Bailey

THE SECRETARY OF THE TREASURY
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MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
UNITED STATES TRADE REPRESENTATIVE
DIRECTOR OF CENTRAL INTELLIGENCE

SUBJECT SIG-IEP Meeting on Thursday, April 14, at 5:00 p.m.

A meeting of the SIG-IEP is scheduled for Thursday, April 14, at 5:00 p.m., in the Roosevelt Room. The agenda is as follows:

1. Long-Term Grain Agreement; and
2. Debt Issues -- Update on Brazil, Argentina, Mexico, Venezuela, Nigeria, Yugoslavia, and Poland.

Background papers are attached.

Attendance is principal, plus one.

DTR
Donald T. Regan

Attachments

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DCI EXEC REG

SENIOR INTERAGENCY GROUP
April 14, 1983

MEXICO

- o Secretaries Shultz, Regan and Baldrige will be in Mexico on April 18 and 19 for a meeting of the U.S.-Mexico Binational Commission.

  - oo Discussions will include the current Mexican economic situation, future economic prospects, the effect of the drop in oil prices and bilateral trade relations, among other topics.

- o The GOM is interested in a rescheduling of official direct and guaranteed credits to the private Mexican sector. The GOM does not appear to be interested in a rescheduling of public sector debt, but that point will have to be clarified.

  - oo The GOM does not want the rescheduling to take place within the Paris Club. The Mexicans appear to be concerned about the negative domestic political connotations of a Paris Club rescheduling and possible adverse effects on their creditworthiness in private markets.

  - oo The GOM would like to work out a rescheduling arrangement with the USG and then have the USG sell it to other Paris Club creditors. This does not conform to usual USG or Paris Club practices.

  - oo This issue will be under consideration over the next few weeks.

- o On March 3, the Government of Mexico and over 530 commercial banks signed the $5 billion loan for Mexico.

  - oo The first disbursement of $1.7 billion was made on March 24.

- o Now that the $5 billion loan has been signed, the GOM and the banks have turned their attention to the debt restructuring which covers all debt coming due between August 23, 1982 and December 31, 1984 -- about $20 billion.

- o Mexico lowered the price of its oil by an average $2.75 per barrel, retroactive to February 1, 1983.

  - oo At recent average export levels of 1.5 million b/d, Mexico would lose approximately $1.3 billion in oil revenues in the remaining 10 months of the year on top of a loss of about $400 million in February alone from a 600,000 barrels per day decline in oil exports due to the uncertainty over what the Mexican price would be.

  - oo Thus, oil export levels would drop from slightly more than the projected $16 billion to around $15 billion for 1983.

- o External debt totalled $79 billion at end-1982.
  - °° Public sector debt amounted to 70% of the total -- $57 billion -- of which $48 billion was medium and long term and $9 billion short-term.
  - °° BIS bank exposure totalled $64 billion as of end-June 1982, $25 billion of which is U.S. bank exposure.

BRAZIL

- o Brazil received the first $2.5 billion disbursement from the commercial banks and its initial disbursements from the IMF in March and has repaid all outstanding swaps to the U.S. Treasury as well as the first installment on its BIS loan.
- o Brazil's major problem appears to be a failure of needed private capital reflows to materialize on schedule.
  - °° Interbank deposits with Brazilian agency banks are $2 billion below the mid-1982 level while availability of short-term trade finance continues to fall $1.5 billion short of Brazilian expectations.
  - °° Despite a disappointing first quarter trade performance Brazil still has a fairly good chance of meeting its goal of cutting the current account deficit from $14.5 billion to $7 billion in 1983, with a trade surplus of about $6.0 billion.
- o Brazil has again accumulated arrears (about $800 million) because of these problems and plans to meet with major commercial banks in London on April 18 to discuss means of improving financial flows.
  - °° A variety of options are under consideration to recapture the shortfalls in trade credit and interbank deposits.
- o Brazil is implementing its IMF-backed stabilization program and is not in any immediate danger of being out of compliance.
  - °° Brazil still needs to implement additional corrective measures relating to prices, wages, and credit policy.
  - °° Failure to do so will erode monetary and fiscal discipline.

VENEZUELA

- On March 27, the Government of Venezuela (GOV) modified the three-tier exchange rate system to provide coverage of most private sector external debt, including that of multinational corporations, at the preferential rate of Bs 4.3/$1.

- The GOV has deferred until July 1, 1983, payment of principal on financial and nonfinancial public sector short and medium-term external debt.

  - The GOV hopes that by July 1, 1983, the program for refinancing short-term public external debt will be in place.

  - The GOV intends to keep interest payments current.

  - In addition, the GOV intends to pay trade-related debt, on the condition that lines of credit be maintained.

- Negotiations between the GOV and the banks will be arduous.

  - Banks are concerned that Venezuela's oil export earnings are likely to fall at least $2 billion in 1983 to $13.5 billion.

  - However, banks are encouraged by the GOV's recent steps to limit 1983 imports and its decision to expand private sector access to the preferential exchange rate for external debt service.

- Foreign reserves have continued to dwindle, adding greater urgency to successful negotiations with the banks.

  - As of end-March, total Venezuelan reserves were reportedly $12.7 billion, including gold.

- Article IV consultations with the IMF appear to have been completed.

  - Venezuela will probably use its SDR holdings ($427 million) and IMF reserve tranche ($817 million) shortly.

  - Finance Minister Sosa has intimated that Venezuela will seek a stand-by program with the IMF this year.

CHILE

- Treasury has advised the Chileans that the Exchange Stabilization Fund (ESF) credit is not possible at this time as discussed at a recent SIG meeting.

- Chile is seeking financing from the CCC and the EXIM Bank.

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- o The GOC announced an emergency economic program on March 22 to arrest the continuing decline of GDP, stabilize the private sector's financial position, improve the public sector's fiscal position, and enhance Chile's international competitiveness.

- o Chile's relations with the commercial banks have improved and progress is being made in negotiations concerning refinancing maturing 1983 and 1984 obligations and provision of $1.47 billion in new money.

  - oo The principal factor responsible for the renewed momentum was the GOC's decision to make $50 million in lines of credit available to private companies to enable them to avoid bankruptcy proceedings and regain the confidence of external creditors.

  - oo Chile's $1.47 billion request for new money includes $560 million to offset the run-off of short-term trade and financial credits which occurred in the first quarter, as well as medium-term amortization payments made in January.

PERU

- o Treasury has advised the Peruvians that ESF credit is not possible at this time as discussed at a recent SIG meeting.

- o Peru is seeking financing from the CCC and the EXIM Bank.

- o The GOP's talks with commercial banks appear to be proceeding well.

  - oo Peru's good relations with the IMF are a principal factor in banks' general receptivity to Peru's request for the $900 million financing package.

ARGENTINA

- o The GOA is in serious danger of being out of compliance with its IMF program by mid-year.

  - oo Argentina has now adopted a system of "voluntary" price controls which includes subsidized credit to firms that agree to submit to government guidelines.

- o These Argentine measures promise to undercut the fiscal and monetary discipline required under the GOA's agreement with the IMF.

- o Argentina's recent actions could jeopardize its negotiations for a $1.5 billion medium-term loan agreement with commercial banks and could undercut efforts to reschedule maturing obligations.

NIGERIA

o Nigeria's economic and financial situation continues to be extremely precarious, despite some rebound of oil production following mid-February price cuts.

o Nigeria still has not made fundamental policy adjustments, preferring to tighten administrative restrictions on imports and foreign exchange.

  °° Import levels evidently have adjusted to about $900 million per month, the amount of foreign exchange being disbursed monthly by the Central Bank. Underlying import demand continues to be quite high, probably at least $1.2 billion per month.

  °° On the basis of current trends, the 1983 current account deficit would be about $5 billion. However, new financing is unlikely to exceed $2-3 billion.

o External debt is estimated at about $14.5 billion at the end of 1982, including up to $6 billion in short-term trade credits in arrears.

  °° BIS-bank exposure was about $6.7 billion as of end-June, of which $1.3 billion was U.S. bank exposure and $1.5 billion was U.K. bank exposure.

o The Government is seeking $1-2 billion from commercial banks for balance of payments support -- partly to refinance short-term arrears.

  °° U.S. bankers have agreed among themselves not to respond until Nigeria moved closer to an agreement with the IMF. European and U.S. bankers were to meet in London on April 11 to discuss Nigeria. No reports are available yet.

  °° Most bankers are disappointed with the Lehman/Lazard/Warburg financial advisors report issued in mid-March. Most do not feel that it represents an honest acknowledgement of the depth of Nigeria's current problems.

o An IMF team is in Lagos now, but there is no evidence that serious negotiations have started. President Shagari again in March publicly ruled out a devaluation, generally considered to be an essential component of a credible stabilization program.

o Key Nigerian officials have hinted that they would like U.S. financial assistance, such as was given to Mexico and Brazil.

o State has formulated a proposal for SIG consideration involving substantial USG financing. An initial $200 million in CCC blended credits would be offered immediately.

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YUGOSLAVIA

- Yugoslavia ended last year with an immediate cash flow problem. It had a large current account deficit for 1982, foreign exchange reserves equal to less than one month's imports, and strong inflationary pressures. Thus, it entered this year with the need to finance its large deficit, roll over its short-term debt, and meet existing amortization payments -- without enough resources to do so.

- Over the past few months, a five-part package has been assembled with the following major elements:

  - assistance from commercial banks consisting of an extension of principal payments, rolling over of medium and long-term loans, and new loans;

  - an IMF standby program;

  - BIS short-term credits;

  - credits from governments; and

  - an IBRD structural adjustment loan. The IMF and other creditors are stressing the need for economic structural and policy changes in Yugoslavia.

- There are some points in the government and bank packages that need to be clarified before the entire package can be concluded. A meeting in Europe is being arranged.

POLAND

- When martial law was imposed in 1981, credit from the West and talks on rescheduling 1982 debts were terminated. As a result, in 1982 Poland's economic activity continued to decline. There was a shortage of imports needed for production for domestic use or export and Western creditors were not paid or only partially paid.

- The Polish financial situation is not expected to change significantly in 1983.

  - Poland is forecast to earn about $1 million net on its trade and invisible account (excluding interest), while facing payment obligations of $14.8 billion.

  - Commercial banks rescheduled the Poles' 1982 debt late in the year and hope to conclude a rescheduling agreement on 1983 maturities, which could preempt the bulk of Poland's hard currency earnings -- leaving little for other creditors.

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- o Creditor solidarity on not re-entering into debt rescheduling discussion with Poland is beginning to show some signs of strain.

  - oo The E.C. Political Ministers, who heretofore have supported our position of "no discussions" indicated agreement with their finance ministers who want to try and recapture some portion of the money owed them through rescheduling.

- o At the April 12 meeting of the Paris Club, the Polish debt situation was reviewed. A working group to evaluate the 1981 rescheduling and the status of information on the Polish economy will be formed. The working group will report to the Paris Club in May.

ISSUE PAPER

U.S.-USSR Grains Agreement

Issue

The current U.S.-USSR Grains Agreement will expire on September 30, 1983. The Soviets claim that they are not interested in further 1-year extensions. They have told us that trade expansion is best facilitated by long-term obligations and are ready to negotiate a new long-term agreement with us. Both sides have indicated a desire to work toward expansion of our grain trade. The Administration must decide soon whether to initiate talks on a new LTA. This is a politically sensitive domestic issue with important foreign policy implications.

Options

Option 1: Allow the existing U.S.-USSR Grains Agreement to expire without providing for any formal agricultural trading agreement between the two countries after September 30, 1983.

Advantages:

- Would be consistent with the President's Poland-related sanctions postponing negotiations on a new long-term grain agreement.

- Could appeal to some as an Administration attempt to reduce government intervention in the international marketing of U.S. agricultural products.

- Would remove special supply assurance provided by the Agreement. (However, trade would still be subject to contract sanctity for 270-day period.)

Disadvantages:

- Would lead to a lower level of U.S. grain exports, and could virtually eliminate U.S. wheat exports to the USSR, increasing the likelihood of mandatory U.S. production controls in future years. Since Soviets orient purchases towards those with whom they have long-term commitments, the U.S. would be a supplier of last resort and competing countries would be greatly encouraged to increase their production still further.

- Could lead to disruption of the U.S. grain market if the Soviets were to resume their erratic purchasing behavior of the early 1970's.

- U.S. farmers would view lack of an agreement as significantly reducing their grain marketing opportunities in the Soviet Union and as undermining the President's commitment to help increase agricultural exports. This could strengthen Congressional efforts to force renegotiation of the agreement.

- Would eliminate one of the few remaining formal U.S.-USSR ties.

Option 2: <u>Begin negotiations on a new LTA as soon as possible</u>.

<u>Advantages</u>:

- Represents our best single hope for increasing the level of our total grain exports and for reducing the pressure for the imposition of mandatory U.S. production controls.

- Although we generally do not favor LTA's, given Soviet planning and purchasing practices, an LTA is necessary if the U.S. is to maximize its grain exports to the USSR; it is necessary if the U.S. is to have access to the Soviet market equal to that of other exporters with whom the Soviets have LTA's.

- Our postponement of negotiations has not prevented any other suppliers from entering into new or expanded LTA's with the Soviets.

- With a U.S.-USSR LTA, competitors would no longer have the strong advantage of a preferred position in that market and would have less incentive to increase production. The farm community is convinced that a new LTA would encourage the Soviets to expand their livestock and poultry industries, and thus would tend to create greater USSR reliance on the U.S. as a supplier.

- Would be enthusiastically welcomed by the agricultural sector and their Congressional supporters.

<u>Disadvantages</u>:

- Would constitute a lifting of Poland-related sanction postponing negotiations of a new grains agreement and increase pressure for the lifting of other sanctions.

- Comes at a sensitive time in our efforts to develop a stronger allied consensus on East-West trade.

- Could open U.S. to charges from the Allies that we are advancing our own economic interests while seeking to curtail theirs.

Option 3: Seek extension of the existing agreement.

Advantages

- Would be consistent with the President's Poland-related sanctions postponing negotiations on a new long-term grain agreement.

- An extension would maintain the framework for U.S.-USSR grain trade and might result in thier purchases from the U.S. than under the no agreement option.

- Would provide less ground for criticism by the Allies than renegotiation.

Disadvantages

- The Soviets claim they do not want a 1-year extension. (A multiyear extension would probably require negotiations.)

- Even if the Soviets agreed to an extension, they would probably seek to keep purchases from the U.S. at the minimum required by the agreement.

- The U.S. would forego the possibility of increasing minimum purchase levels in a new agreement.

- A mere extension would be deeply disappointing to the U.S. agricultural sector and its Congressional supporters and would simply postpone the issue.

Discussion

U.S.-USSR Grain Agreement in the Context of the World Grain Market. It is quite likely that a long-term grain agreement between the Soviet Union and the United States would have an effect on the total volume of world grain trade, and the proportion supplied by the U.S. in future years, and perhaps even in the current marketing year. Initiation of LTA talks alone would be an important positive signal and could lead to significantly larger purchases of U.S. corn for shipment in the remaining months of the current LTA. Soviet buying in the past has frequently been signal-oriented.

The Soviets do not look upon a one-year extension as a long-term commitment, and have preferred to import increasing amounts from those countries with whom they have LTAs. Moreover, since those countries do not have the feed grain

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availability that the U.S. does, the Soviets have tended to limit the expansion of their livestock industry (meat consumption has been fairly stagnant for the past five years or so) and draw upon their somewhat meager grain reserves. They have clearly stated that they would like to expand livestock production and reserves and that an LTA with the U.S. would facilitate an expansion of our trade. If, by failing to negotiate a long-term agreement, the Soviets were further discouraged from satisfying their import demands in the U.S. market, they would continue to seek alternative sources of supply. The prospect of servicing a consistently large buyer, such as the Soviet Union, would prompt other exporting countries to further increase their production while the U.S. is cutting back. (Since the 1980 Soviet grain embargo, Canada has increased its grain production by more than 50 percent while Argentina has increased its production by more than 30 percent.) This increased production would reduce the U.S. share of the growth in global grain trade.

The Soviets do not regard the existing 270-day contract sanctity provision as adequate since their economic plans run five years in length. With erratic grain crops, they seek assurance far into the future that grain supplies will be available for them to expand their livestock herds and meet their domestic consumption targets. Hence, the importance they place on LTAs.

While LTAs are normally counter to the Administration's philosophy of government non-interference and the market, it is generally accepted that an LTA with the Soviets is desirable from an economic point of view. The Soviets are planners who need to work with long-term commitments, and their market has a critical bearing on U.S. export expansion and domestic policy. An LTA also provides for an exchange of information with a country that publishes very little otherwise, and it reduces Soviet capability for disrupting the market.

<u>U.S. Foreign Policy Considerations.</u> The U.S. views trade with the Soviet Union in the context of our overall bilateral relationship. In recent years, these relations have been soured by the continuing Soviet military buildup, Soviet behavior on regional issues (such as Afghanistan and Poland) and bilateral concerns (such as human rights). As a result of Soviet involvement in the imposition of martial law in Poland, the President in December 1981 implemented a sanction postponing renegotiation of a new LTA. However, the U.S. proposed extension of the agreement for 1 year, to which the Soviets agreed, making it possible to maintain the formal framework for the grains trade, and offered access to 23 million tons of grain in the current agreement year. This was consistent with the policy of supporting non-strategic mutually beneficial trade with the USSR, while opposing

subsidized trade and trade which contributes to the Soviet military buildup.

Negotiation of a new LTA with the Soviets would constitute a lifting of this Poland-related sanction and increase pressures for the lifting of other sanctions. It would also come at a sensitive time in our effort to complete the various East-West trade studies with our Allies in order to develop a stronger consensus between now and the Williamsburg Summit.

Although the Allies have not refrained from entering LTA's with, or expanding grain sales to the USSR, we would still face the charge that we are pursuing the advancement of our own economic interest in agricultural trade while seeking restraint to their industrial and energy trade.

U.S. Domestic Considerations. The LTA is the most politically sensitive issue in the agricultural sector and the one which has drawn most criticism of the Administration from farm groups. There are strong Congressional pressures for a new LTA. Failure to begin negotiations could result in a serious confrontation with Congress over the issue.

The U.S. farm sector is experiencing serious economic hardships due to over-abundant grain supplies, high interest rates, and a cost/price squeeze. In fact, despite the U.S. preference to expand exports, the situation has become so dire as to necessitate dramatic domestic action to cut production through the payment-in-kind (PIK) program. Further measures might be necessary in the near future if U.S. exports do not resume growth and other exporting countries increase their production even more. Our trade with the Soviet Union could be an important factor in determining what these policy decisions will be.

USDA believes that an increase in U.S. agricultural exports to the East Bloc alone might be enough to make the difference between chronic surplus and a healthy farm economy in the U.S. in the years ahead. If our yearly Soviet trade had continued to grow from the 15 million ton pre-embargo level rather than fall to the 6 million tons expected this year, we would have achieved record grain exports and might not have needed production cutbacks.

All of our domestic support programs entail substantial budget outlays and lead to increased government interference in agriculture. The negotiation of a new long-term U.S.-USSR grain agreement is virtually the only cost-free, market-oriented step the Administration can take to help the farm community. It is also consistent with the central feature of the Administration's farm policy -- increasing agricultural exports.

U.S.-SOVIET GRAIN TRADE 1973-1982

	Total USSR Grain Imports (mmt)	US Grain Exports to USSR (mmt)	US Share of Total USSR Grain Imports (%)
FY 1973	22.5	14.1	63
FY 1974	5.7	4.5	79
FY 1975	7.7	3.2	42
FY 1976	25.6	14.9	58
FY 1977	8.4	6.1	73
FY 1978	22.5	14.6	65
FY 1979	19.6	15.3	78
FY 1980	27.0	8.3	31
FY 1981	39.0	9.5	24
FY 1982	39.0	13.9	36
FY 1983 (projected)	34.0	7.0	21