compensation and its general credit standing, the principal constraint on the GOC remains its desire to keep its creditworthiness (and respectability and influence) in the West.

A confrontation with Chile over treatment of U.S. investment would give to Chile the political benefit of championing a popular cause in Latin America and elsewhere in the underdeveloped world, with corresponding disadvantage to us. It would heighten the chances of the confiscation without compensation of all already expropriated and remaining U.S. investment in Chile, and encourage some moves against U.S. investment elsewhere.

To the extent that the GOC established the belief that it was the victim of U.S. coercion, it would rally support to itself, and could shift to the U.S. the blame for its own economic and other failures.

A confrontation would also over time have the effect of impelling Chile's drift out of the hemisphere and toward reliance for survival on the Soviet Union. Such a development would have both positive and negative aspects for us. On the one hand it would increase the demands on Soviet resources and limit the attractiveness of Chile as a model for Latin American and other developing nations. On the other hand, confrontation would virtually eliminate what connections and capacities for influence in Chile that we now have, and would stimulate an increase in Soviet presence and influence in South America.

A satisfactory outcome on compensation to expropriated companies would reduce the likelihood or imminence of a confrontation over investment. Such a settlement is likely to be unattainable, whether or not we make a positive effort to encourage it, and the U.S. response to an unsatisfactory outcome will have to be decided when the time comes in the light of our overall interests.

Even if unsuccessful with respect to the compensation outcome, however, our having made the effort could in itself improve our position against charges of coercion by showing a positive, forthcoming attitude, and might have a general moderating effect on GOC policy on other issues of importance to the U.S. On the other hand, such an effort could be

depicted as evidence of a U.S. intent to coerce Chile by making normal economic relations contingent on satisfaction of copper interests. There is also danger that it could be taken by the GOC as a sign of weakness, a retreat from our earlier stand on compensation, and result in a harder Chilean position.

The making of a positive effort to induce a satisfactory compensation outcome would raise problems in another direction. Apart from the scant likelihood of success, an offer to the GOC to relax restrictions on provision of new resources provided compensation treatment were acceptable, would risk drawing us into direct negotiation of a package deal with the GOC. To be attractive, it would have to imply U.S. readiness to re-negotiate the Chilean foreign debt or to otherwise supply resources which would relieve the Allende government of one of the most important pressures on it, namely its impending foreign exchange crisis.

IV. The Issue

Whether to seek to influence the GOC to take a non-punitive approach on compensation by giving a positive signal that the USG would respond to it with a relaxation of its present restrictive policy against new resources for Chile. This signal could be sent through official channels or conveyed through a third party intermediary such as an international financial figure. In the event Chile provided compensation acceptable to the companies, the U.S. would take a positive attitude toward GOC loan applications to Ex-Im Bank and the international lending agencies and would consider participation in debt rescheduling if other creditors responded to Chilean initiatives. We would not make substantial new AID development loans.

Advantages of Affirmative Choice

—This action would be consistent with the SRG decision of December 30, 1970 that the U.S. would be prepared to relax or intensify present economic restrictions depending on Chilean responses and the outlook for obtaining favorable results; it would also be consistent with the stance taken by Ex-Im Bank.

—It would strengthen the U.S. position, in the event of a clash with the GOC, against Chilean efforts to place on us responsibility for the GOC’s economic failures and rally domestic and international support.

—If successful, it would avoid confrontation with the GOC on an issue which the GOC could exploit to weaken the opposition in Chile and to rally the support of other LA’s.

—It would provide maximum support for U.S. investor efforts to obtain just compensation and offer the best hope, however slim, of achieving that objective.

—If successful, it would minimize OPIC losses.

—It might moderate GOC policy on other issues of importance to the U.S.

Disadvantages of Affirmative Choice:

—It could draw the U.S. into direct negotiations with the GOC and encourage demands for financial assistance we would not be prepared to meet.

—If an accommodation with the U.S. resulted, it would strengthen the GOC’s image as a new model of “democratic” marxist state and could increase its influence to our disadvantage.

—If financial resources were made available to the GOC, they would help alleviate the economic costs of its policies.

—If carried out it would arouse criticism in the U.S. as an indirect contribution of U.S. resources to finance the compensation of the expropriated interests, and as undue support to a socialist regime.

—If carried out, it could be taken by the GOC as a sign of weakness, a retreat from our earlier stand on compensation, and result in a harder Chilean position: or as evidence of a U.S. intent to coerce Chile by making normal economic relations contingent on satisfaction of copper interests.

Annex 1

Annex 2