

Central Intelligence Agency



Washington, D.C. 20505

23 May 1985

MEMORANDUM FOR: (See Distribution List)

SUBJECT: Nicaragua: Initial Reaction to US Sanctions [redacted]

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1. This report provides a quick overview of Managua's initial reaction to US economic sanctions. As such, it covers not only the moves Nicaragua already had underway, but also initiatives that were implemented in the immediate aftermath of the US decision. While most of the emphasis is on the economic side, Managua's political maneuvering--both domestically and abroad--is also reviewed. As things now stand, we plan to publish a more detailed review of the impact the sanctions are having on Nicaragua sometime this summer. [redacted]

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2. This report was prepared by [redacted] Middle America-Caribbean Division, Office of African and Latin American Analysis. [redacted]

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3. Your comments and suggestions on this report are welcome and may be addressed to the Chief, Central America South Branch, [redacted] [redacted]

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[redacted]
Deputy Director
African and Latin American Analysis

Attachment:
Nicaragua: Initial Reaction to
US Sanctions [redacted]

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SUBJECT: Nicaragua: Initial Reactions to US Sanctions [redacted]
(Attachment: [redacted])

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Central Intelligence Agency



Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

NICARAGUA: INITIAL REACTION TO US SANCTIONS

23 May 1985

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Nicaragua: Initial Reaction to US Sanctions

Summary

Managua, apparently anticipating the recent US embargo, has for some time been reducing its economic links to the United States. In the immediate aftermath of the recent US action, the regime has intensified its efforts with a diplomatic offensive to play up international opposition to the US moves, win economic assistance, and find new markets for its goods. Domestically, the Sandinistas have tried to use the embargo to rally popular support, shift blame for economic problems to the United States, and coopt the opposition. The loss of US markets, imports, and managerial expertise will cause some serious disruptions in the near term. The experience of other states embargoed in the past, however, suggests that Nicaragua over time will find alternatives that will sharply reduce the effectiveness of the sanctions.

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On the economic side, the embargo came at a time when trade with the US was slowing. Even as trade was falling off, Managua--before the embargo--was making contingency plans to cut back its economic ties with the United States. For example:

-- [redacted] the Sandinistas had begun negotiating for agricultural equipment, pesticides and herbicides with the USSR, East Germany, and Czechoslovakia.

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-- The Central Bank recently made back payments of \$6.2 million on its rescheduled debt with a group of commercial creditor banks to improve its fiscal image.

[redacted]

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Following the US decision to impose sanctions, Managua took further steps:

-- Ortega added Western capitals to his Soviet and East European trip. Several West European governments gave some indications that they might provide Nicaragua with alternate markets for its produce.

[redacted]

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This Paper was prepared by [redacted] Office of African and Latin American Affairs, with a contribution by [redacted] Office of African and Latin American Affairs. Comments and queries are welcome and should be directed to the Chief, Middle American-Caribbean Division, ALA [redacted]

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-- [Redacted]

Managua began

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establishing front companies in Panama.

Looking ahead, perhaps the most immediate problem facing the Sandinistas will be on the export side. Managua has yet to secure new markets for perishable exports, and losses are likely to mount at least in the short run. The Sandinistas claim to have commitments from Belgium to buy bananas and the Canadians to purchase beef. Canada's External Affairs minister, however, has stated Ottawa will not raise its quota of Nicaraguan beef at this time. Another problem area for Managua could prove to be its oil refining and distribution system.

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[Redacted]

Earlier, Brazilian and Cuban consultants had been brought in to assess requirements for operating the plant,

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[Redacted]

Domestically, the regime has tried to use the embargo to its advantage to try to garner popular support, justify further economic sacrifices, deflect discontent over economic issues to the United States, and coerce opponents. Diplomatically, the Sandinistas have tried to put Washington on the defensive in various international forums such as the UN Security Council and the World Health Organization. Managua will also be especially aggressive in exploiting any splits between Washington and Western Europe in an effort to win additional economic assistance.

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Despite all these moves, the US embargo will put additional strain on Nicaragua's already limited managerial skills in the near term as the regime adjusts to the sanctions, and material and parts shortages further erode industrial capacity. In economic terms the direct costs of the embargo to the Sandinistas could reach \$25 million as exports are disrupted--an amount equal to nearly 1 percent of the country's economic output and about 10 percent of 1984 Communist economic aid. In political terms, the problems caused by the sanctions probably will add to popular discontent.

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Nicaragua: Initial Reaction to US Sanctions

Economic Conditions At the Time of the Embargo

Nicaragua's economic difficulties have mounted over the past few years and have become critical in recent months. Last year, for example, official statistics and US Embassy reporting indicated that the Nicaraguan economy was buffeted by an array of problems including serious hard currency shortages, an annual inflation rate of 60 percent, and a general deterioration in production. Indeed, the Sandinistas' emphasis on military spending--which rose from 25 to at least 40 percent of the budget in January 1985--and general mismanagement of the economy had directly and indirectly depleted dollar reserves by February. The hard currency shortage in turn led to a severe petroleum crisis that further reduced agricultural and industrial output, sharply cutting exports. By the time US sanctions were imposed, Nicaragua's foreign exchange and oil situation had improved slightly because of foreign assistance--largely from Soviet bloc sources--but domestic production continued to decline. [REDACTED]

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Faced with hard currency constraints, the Sandinistas over the past six months have imposed austerity to limit import demand, further eroding an already falling standard of living. In addition, Embassy reporting indicates the regime has attempted to squeeze most hard currency holdings out of the private sector by controlling all export sales and requiring dollar payments for most imported goods, all international phone calls, expatriate rents, real estate purchases, and international airline tickets. Managua also has established a multi-tiered exchange rate system and devalued the cordoba, although the new official rate (28 cordobas per dollar) still significantly overvalues the currency--the black market rate is over 600 cordobas per dollar. All of these moves to check the loss in hard currency came on top of other official actions to limit demand--including the Sandinistas decision to quadruple the price of basic commodities since January while only doubling government-controlled wages. [REDACTED]

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Trade and Aid Picture

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By the time US sanctions were imposed, Managua had seen its trade and aid picture change dramatically from the early days of the revolution. On the export side barter and resale operations had become increasingly important. During the past year, for example, Managua sold crude oil from Libya, Iran, and Algeria on the spot market for dollars. The Sandinistas agreed to pay for the crude over several years. [REDACTED]

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[REDACTED] Even with this help Managua had to rely on barter and arrearages to make ends meet. Indeed, based on Embassy reporting, 70 percent of the country's trade was on a barter basis at the time the embargo was announced. Moreover, by the end of 1984, Nicaragua's overdue foreign debt payments, [REDACTED] had approached \$500 million on a total

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debt of \$4.3 billion. Nicaragua's debt service for the coming year will be roughly equal to its projected export earnings of about \$350 million. [redacted]

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Another striking change in Managua's trade pattern was the marked drop in the US market share. According to US trade statistics Nicaraguan sales to the United States decreased from \$214 million in 1980 to \$58 million in 1984. US exports to Managua declined from \$247 million in 1980 to \$110 million in 1984.

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Foreign aid has remained the lone bright spot in Managua's overall financial situation. Since 1982, aid and grants replaced revenues earned from exports as the Sandinista's principal source of import financing. According to our estimates, based largely on US Embassy and press reporting, Managua during 1984 received a total of approximately \$510 million in official loans and grants, including Soviet oil deliveries--50 percent greater than the amount earned through exports. Half of this aid--\$250 million--came from Communist sources. Communist aid agreements do not provide foreign exchange, but are tied to equipment purchases. The Soviet Union, Cuba, and East Germany were the major suppliers. Managua also received about \$250 million in military equipment--largely in the form of grants--from Warsaw Pact countries and Cuba.

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In 1984 and early 1985, several Western nations, including Canada, Denmark, France, Spain, and the UK, agreed to maintain aid levels already promised but declined to increase grants and new low interest project funding. [redacted]

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[redacted] Italy, which was financing the construction of two geothermal plants, increased its commitments because of cost overruns in late 1984 but has insisted that Nicaragua adhere to repayment schedules. [redacted]

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Dealing with US Measures

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Initial Preparations...

While Nicaragua's shifting trade picture has in part been a result of debt and other economic problems, it can also be seen as a calculated effort to shift away from economic reliance on the United States. The Sandinistas' actions indicate they anticipated the imposition of US sanctions and had already taken some preliminary steps in trade, finance and logistics to deal with them. [redacted]

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Trade. As early as last year Managua began looking for new import and export markets in an apparent attempt to reduce US trade connections. For example:

-- [redacted] in late 1984 Managua shipped 600-800 boxes of bananas as a market feeler to the UK and Netherlands, although no plans for future shipments were specified.

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-- [redacted] the Sandinistas had begun negotiating for agricultural equipment, pesticides and herbicides with the USSR, East Germany, and Czechoslovakia.

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We expect that Managua will claim publicly that several trade deals already in progress were in response to US actions. Managua has already claimed, for example, that two Soviet ships that arrived on May 6 with donations

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of diesel oil, tallow, and wheat were in response to the US embargo, but the ships would have had to set sail well before the beginning of May.

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Finance. Managua has also taken a number of steps to enhance its fiscal image in order to secure new credit lines for hard currency imports. Since the end of March, Managua used proceeds from a sale of Algerian crude to make at least \$23 million in overdue payments to key creditors. Specifically:

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-- The central bank also made back payments of \$6.2 million on its rescheduled debt with a group of commercial creditor banks.

-- Nicaragua paid \$2.1 million on its debt to a Libyan-Kuwaiti-Spanish joint venture bank.

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Logistics. Managua did not limit its attention just to trade and financial flows. Before the US actions were taken a number of operational shifts were begun. For example:

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-- Nicaragua's airline, Aeronica, has been studying contingency plans since early April, in anticipation of losing US landing rights. it bought \$100,000 in spare parts in Miami and chartered five cargo flights to transport them.

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-- the airline may also establish service to Merida, Mexico and the Cayman Islands with a direct link to Miami.

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-- Cuba and Nicaragua are also forming a joint venture trading company in Spain.

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...and Subsequent Moves

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[Redacted]

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Immediately after the embargo took effect, Nicaraguan efforts to consolidate and protect their interests in the US intensified. [Redacted]

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Trade and Aid. Managua had hoped that Ortega's trip to the Soviet Union and Europe would open additional trade doors. While Ortega found widespread opposition to the US sanctions, this support apparently translated into only marginal additional economic assistance. Even so, he gained:

- Public assurances from the Soviets that they would help Nicaragua confront US aggression.
- A commitment from East Germany to increase current levels of economic assistance.
- Assurances from West European governments that they would not participate in the embargo and some indications that several might provide Nicaragua with alternate markets for its produce. Sweden told US embassy officials it would probably increase aid. [Redacted]

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[Large Redacted Block]

The Sandinistas have also taken initial steps to define a strategy on how to deal with debt owed in the United States. They have already announced that they will not make payments on their debt to one US pharmaceutical company, and more such repudiations may follow. Currently, they are behind on payment of numerous debts to US companies. Many of these firms have already privately written off the debts, ranging from a few thousand to several million dollars, [Redacted]

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[Redacted]

Logistics. As far as the mechanics of trade and finance are concerned several moves have been made by Managua since 1 May:

- [Redacted] Managua has already begun establishing front companies in Panama.
- [Redacted] the Sandinistas are completing arrangements to purchase two cargo vessels to be used in trade with Eastern Europe. [Redacted]

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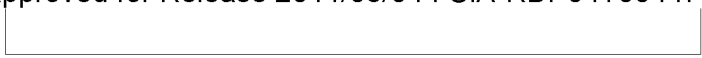
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[Redacted]


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On the Domestic Side


While sanctions will cause Managua numerous economic problems, the Sandinistas are attempting to use the embargo at home to rally popular support for the regime, justify further economic sacrifices, and press the opposition to back their policies, according to the US Embassy and press reports. In the wake of severe consumer shortages caused by hoarding immediately prior to the US announcement, the government warned Nicaraguans in a tough May Day speech that the US embargo would lead to further economic difficulties and listed various steps the population could take to help the country through the crisis, including increases in productivity and decreases in demands for wage hikes. The Sandinistas also warned the opposition to stand with them or risk losing "their place in the ranks of national dignity." 

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Managua has not limited its internal response to words. The regime has also announced some more concrete proposals:


- A few days after the imposition of the sanctions Managua declared that it would increase its controls over the internal distribution of all goods produced in the private sector.
- At the same time the Sandinistas declared that producers would receive partial payment in dollars as an incentive to increase production.
- In addition the regime announced that to obtain spare parts the government would oversee the cannibalizing of all worn out machinery of US manufacture. 

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For their part, the domestic opposition has been generally cautious on the sanctions issue. The politicians have limited their remarks to blaming the embargo on Ortega's trip to Moscow. Private sector representatives have told US Embassy officials that the economy was already in shambles and that the embargo would add only marginally to their problems. 


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The Diplomatic Offensive

With official international sentiment firmly opposed to the sanctions, the Sandinistas moved rapidly on a variety of fronts to put Washington on the defensive and undercut US efforts to isolate Managua economically and politically. Managua labeled the sanctions an act of war and a prelude to military invasion, 

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 In the immediate aftermath of the embargo, Managua also played hard on regional peace themes that were aimed at engendering international support.

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-- The Sandinistas have publicly reiterated their willingness to meet with US officials despite the embargo.

-- They renewed their pledge to send 100 Cuban military advisers home and to consider reducing the Cuban presence further. [redacted]

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Managua has also tried to internationalize the sanctions issue, arguing that the sovereignty of the entire Third World is at stake. The government has presented its case before various international organizations, regardless of their relevance to the embargo issue, such as the UN Security Council and the World Health Organization. [redacted]

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[redacted] The Coordinating Bureau of the Nonaligned Movement has already approved a resolution condemning the sanctions. [redacted]

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In our view, President Ortega has tried to limit the international damage from his ill-timed trip to the Soviet bloc. Indeed, Ortega's decision to extend his trip to include West European capitals was probably a dual effort to offset perceptions of Nicaragua as a Soviet client state and garner additional support from sympathetic governments. [redacted]

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The Sandinistas have been more circumspect, however, in looking for a favorable consensus among their Latin neighbors. Managua has backed away from earlier statements that it would take its case to the OAS. Publicly, it has stated that using the OAS was "inconsistent with its strategy." We agree with other observers that the decision also reflects the regime's recognition that it would be unlikely to gain anything more than a mild anti-US resolution in the OAS. Even so, to shore up their regional support the Sandinistas have sent a high level delegation to key South American countries and have held bilateral meetings with the other Central Americans. [redacted]

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Likely Next Steps

Based on their reactions to date, we expect the Sandinistas to continue to appeal to domestic and international audiences for political and economic support while taking concrete steps to soften the blow of trade sanctions. [redacted]

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On the Economic Side

Regarding exports, Nicaragua has four basic ways to respond to the US-directed cutoff of trade. To offset the direct cost of the embargo, which we estimate could reach \$25 million as export markets are disrupted, Managua could:

- Try to divert previous US purchases to other hard currency markets, such as Western Europe.
- Try to increase its sales to the Soviet bloc, realizing that hard currency payments would be unlikely, but that Nicaragua could use the limited East European markets to make aid repayments in

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goods.

--Ask the Cubans to sell goods through their sales networks.

--Sell to middlemen in neighboring countries who, in turn, would try to sell the items in the United States or elsewhere.

In our view, Managua will operate actively on all these fronts to minimize losses of foreign exchange. [redacted]

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One of the Sandinistas' highest priorities will be to continue their search for new export markets for Nicaraguan commodities displaced by US sanctions--bananas, meat, seafood and tobacco. The first target will probably be sympathetic countries in Western Europe and secondarily Nicaraguan allies in the Soviet bloc who would offer barter options. Indeed, in a press release, Nicaragua's Agriculture Minister announced that his country would now sell its bananas to Belgium and meat to Canada, but this has not been confirmed by either country. In fact Canada has stated it will not increase its quota of any Nicaraguan imports at this time. The EC has only a limited ability to absorb additional agricultural imports, and already has stockpiles of meat. As for tobacco Bulgaria seems a likely target, as that country recently has become increasingly involved in Managua's tobacco industry. [redacted]

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[redacted] just before the embargo, Nicaragua replaced its Cuban tobacco advisors with Bulgarians and also enlisted Soviet aid in building a leaf

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processing plant. Managua will also probably try to sell its goods such as shrimp and spiny lobster, which when packaged are not indentifiably Nicaraguan, to the United States through both witting and unwitting third countries. [redacted]

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On the import side, we expect the Sandinistas to take a two-track approach. First, Managua will continue to press countries opposed to the embargo to make new credit lines available. Although in most cases the government may not obtain any extensive new aid, it will probably receive a few one-time gifts of food or other consumer products. In addition, we expect the Nicaraguan Government to turn to Mexico and other Western nations to obtain many of the spare parts required for the US-made machinery used in Nicaraguan industry. If the embargo continues to exclude international subsidiaries of US companies, Managua will be able to find some parts through these sources. [redacted]

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On both the export and import side Nicaragua may also tap into Cuban-run front companies to increase sales of goods to the United States as well as obtain needed US spare parts--especially those difficult to obtain from other suppliers, such as specialized oil refinery equipment. Havana already has a well-established network of foreign based front companies designed to help evade the US trade embargo as well as earn hard currency, acquire Western technology, provide cover and funding for intelligence operations, and satisfy consumer demand for other Western goods. [redacted]

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Havana has been able over the years to purchase US-origin products including microcomputers, semiconductors, video and photocopier equipment, automobiles, and spare parts, tape recorders, medical supplies, agricultural machinery, tools, construction materials, and clothing. These companies have also sold Cuban products to US buyers who were unaware of the origin of the goods. [Redacted]

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The Sandinistas, of course, will have to deal with more than just a disruption in the flow of goods and money. Although Nicaragua already relies heavily on many industry advisors from Communist and newly industrialized nations, finding satisfactory replacements for the few key US managers in country will be difficult, if their companies choose to withdraw them. Perhaps the greatest problems in this area centers on the oil sector, which was experiencing difficulties well before sanctions were imposed.(1) Nicaragua will probably seek assistance in substituting US managers in its oil industry with Mexican, West European, Cuban, or Iranian teams. [Redacted]

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[Redacted]

Moreover, the Sandinistas had Brazilian and Cuban teams examining the refinery in late 1984. As far as the oil sector is concerned, the sanctions could offer the Mexicans an excuse to move toward reinstatement of normal deliveries, but we believe political and financial considerations will preclude such a development. [Redacted]

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[Redacted]

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On the Political Side

On the international front, Nicaragua will almost certainly continue its diplomatic maneuvering, using a variety of forums to build pressure on the United States to remove the sanctions. The Sandinistas will also try to exploit splits among Western allies in an effort to isolate the US and win economic assistance. The Sandinistas will probably hope to gain from this split, believing that the Europeans' concern about appearing to support the US embargo may inhibit them from pressing the regime on other key issues, especially domestic political liberalization. [redacted]

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At home, the Sandinistas will continue to use the external threat to galvanize popular support and redirect anti-regime sentiments toward the United States. As the effects of the embargo take hold and further erode living standards, the government will increasingly try to use the United States as a scapegoat for its own mismanagement. In our view neither of these strategies is likely to broaden the regime's popular base in the near term. [redacted]

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Further, we expect the regime to continue making conciliatory gestures to internal political opponents. The Sandinistas, however, will move carefully looking for ways to demonstrate flexibility to the international community without appearing to cave in to United States economic pressure. Because gestures represent no real change in government policy, however, the opposition will continue to move cautiously to avoid provoking the government--any public statement would almost certainly have to focus on the implicitly off limits issue of the difficulties posed by the embargo. As a result, opponents will have less maneuvering room to criticize the regime on any issue. For their part, private sector opponents of the regime are unlikely to turn against the United States because of the sanctions, but they may decide to leave Nicaragua if government controls over production and distribution become still more burdensome. [redacted]

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The Medium and Longer Term Outlook

We believe the Sandinistas will have to expend considerably greater energy to cope with the additional strain economic sanctions will place on their already thin managerial pool. Export cutbacks will have to be assessed, alternative markets located, middlemen found, prices and terms arranged, shipping organized, and delivery and export dates coordinated. At the same time, the Sandinistas will have to obtain more foreign loans and make important decisions on the distribution of import reductions. While coping with these direct impacts will be a challenge, dealing with the indirect effects, such as the possible disruption of other exports, will only add a new level of complexity to the situation. [redacted]

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On balance, we judge from the experience of most other embargoed countries that the economic disruptions initially caused will ease as Managua finds avenues around trade sanctions. Given the relatively low level of US-Nicaraguan trade, it is likely that lost US markets, for the most part, will be replaced

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within two to three years. As the Sandinistas continue to redirect the economy away from the United States, they will need fewer embargoed goods. Moreover, any problems in getting spare parts should be eased as US equipment is replaced with machinery from other countries. The transition of course will be smoother and quicker if the Soviets and Bloc allies are willing to increase their assistance still faster to offset Nicaragua's economic losses.

[Redacted]

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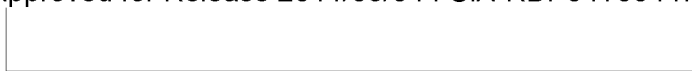
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Text Table: A Snapshot of Select Commodity Exports

Bananas:



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Nicaragua would have to abandon bananas as a crop and grow other vegetable products instead if the US were to ban banana imports. Prior to the embargo, almost all of Nicaragua's banana export crop was sold to the United States, generating a hard currency profit of \$4-8 million per year. Nicaragua had exported about four million boxes a year to the United States at a price of \$6 per box. Estimates place shipping and production costs per box at \$4-\$5, leaving \$1 to \$2 profit per box. If Belgium or another European country agrees to purchase the bananas, Nicaragua will have to pay added shipping costs leading to a reduction in profits. We believe the added shipping costs would be between \$.40 to \$.60 per box and could substantially offset profits, possibly eliminating incentives to produce the crop.

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Meat:

Managua will probably search only for hard currency sales and not for barter arrangements as it looks to markets in Western Europe and also neighboring countries. In 1984 Nicaragua earned \$10 million from beef exports to the United States, and would likely have earned closer to \$20 million if the USDA had not stopped imports during four months for noncompliance with health regulations. Nicaragua's profit margin on meat is much larger than on bananas because transportation and production costs are a smaller percentage of the sales price.

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Seafood:

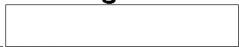
Nicaragua sold nearly \$10 million worth of seafood to the United States in 1984. The Sandinistas are likely to continue searching for hard currency markets for their seafood exports, which are fairly profitable. While seafood exports are subject to transportation costs similar to those of beef and bananas, their production costs are lower. Seafood value per pound is higher making additional shipping costs to Europe less significant, assuming the fish can be kept fresh. Since 1977, Nicaraguan shrimp and lobster production has declined steadily, but their overall values have been rising. Part of the production loss stems from lack of spare parts and petroleum to maintain the fleet. Actual hard currency costs of exporting shrimp will be limited to the transport costs and brokerage fees as long as the Soviets continue to supply Nicaragua with petroleum.

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Tobacco:

It is very likely that Bulgaria will be one of the first alternate markets for Nicaraguan tobacco even though Managua may receive barter goods and not hard currency. Nicaragua's overall sales of tobacco to the US amounted to approximately \$3.5 million in net hard currency earnings in 1984. While the US was Managua's largest tobacco importer, Bulgaria was also an importer, and is becoming more involved in Nicaragua's tobacco production and processing in 1985.

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