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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

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27 October 1982

National Intelligence Council

MEMORANDUM FOR: Deputy Director for Intelligence
 Deputy Director for Operations
 Director, EURA
 Director, OALA
 Director, OEA
 Director, OGI
 Director, NESA
 Director, SOVA
 Chief, PES
 Chairman, National Intelligence Council

FROM: Maurice C. Ernst
 National Intelligence Officer for Economics

SUBJECT: International Financial Issues

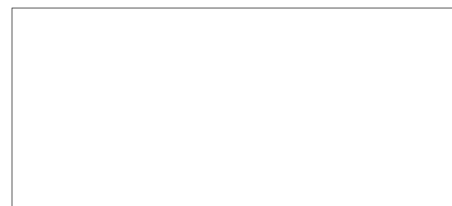
1. International financial and debt problems are likely to get as much attention in 1983 as did energy problems during the 1974 and 1980 oil crises. There is already enormous interest in these problems at the policy level, including the Cabinet and Sub-Cabinet. Policy officials are hungrily grabbing any papers and nuggets of information they can get their hands on and are extremely receptive to any new ideas and analyses. Although the financial issues are of particular concern to OALA, they cut across everyone's interests because of the potential economic and political repercussions.

2. Some of the main characteristics of the international financial problem are:

- o The economies of most LDCs, including particularly Latin America, are being hit hard, as is Eastern Europe.
- o The debt problems have worsened greatly in recent months and things are likely to get even worse next year.
- o There is cause for concern that LDC problems will breed protectionism, bilateralism, and perhaps a borrower's revolt of some sort.

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- o In the latter event, there could be a threat to the stability of the international financial system.
- o LDC debt problems are almost certain to be an important issue in the North-South dialogue, which could get very nasty.
- o And the financial position of some banks is going to be weaker, posing difficult longer-term problems for governments.
- o Although financial problems are unlikely to lead directly to radical left or Communist takeovers in LDCs, they will probably breed anti-US policies of various kinds and increase political tensions in many LDCs.

Issues for 1983 and the Role of CIA

3. CIA's role on international financial issues will involve large parts [redacted]. Although much of the CIA contribution will be country-specific, some issues will be best addressed on a regional or functional basis. Obviously there will have to be a great deal of current monitoring and current intelligence production. I believe that the bi-weekly report "The International Financial Situation Report" that OGI has just begun to publish, will serve an important purpose in bringing together material that would otherwise be widely dispersed or missed altogether. In order to regularly report on and assess related developments, such as changes in LDC trade, policies, or politics, special consideration of this issue might be given in the IEEW. Beyond current monitoring and reporting, there will be a need for various kinds of ad hoc assessments, some of the more important of which are listed below. I do not try to assess their feasibility, given resource constraints and trade-offs [redacted]

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Specific Issues

Mexico

- (1) Continuing assessments of Mexican trade, balance of payments, debt, unemployment, inflation, political maneuvering, and negotiations with the US and the IMF, are much in demand.
- (2) There will also be demands for support of an interagency group which has just been established to develop policies to help the De la Madrid administration. Assessments which could be helpful to this group include:
 - o Mexico's oil and gas production and export possibilities-- equipment, financial and market needs; potential role of the US.

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- o Likely food needs, especially grain, in the next year or two.
 - o Possibilities and prospects for non-oil export markets, including consideration of how US action might facilitate or hinder these exports.
 - o The potential for private direct investment in Mexico--what kinds of measures are required? Are these realistic, given Mexican politics?
- (3) Mexico is trying to negotiate an agreement with the IMF. Once such an agreement is negotiated, there will need to be a careful assessment of the political barriers to implementation and the possible scenarios that may develop. Which are the areas of possible slippage? What would be the consequences if slippage occurs? How divisive will the austerity program be?

Brazil

- (1) Brazil's financial situation is touch and go--a major crisis could develop at any time. The first priority will be to watch this closely.
- (2) There is also a priority need to examine possible economic trends over the next two to three years. The main question is to assess what kinds of policies and international economic trends would be required to put Brazil in a comfortable financial position, the likelihood that this will happen, and the possible consequences if it does not. The assessment should include consideration of:
- o Export prospects--markets for traditional exports; possibilities and policy requirements for new exports.
 - o The potential for import savings--in the energy area, in response to specific policy instruments; as a consequence of lower production.
 - o Alternative possibilities for credit flows and debt services.
- (3) Brazil is a natural leader among LDCs as one of the two largest debtors, a country with a large, diversified economy, and a recent history of moderate, "responsible" policies. We should pay particular attention to political currents that may affect Brazil's policies in dealing with the financial and debt problems. We need to know what and how domestic political pressures and foreign policy objectives may affect these policies.

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Argentina

Apart from current monitoring, the two key questions in Argentina related to financial issues are:

- (1) What would have to be done to get the financial situation under control--rescheduling; an IMF agreement requiring some additional austerity?
- (2) Whether doing these things is politically feasible.

Obviously the answer to the second question depends partly on how difficult the necessary adjustment will be but partly also on the way the balance of political forces evolves.

Other Latin America

Venezuela, Ecuador, Chile, and Peru are having serious financial problems as are most countries in Central America and the Caribbean. The remainder of Latin America also is having difficulty getting credit. Assessments of the economic and political dimensions of the financial problems are needed. The assessments should cover:

- o The nature and dimensions of the financial problem;
- o The economic adjustments likely to be necessary;
- o The political frictions and constraints on such adjustments;
- o And the possible fall-out for domestic and foreign policies.

Africa

A large number of Sub-Sahara African countries have been in dire financial straits for the past two years. Little attention has been paid to them because, apart from Nigeria, all are extremely small and their debt makes up only a minute share of total LDC debt. Nevertheless, debt problems may have serious consequences for the countries themselves, requiring severe economic retrenchment and possibly breeding even more political instability.

It would be very useful to have brief assessments of:

- o The dimensions of the debt problem.
- o The other economic factors (especially export prices) driving the economic situation.
- o The economics and politics of the adjustment process.

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Oil Exporting Countries

The soft oil market has pushed most OPEC countries and other oil exporting countries into large current account deficits and greatly reduced the surplus of the Persian Gulf countries. The financial squeeze has implications in a number of areas, including:

- o The incentive to raise oil out-put;
- o Domestic budgets and economic development;
- o Foreign aid;
- o OPEC cooperation and Saudi policy;
- o US oil policy.

Global

Some issues will need to be examined on a global basis:

- (1) There is a need for improving data bases on international finance. In particular, the existing OGI data base on LDC debt needs to be expanded to include short-term debt. Moreover, because the distinction between OPEC countries and other LDCs is rapidly losing meaning, the data base should include both categories. In addition, it should include the Communist countries.
- (2) There will be a need to assess the global economic impact of LDC and East European debt problems. In order to pay their debts these countries will have to cut imports and reduce economic activity. This will mean lower exports from the industrial countries, which will reduce their economic activity.
- (3) The impact of LDC financial problems and economic adjustments on various aspects of the US economy will be a matter of growing concern.
- (4) Financial and debt issues are certain to be pushed hard by LDCs in various international fora, such as the UN, the World Bank, etc. There will be loud and insistent demands for a restructuring of debt on terms favorable to the borrower. This political process will have to be closely followed and assessed. More generally, it

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will be important to continuously assess any indications of collusion among LDCs in handling debt issues, such as rescheduling.

There are a great many important questions concerning aspects of the international financial system on which CIA has little unique information or expertise, but may be able to make a highly selective contribution,

[Redacted]

These include, for example:

[Redacted]

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