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Attachments to a Memorandum From the Chairman of the Interagency Committee on Debt Renegotiation (Weintraub) to the Senior Review Group

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Nota de Archivo: *Summary: These attachments to a January 12, 1972, memorandum from Weintraub to the Senior Review Group provided analysis and background of the Chilean request for bilateral talks to reschedule Chile's external debt and outlined the status of the Chilean economy, U.S. objectives for the talks, and the proposed conduct of the negotiations. Source: National Archives, Nixon Presidential Materials, NSC Files, Box 776, Country Files, Latin America, Chile, Vol. VII. Secret and Confidential. Weintraub's memorandum (Document 286, Foreign Relations, 1969–1976, vol. XXI, Chile, 1969–1973) and attachments were sent through Meyer and distributed to Kissinger, Irwin, Connally, Nutter, Moorer, and Helms. Only Annexes A and B are published; Annexes C through G were not found.*

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(1) Letelier Memorandum on Debt Rescheduling of November 29

(2) Chilean Embassy Complementary Memorandum of December 8

Annex A

Analysis of the Chilean Request for Debt Rescheduling:Assumptions and Issues

[Omitted here is a Table of Contents.]

A. BACKGROUND

1. Introduction

In conjunction with similar requests to other creditors, the Government of Chile on November 29 formally requested the United States to participate in negotiations for the rescheduling of Chile's external debt. The Chileans stated their preference for bilateral negotiations with the U.S. They also informed us that Chile had declared a unilateral moratorium effective November 12 on debt servicing, except for short-term commercial payments and those to international financial institutions. They later requested ninety day deferments from the U.S. and certain other creditors pending renegotiation of debts.

The State Department has held extensive discussions with other agencies over the past several weeks on the nature of the response which the U.S. Government should give to the Chilean request for debt rescheduling. After receiving authority from the NSC, the Department notified the Chileans that the U.S. would participate in multilateral debt discussions which are scheduled for early February in Paris. The French, as chairmen of the Paris Club of creditors, were also notified. The State Department provided data and analysis of the options to the National Advisory Council and asked the NAC to provide technical advice to the negotiators on various financial issues.

2. The Chilean Request

The request for rescheduling comes at a time of serious deterioration of Chile's internal and external economic position. Chile's foreign reserves, which were approximately $365 million a year ago, are now estimated to be slightly below $100 million. These are expected to decline further in view of copper production difficulties in Chile, the softness of copper prices, and the growing need for imports, particularly of foodstuffs. The Chileans have estimated that about 40% of the foreign exchange earnings expected for exports in 1972 and 1973 would be required to meet external debt servicing; however, this analysis is still to be confirmed by the Paris Club creditors.

We believe that the major Chilean motivation in seeking the rescheduling is straightforward, that is, to obtain relief from its external debt burden and thus to avoid an imminent foreign exchange crisis. We also believe that the present Chilean default on payments to the U.S. will continue if there is no debt relief, but that the Chileans wish to formalize relief through a rescheduling agreement which would allow them to maintain a certain degree of respectability in international financial markets. Finally, we suspect that the Chileans may also have in mind setting up a situation in which President Allende can blame foreign countries, particularly the United States, for internal austerity measures if the rescheduling negotiations fail.

An analysis of the Chilean internal economic and external situation is contained in Annex B.

3. United States Objectives

The U.S. has approximately $1.5 billion outstanding to Chile, of which $920 million is owed to USG agencies and $560 million to private creditors which is guaranteed by the Chilean Government. About $200 million of the private creditor loans are insured by OPIC or Eximbank, so that total USG exposure is approximately $1.1 billion.

The United States has several conflicting objectives which need to be reconciled: we do not want to help Allende any more than necessary with debt relief at a time when he faces a real economic crisis; we do not want to allow Allende to exploit our actions for his own internal and external political benefit; we want to use debt relief as a means of obtaining assurances regarding the payment of debts owed by the nationalized companies; and we want to avoid a lengthy default or possible repudiation of debts to United States official and private creditors.

The Chilean request for debt relief comes at a time of great political delicacy in our relations with Chile and the hemisphere. Ambassador Davis and the Chilean opposition forces are urging that we maintain our posture of quiet restraint and not give Allende a pretext for rallying his divided nation against a "foreign devil". At the same time, domestic opinion in the United States may be sensitive to our giving debt "relief" to a country which has recently expropriated the assets of U.S. companies without providing adequate compensation, unless it is understood that debt relief is a way of protecting our creditor interest against continued default. (We have already learned that Anaconda wishes to avoid confrontation in the debt renegotiations, preferring to use the discussions to encourage whatever progress is possible.)

Ambassador Davis has pointed out the likely adverse effects of invoking the Hickenlooper Amendment at a time when there are compelling reasons for not initiating a confrontation with Allende. Our reason for not invoking it now is that we believe negotiation will be more productive in protecting our economic and political interests. The basis for not invoking it is that the appeals process has not been completed. The benefits of invoking the Amendment on the economic side would be mainly symbolic since there have been no new AID loans in almost two years and disbursements have been proceeding at a slow rate on the $20 million remaining in the AID pipeline. The Eximbank has stopped disbursements completely as a banking measure in response to default. However, both the State Department and the Defense Department feel strongly that disbursements on military credits (amounting to $8 million) should not be suspended so long as legally possible in view of the potential role of the Chilean armed forces as a center of opposition to Allende.

The rescheduling of debt to protect U.S. creditor interests is not considered to be assistance within the meaning of the Hickenlooper Amendment. Therefore, even if the USG were to invoke the Hickenlooper Amendment before debt

renegotiations were concluded, it would not preclude us from reaching a settlement on debt.

Debt relief would appear to be inconsistent with our objective of giving Allende as little help as possible in overcoming his balance-of-payments problems. However, if Chile does not get relief, it will almost certainly continue in default on its debts to us. Therefore, the impact of debt relief on the Chilean balance of payments will be considerably less than the results of a continued default if we can obtain a reasonably tough formula through our participation in multilateral negotiations. There is a reasonable prospect that deferral of debt service can be limited to less than the three years requested by the Chileans, and possibly to less than all of Chile's principal and interest obligations during the period. In this case relief would be less than Chile could obtain through a continued default. We also believe that the level of new credits which Chile could obtain by regularizing its debts will be very much lower than in the past and will not be greatly improved, certainly with respect to U.S. creditors, as a result of our participation in a debt relief exercise.

A more detailed analysis of the impact of debt relief on the balance of payments is contained in Annex B and Table VIII. The National Advisory Council has been requested to provide additional data.

4. Conduct of the Negotiations

Our participation in a debt rescheduling exercise is complicated further by the possibility that a debt rescheduling agreement might be ready for signing before or about the time the special copper appeals tribunal in Chile will render its decision, which is expected to deny adequate compensation to the companies. It should be noted, however, that our participation in the Paris Club negotiations does not irrevocably commit us to signing an agreement with the Chileans if we later decide that it is not to our advantage to do so.

We anticipate that the rescheduling exercise will proceed at a moderate pace during the multilateral stage of the negotiations. Subsequently, assuming that the terms of debt relief are worked out in concert with other creditors, we would then have more flexibility on the pace of the bilateral discussions with the Chileans prior to signing an agreement. The expectation is that we would sign, given the total debt at stake and the external politics involved, but there might be domestic fallout in the U.S.

Any obvious efforts to slow the pace of multilateral negotiations might lead to confrontation with the Chileans and resistance from other creditors. However, the actual signature of the agreement could be delayed, if necessary, in order to observe political developments within Chile at a time when increasing austerity will probably be accompanied by growing internal dissatisfaction and unrest. In addition, a deliberate negotiating pace allows more time to assess the Chilean intent to pay its loan to Kennecott and to observe somewhat more fully the copper appeals process and the Chilean Government's final intentions regarding compensation. These issues are discussed separately below.

B. ISSUES

1. The Debts of the Nationalized Companies

The Chileans have stated their intentions to honor the foreign debts of companies whose assets have been nationalized by the Chilean Government, although retaining the proviso that repayment of copper debts must be consistent with the terms of the recent copper amendment to the Chilean constitution.

The agencies are agreed that we should seek confirmation from the Chileans that they will repay these debts and any others which may result from future nationalization. We should inform other creditor governments early in the negotiations that debt assumption will be one of our objectives, and be prepared to adapt our tactics to their responses and the amount of support we can expect from them. The manner of our injection of this issue into the talks, and the degree to which we insist on Chilean recognition of this link at the outset, are important to the achievement of our objectives.

The USG can also seek Chilean recognition during the negotiations that all expropriation-related obligations, whether debts of nationalized companies or payments undertaken by the Chilean Government in connection with current nationalizations, should be included in Chilean public debt. By introducing nationalization costs into the discussion, it will be possible to mobilize sentiment among other creditor nations for urging restraint on Chile with regard to new takeovers, so as to avoid incurring additional external obligations during a payments crisis. It will also be possible to argue that uncertainties regarding the size of Chile's expropriation-related obligations make it necessary to limit debt relief to only one year, until the full extent of these external obligations is known.

The debts of the nationalized companies can be divided into at least four categories by juridical and contractual status: non-copper debts owed to U.S. creditors; copper debt to U.S. copper companies; copper debt to other U.S. creditors; and copper debt consisting of promissory notes from the government Copper Corporation (Codelco) to Anaconda.

a. Non-copper debt

The debts of non-copper companies which have been, or which (like ITT) may be nationalized, are not covered by Chilean legislation. Since Allende has not made any public statements against these debts, there is a reasonble prospect that he would be able to reaffirm past Chilean promises to repay.

b. Copper debt to third parties

A provision in the Chilean constitutional amendment states that copper loans will not be repaid if a finding is made that these were not "usefully invested". (The Eximbank has received assurances from the Chilean Minister of Finance that the obligations of the mixed mining companies to it will be honored and believes Chile will agree to pay these debts on a rescheduled basis.) The U.S. banks are negotiating the terms of a rescheduling and the validity of the copper debts has not been called into question. Therefore, short of a breakdown in the negotiations, Allende will probably be willing to confirm his past commitments on these debts as part of the price for agreement on debt rescheduling.

c. Intercompany copper debt

The intercompany copper debt is a more difficult problem in view of a Presidential decree on December 30, 1971 suspending payment on Kennecott debt amounting to $88 million until a three month study can be carried out by Codelco to determine whether the loans were usefully employed. This loan arises from the 1967 partial nationalization of copper when the government Copper Corporation took a 51% ownership share in the mines. Kennecott was given promissory notes which were subsequently paid off by Codelco in return for a loan of similar amount by Kennecott to the Chilean operating companies. The validity of this loan (which has OPIC insurance of $85 million) is now being challenged.

d. Codelco notes to Anaconda

The promissory notes to Anaconda are closely tied to the compensation issue. These notes, amounting to $152 million, arise from the Chilean purchase of a majority interest in Anaconda's major mines in 1969. They are subject to special provisions under the copper amendment to the Chilean constitution which specify that the notes be honored only to the extent that a positive compensation award is made to the companies. The juridical status of these notes, therefore, is different from that of the Kennecott debt. Since Allende has already committed himself publicly to an excess profits determination which would appear to cancel out any compensation, and since the prospects of this action being reversed by the Chilean special appeals tribunal are very slim, the notes are close to being repudiated and assurance for their payment would be extremely difficult to obtain.

2. The Compensation Issue

All agencies are agreed that compensation for the expropriated assets of United States companies is not a realistic objective in the context of debt renegotiations. The assessment is that it would be futile and disruptive to raise compensation as an absolute condition for debt relief since this would simply lead to a political confrontation. There is agreement, however, that every reasonable effort should be made to protect and improve the position of the expropriated companies.

By pressing for a compensation link in the context of debt renegotiations, we introduce a highly sensitive issue with a strong potential for political exploitation by Allende. We also run the risk of losing the cooperation of other creditors by introducing an issue which they may feel is primarily of bilateral significance to the United States. Therefore, the agencies are agreed that priority should be given to debt assurances, which may be achievable, rather than to compensation, which is not.

In spite of these disadvantages, the sensitivity of the compensation issue for domestic and Congressional opinion in the United States and for our overseas investment in general requires that compensation be raised in some manner during the talks. The attitude of the companies will be an important element in determining the extent to which we raise the issue.

For the reasons cited above, the agencies believe that compensation should be raised at the discretion of the negotiators when they perceive appropriate opportunities for injecting it into the talks.

3. Terms of the Rescheduling

The Chileans have asked for a rescheduling of principal and interest due on both government loans and supplier credits in each of the three years 1972–74, with a grace period of three years and repayment over an additional ten years. This compares with the 1965 Chilean rescheduling which provided only for 70% of principal on supplier credits for two years, with a grace period of two years and repayment over five additional years. Other Latin American reschedulings in recent years have been on fairly hard terms and confined largely to supplier credits. The consolidation interest rates were more or less the commercial rates prevailing at the time.

The agencies are agreed that the terms of the present rescheduling should be made as hard as possible within the limits of the Chilean ability to pay, so that Allende is forced to take responsibility for his own economic policy failings. This objective could best be served by seeking to limit debt relief to less than the period requested by the Chileans, and hopefully to less than all of the principal and interest due.

The State Department has already calculated several hundred rescheduling options on the computer, using various assumptions regarding the amount of principal and/or interest, the period of consolidation, the grace period, the repayment period, and rates of interest. A sample listing is provided in Table XIII attached.

The NAC will advise on terms and rates of interest as required.

4. World Bank and IDB Participation in a Rescheduling Exercise

The World Bank and the Inter-American Development Bank have not, with two minor exceptions, participated in debt exercises by rescheduling their own debt, although they have at times provided additional financial assistance to countries in debt difficulty. The motivations of these institutions are to protect their credit ratings in the bond markets, and to avoid having to make up their reduced income by asking the very same creditor countries either to replenish their funds or to permit further borrowing on their capital markets.

The GOC has announced that it will not seek rescheduling of its debts to the international financial institutions, although it has indicated that it might be obliged to do so if new credits were not forthcoming from the Banks. At the moment, however, the Banks have no incentive to participate in a rescheduling, since payments are continuing on their loans.

The chief advantage of Bank participation in a rescheduling exercise is to assure equal burden sharing for all creditors. Since the Banks took the same risks in lending to Chile, the renegotiation of their loans along with other creditors would be consistent and equitable. The Banks might also adopt a tougher attitude in support of stabilization programs for Chile if their own resources were at stake, and it would establish a precedent for Bank participation in future rescheduling exercises.

All agencies are agreed with the general principle of equal burden sharing for the international financial institutions. There may be disadvantages, however, in applying this principle to the Chilean case. Among these is the risk that it would complicate our pending legislation at a time when the appropriations outlook is unclear, and would therefore be an inappropriate time to urge the Banks to initiate a new policy which might affect their bond markets. The Banks themselves would oppose such an initiative and might be supported by a majority of other creditors. Finally, it may not be desirable to go beyond what the Chileans have asked for, since a rescheduling of the Banks' loans would relieve Chile of about $25 million annually in payments which it is now committed to make. This argument may not be sustainable if the terms of the rescheduling agreement can be varied so that overall payments remain about the same.

The NAC has been asked to advise on this issue.

5. IMF Participation in the Negotiations

All agencies are agreed that we should seek a major role for the IMF in the debt renegotiations and press for a tight stabilization program, preferably supported by a standby arrangement. The IMF has been involved in most rescheduling exercises in the past, and has been instrumental in formulating new credit policies, including stabilization programs for the debtor country. Of the seventeen reschedulings thus far, fourteen involved a standby for the debtor country.

The Chileans have already stated that for political reasons they are unwilling to request a standby if it means submitting to the discipline of the IMF and making commitments to the Fund regarding their internal economic policies. They have agreed, however, to "cooperate with the Fund in an effort to find appropriate solutions for the balance-of-payments difficulties". An IMF mission departed for Chile on January 3 to advise on the balance-of-payments problem, but it is not yet clear what role it will take in the debt rescheduling exercise.

Early indications from other creditors—notably the French, Germans, Italians, Belgians and Swiss—indicate that they will also seek IMF participation and a stabilization program, preferably but not necessarily supported by a standby, as a condition for rescheduling.

The NAC will advise on this issue.

6. Acceleration provisions in Eximbank copper loans

The Eximbank has acceleration provisions in its loans to the copper companies which are tied to cash flow and net profit levels. These provisions are activated if certain conditions are met, with the result that amounts due for repayment during the next three years could be substantially increased. The significance of these provisions and their possible impact on the debt rescheduling negotiations is being considered by the National Advisory Council.

7. Eximbank's preferred position vis-à-vis private creditors whose loans are insured by OPIC

The Eximbank is a senior creditor on loans to the nationalized copper companies. The subordinated creditors are insured by OPIC and a decision by the Eximbank to assert its seniority rights is one of many factors that could affect the extent of OPIC's liability to the copper companies. The NAC has been asked to assist in clarifying the technical aspects of this issue.

Annex B

Background Paper on the Chilean Internal and External Situation

[Omitted here is a Table of Contents.]

1. The Chilean Economy

The balance-of-payments outlook for Chile for the remainder of this year and for 1972 indicates that Chile is facing an extremely difficult situation. An anticipated decline in export earnings due to falling copper prices and reduced output levels will cause the debt service ratio to rise much higher than the 22% originally forecast for 1971. In addition, the rapid increase in imports and the decline in capital inflows during the last 12 months are expected to reduce net international reserves from $367 million in December 1970 to less than $100 million at the end of 1971 (not counting IMF and SDR positions). A continuation of the present trends would create strong pressures on remaining reserves during 1972, and for this reason the Chilean Government is taking severe measures to protect its balance-of-payments position.

Even before the Allende Government came to power, it was clear that Chile's balance-of-payments position was headed for serious difficulties. Since then, the Allende government's actions and world reactions have served to worsen considerably this balance-of-payments outlook. Chile's investment atmosphere has become clouded by expropriations and interventions, and private sector confidence has been affected by continuing uncertainties regarding the future policies of the Government. This uncertainty has affected both domestic and foreign investors alike, and they have reacted by cutting back drastically on planned increases in investments. Allende's wage and income redistribution policies, involving a freeze on prices and a 30% across-the-board increase in wages, have affected the profitability of investment in Chile, and the demand for goods and services is far outstripping the economy's ability to produce. In 1971 excess demand was satisfied in part through increased import levels, but the drain on reserves combined with declining export levels has led to the current balance-of-payments crisis.

Chile's balance of payments difficulties in 1972 will be worsened by several domestic problems. The continuing shortfall in agricultural production will add to import demand. The domestic incomes policy and government deficits will continue to stimulate demand, domestic inflation, and again import demand. Despite rigid price controls, an inflation rate of about 20% for 1971 is predicted. Private investment—both domestic and foreign—has fallen off noticeably during the last two years and will have to be stimulated or replaced with public investment. In either case, a rise in the level of investment will require additional imports if production levels are not to be seriously affected in 1972. Finally, the oft-cited need for worker discipline and greater productivity is critical in the copper sector which provides 80% of the necessary export earnings, as well as in industries with a high potential for import substitution. In contrast to 1971, the shortage of foreign exchange in 1972 will determine to a far greater extent the range of economic policy options open to Allende, dictating in most cases the need for greater economic controls.

For this reason Allende has been forced to adopt several extreme economic measures which will adversely affect his domestic political position. These measures include the further restriction of consumer and producer imports, the formal devaluation of the escudo which will stimulate inflationary pressures, and the suspension of service on foreign debt which, in the absence of regularization through debt rescheduling, may lead to a decline in foreign credits and additional constraints on Chile's ability to import.

An important source of potential relief for Allende's problems could come in the form of new credits, but the outlook is far from optimistic. In 1971, disbursements were expected to be $442 million, of which $240 million were from private creditors. However, new credits from international banks and Western official sources have declined in 1971 and disbursements from the pipeline in 1972 will be substantially reduced. The outlook for increased flows from government or private sources under present circumstances is not good, unless the Socialist countries step in to fill the gap.

2. Credits from Socialist Countries

Over the longer run credits from Socialist countries could be useful in providing machinery and raw materials but it is unlikely that such credits will reach anywhere near the level of Western credits in recent years. Moreover, the price of converting to Eastern bloc suppliers will be high because of unfamilarity with bloc trading arrangements, the lower quality of capital equipment and the unavailability of required spare parts. It is not even certain that the Socialist countries will be willing to undertake the potentially high cost of underwriting Chilean foreign trade, although several new credits have been negotiated recently by these countries with Chile.

According to a CIA report, the three Russian commercial banks in London were recently instructed to make available $50 million for six months to the Chileans. In addition, the Department of Commerce reports that supplier credits have been negotiated with Poland for $35 million and Hungary for $15 million, and a long-term loan for mining equipment and technical assistance has been signed with Bulgaria for $20 million. Direct investments totaling $70 million are planned by Czechoslovakia, Romania, and Hungary.

3. The Chilean request for debt relief

On November 9 President Allende announced his government's intention to seek a renegotiation of Chile's outstanding foreign debt, and on November 29 the Chilean Ambassador submitted a formal request for debt rescheduling to the United States. The Chileans informed us that they had suspended debt service on November 12 on all obligations to major creditors with the exception of short-term commercial debts and obligations to the World Bank group and the Inter-American Development Bank. Debts to minor creditors "which by virtue of their insignificant amounts have little importance in terms of the service of the country's foreign debt" will also be excluded. The countries concerned are mainly in Latin America.

The creditor countries with which Chile wishes to renegotiate its debts are listed in Annex C–2. A notable omission from the list is the Soviet Union, which has larger scheduled repayments in 1972–74 than at least seven of the "major" European creditors. It is not clear whether the Soviet Union will be approached for debt rescheduling, but according to an informal report from an IMF official, the Chileans would like the USSR to participate, perhaps in the form of program loans (Annex D).

The Chileans are also approaching private creditors for rescheduling, and a meeting was held on December 14 with 43 United States banks in New York under the joint Chairmanship of First National City Bank and the Bank of America. The Chileans proposed a three year grace period on maturities falling due in 1972–74, followed by seven years repayment. The banks replied that this would be unsatisfactory and made a counter-proposal which is summarized in Annex F. We are keeping in contact with the banks.

With regard to current payments, the Chileans failed to make two interest payments to AID amounting to $223,000 which fell due before the November 12 cut-off date. They subsequently promised to make these payments and to make exceptions of two more small interest payments amounting to $207,000 which fell due after November 12. They then asked for a ninety day deferment which AID declined, and the payments have not yet been made.

On November 30, the Chileans defaulted on a payment to the Eximbank, and on December 7 the Eximbank suspended disbursements, insurance, and guarantees to Chile. The Department of Agriculture was asked to defer repayments due on December 31 for ninety days, but declined in view of the pending debt renegotiations.

4. Terms of the Chilean Proposal

The Chileans have suggested a rescheduling of principal and interest due in each of the three years 1972–74 (plus apparently the last six weeks of 1971 after the November 12 cut-off date) with a grace period of three years and repayment over an additional ten years. This compares with the 1965 terms which provided for rescheduling of 70% of principal only for two years, with a grace period of two years and repayment over five additional years (Table XI). The Chileans may wish to draw parallels with more generous rescheduling agreements involving the United States, and in this connection we have learned that they are asking the IMF about the terms of our recent agreements with Yugoslavia and Egypt.

A preliminary repayment schedule has been calculated on the basis of the Chilean proposal and is presented in Table XIII along with other possible schedules for repayment.

5. The Response of Creditors to the Chilean Request

We have received reports from most of the major European creditors that the GOC has also formally approached them for debt relief. The Chileans apparently did not put forward specific proposals, but offered to send a mission in mid-December to negotiate on a bilateral basis. The comments of major creditors on various issues are shown below.

a) Multilateral versus Bilateral Negotiations

All of the ten creditor countries that have consulted with us favor multilateral negotiations, at least in the early stages. (Annex E) Japan stated that it probably would prefer multilateral talks, but its decision would be influenced by the position taken by the United States.

Likewise, all of the seven countries that expressed an opinion on US attendance favored US participation in the multilateral negotiations. The most extreme position on this subject was taken by France. It stated that multilateral negotiations could not take place without US participation. This categorical statement was based on France's impression that Germany also would not take part if the US did not participate. Germany, however, although publicly stating to Chile that negotiations would not be possible without US participation, said in private to US officials that it would not rule out multilateral negotiations which excluded the US, if the US and Chile preferred separate bilateral talks.

b) Participation of IBRD and IDB

Five of the creditor countries preferred participation by the international financial institutions (IFI's), although it was not clear in some cases if the countries expected the IFI's to renegotiate their loans to Chile, or only to attend the meetings as observers.

Germany felt that the IBRD should participate in the meetings, and not just as an observer. France, Italy, Belgium, and Switzerland also favored participation by the IBRD, but did not make clear whether they expected the Bank to reschedule its loans or simply to participate as an observer.

France, Belgium and Switzerland mentioned that the IDB should participate in the meetings. The other countries did not single out the IDB.

c) Participation of the IMF

France and Germany felt that the GOC should negotiate a stabilization program which included a standby agreement with the IMF. Belgium, Italy and Switzerland also preferred that the IMF participate in the meetings although a standby agreement was not mentioned.

d) Suspension of Debt Service

Only Germany appears to have been advised by the Chileans that debt service payments were suspended on November 12. Belgium, Canada, and Japan, however, have informed us of overdue payments to private or public creditors. The Belgian creditor was told that the payment, due on October 24, was being included in the debt negotiation. The Japanese firm was requested to extend the November 30 due date by 90 days.

None of the countries has stated that Chile should resume servicing its debt as a precondition to the renegotiation meetings (although as mentioned above only Germany was informed that Chile had suspended its payments). France was specifically asked to agree to a moratorium on payments until January 31, 1972, but refused on the grounds that this kind of step could only be taken in the framework of multilateral negotiations. Italy stated that by law it would be required to suspend disbursements if repayments were suspended. No other country expressed an opinion on this subject.

e) Response to the Paris Club Invitation

We have already been approached informally by the French Government which is proposing to reactivate the Paris Club as a multilateral forum for the discussion of Chile's debt problem. The French suggested a meeting of creditors for late November, which we and other creditors indicated would be premature. They are now thinking of a meeting in early February. Thus far Italy, Canada, the Netherlands, and Switzerland have indicated that they would respond favorably to such an invitation. The Chileans have also indicated willingness to participate now that the creditors have expressed their preference for multilateral negotiations.

6. Amounts due to United States and other foreign creditors

At the end of 1970, Chilean external public debt amounted to over $2.6 billion (including undisbursed and amounts due from prior nationalizations). The U.S. is by far the largest creditor with almost $1.4 billion outstanding or 57% of the total. This amount includes loans from USG of approximately $900 million. The remainder is due to private banks, suppliers, other financial institutions, holders of Chilean public bonds, and holders of Codelco notes arising from past nationalizations. (Table I–A)

During the next three years, 1972–74, Chile is scheduled to repay almost $500 million to public and private creditors in the U.S. Debt service during the period will amount to 32% of total loans outstanding, which is lower than the proportion due to other major creditors in almost every case, reflecting the more favorable terms of United States credits. The higher ratio for other creditors also means that they will have to postpone a larger proportion of their credits in a rescheduling.

Repayments to United States Government agencies are scheduled to be $236 million during the period November 12, 1971 to December 31, 1974. Eximbank is the major creditor agency in terms of repayments falling due during the period (80% of the total), although AID has a larger outstanding balance. (Table III) In addition to direct credit obligations, Exim has guarantees and insurance outstanding of $31 million, and OPIC has insured debt obligations amounting to $162 million. These amounts, added to direct credits outstanding from the USG of $892 million as of June 30, 1971 give a total exposure of $1.1 billion.

7. Eximbank, OPIC and private creditor exposure in Chilean copper companies

Two of the most critical issues in our relationship with Chile are the compensation for US companies whose assets have been expropriated and the assumption by the Chilean Government of debts owed by the nationalized companies. The Gran Mineria copper companies alone have $400 million in equity at stake, plus $118 million in intercompany debt and $152 million in unpaid Codelco notes from the 1969 nationalizations. (Table V)

In addition, the major copper companies in Chile have other obligations to foreigners amounting to $375 million, of which $183 million is owed to Eximbank and about $95 million to private US banks.

OPIC also has a major interest in the assumption of debts—both copper and otherwise—by the GOC. It has almost $100 million in debt coverage on intercompany copper loans (not counting $11 million debt coverage in dispute with Anaconda), as well as $60 million in additional insurance on private debt obligations of other Chilean public and private borrowers. (Table IV)

8. Military Credits to Chile

The Defense Department has a long standing link with the Chilean military and still has a modest FMS credit program that initially had a total value of $23 million. (Table III–A)

To date, approximately $15 million of this total amount has been disbursed by DOD agencies leaving an undisbursed balance of $8 million. Against this $15 million disbursement, a total of $6 million has been repaid, leaving a total current outstanding debt of $9 million, and a potential future disbursement of $8 million. Thus, the potential total Chilean debt under current FMS credit arrangements is $17 million. Chilean payments against the current outstanding debt are on schedule.

The Chileans have not indicated any intention to reschedule military debt to the United States, and the Defense Department believes that Allende will continue to supply foreign exchange for the servicing of Chilean military debt.

9. The Role of the IMF

The Chileans have drawn their gold tranche of $39.5 million, but have indicated that for political reasons they are unwilling to utilize their credit tranche or request a standby. The Chilean quota of $158 million allows them to draw up to another $39.5 million in the first credit tranche, if they submit to the discipline of the IMF and make commitments to the Fund regarding their internal economic policies. This the Chileans are unwilling to do, although they have recently obtained a drawing of $39.5 million from the IMF under the compensatory financing facility to help cover the anticipated decline in copper exports.

10. The Impact of Debt Relief on the Chilean Balance of Payments

Debt relief is designed to salvage the maximum level of repayment possible for US creditors when the alternative would be total default. Since Chile is already in default and is likely to remain so until a rescheduling agreement is signed, debt relief in some form will be needed to bring about a resumption of payments.

The effect of the Chilean balance of payments will depend on the duration of the present default, the terms of the rescheduling, and the level of new credits that Chile can expect to receive. It is clear that the Chileans will obtain balance-of-payments relief whether there is agreement on rescheduling or not, since a default would have much the same effect as debt relief if obtained on the terms they have requested. The main questions are how much debt relief Allende can obtain, and what effect a continued default would have on Chile’s international credit standing.

a) Debt relief

If Chile can obtain debt relief on the terms it has suggested it could defer almost $900 million in principal and interest over the next three years, of which half would be due to the United States. This assumes that the creditors will agree to these terms, which are considerably more generous than those agreed upon in the 1965 rescheduling. It is more likely that the creditors will insist on a more limited term with only partial debt coverage which would limit the scope of relief and require corrective policies before further relief could be considered.

If a rescheduling agreement is reached, the Chileans could expect to maintain some degree of respectability in international financial markets. However, the flow of new credits is unlikely to match the amounts which Chile has obtained in recent years. The 1970 level of $372 million included $145 million in credits from public and private creditors in the United States. The level of new credits from this source will be negligible whether Chile reschedules or not, and for this reason Chile might benefit more from a selective default on United States obligations than it would from a rescheduling. The same reasoning does not apply to European creditors where the flow of private credits might continue or even expand to fill the gap left by the United States if Chile successfully reschedules.

b) Default

If the Chileans fail to obtain debt relief, they will probably continue to default on payments and thereby obtain relief in any event, but at the cost of losing a large part of the foreign credits (and disbursements from the pipeline) which would otherwise have been available from traditional sources. Any attempt to estimate the flow of new credits into Chile in the next three years would be highly speculative. However, it can be assumed that a total default, which would save Chile $300 million a year in debt service, would be somewhat counterbalanced by a decline in new credits from all sources, unless the Chileans can obtain additional credits from the Socialist countries.

The attached Table XIII shows the level of debt relief which Chile could obtain under various rescheduling assumptions.