

TRANSMITTAL SLIP		DATE	28 Mar 83
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TO: <input type="text"/>			
ROOM NO.	BUILDING		
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REMARKS:			
<p>Comments, please, ASAP</p> <p>2.</p>			
FROM: Harry Rowen, C/NIC			
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MESSAGE NO. 457 CLASSIFICATION CONFIDENTIAL No. Pages 5

FROM: Paul McGonagle EB/IPD/OMA 632-0633 4830
(Officer name) (Office symbol) (Extension) (Room number)

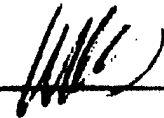
MESSAGE DESCRIPTION Paper on the International Debt Problem - Political
and Security Considerations

<u>TO: (Agency)</u>	<u>DELIVER TO:</u>	<u>Extension</u>	<u>Room No.</u>
<u>CIA</u>	<u>Harry Rowen</u>	<div style="border: 1px solid black; width: 100px; height: 20px;"></div>	<u>7E62</u>

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FOR: CLEARANCE INFORMATION PER REQUEST COMMENT

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S/S Officer: 

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International Debt Problem
Political and Security Considerations

The adjustment effort required of the LDCs is placing an unavoidable strain on their political systems with implications for many of our foreign policy objectives, including matters of regional peace and security, North-South economic relations and cooperation with our European allies.

Regional Peace and Security

Of particular concern is the danger that the pressures on the political/economic systems of key countries could spark changes in governments, changes in policies, and/or changes in a country's ability to influence events. To the extent these countries are unable to resolve their problems, or find the solutions excessively painful, or perceive that the industrialized nations are unable or unwilling to provide needed resources, they may begin to look for alternative sources of assistance and lose interest in courting the West with moderate policies.

For instance, in the Middle East, Egypt and Sudan are key to the peace process. Sudan, by almost all measures one of the world's most indebted economies, will continue to face tough economic conditions for the foreseeable future and radical states such as Libya will be looking for opportunities to take advantage of those difficulties to overthrow the present pro-Western regime.

In Egypt, an even more critical country, the economic difficulties are not so imminent. Nevertheless, unless the Egyptian government takes strong remedial action, Egypt is likely to undergo severe balance of payments difficulties including eventual debt service problems in the next few years. A great deal of Egypt's difficulties comes from price controls and subsidized foodstuffs and so far the Mubarak regime has been unwilling or unable to take corrective action for fear of public unrest or even violence. Rather than undertaking the necessary reforms, we expect the Egyptians to request further U.S. assistance. That assistance will become more expensive every year, however, and should we be unable or unwilling to respond to their demands, the GOE will either look for additional resources elsewhere or undertake politically difficult and possibly destabilizing reforms. Either way, Egypt's economic difficulties are going to make its participation in the peace process more expensive and possibly more unpredictable.

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In the Caribbean and Central America, U.S. and Venezuelan foreign policy has coincided in recent years. The Venezuelan-Mexican oil facility and other Venezuela aid has provided many countries of the region with much needed balance of payments support. The GOV has supported the move towards a democratic government in Salvador, while attempting to moderate the Sandinista regime in Nicaragua. While Venezuela's current economic debt problems probably do not affect that country's stability -- at least in the short run -- it will limit the resources available to Venezuela to continue to play its positive role in the region.

In Africa, Nigeria has been a strong supporter of the peaceful resolution of disputes and an important barrier to Libyan efforts to further radicalize the region. It has also been supportive, though not uncritical, of our effort to conduct negotiations over Namibia. Nigeria's balance of payments difficulties are severe, however, and have been further complicated by the drop in oil prices. A decrease in Nigeria's economic growth rate or even a possible fall in its level of income could prove destabilizing and threaten both Nigeria's struggling democratic process as well as the country's unity. A new civil conflict in Nigeria could affect its oil production. More importantly, it would likely have a high human cost and stimulate separatist movements throughout Africa. Nigeria will be looking for Western assistance in meeting its economic needs. If the Nigerians perceive that we have not responded adequately, their moderate stance in the region could eventually be affected.

North-South Economic Relations

As long as their balance of payments positions remain precarious, many of the LDCs are going to look for solutions to their problems through changes in the International Economic System. Pressures from the LDCs for greater concessions by the industrial nations on North-South issues are likely to increase. We can, for example, expect increased strident demands in UNCTAD for new and more generous commodity arrangements. We may also see increased demands for a debt moratorium perhaps unilaterally declared by the LDCs. While enthusiasm for such a moratorium is not yet readily apparent among the major LDC debtor nations it could become so if the current debt strategy does not lead to rapid resolution of their problems. It would be more likely, for example, if several large Latin American LDCs -- Mexico, Argentina, Chile or maybe Brazil or Venezuela -- had a succession of fall-offs from IMF programs. There is already some agitation for this move among smaller debtor nations such as Bolivia and Nicaragua.

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There are also likely to be residual long-term consequences of the current debt situation. The populace of countries such as Argentina and Mexico may now blame their own governments for mismanagement of their economies but as time goes on they are very likely to redirect the blame toward the West in general and the United States in particular. Unfortunately, other than being careful not to make it worse by either moralizing or being condescending there is very little we can do to stop this process.

Bilateral Problems and Instability in Key Countries

Not all the consequences of the current situation will appear in either a regional or multilateral framework. Many will be country specific. We will continue to receive many requests for assistance and with a limited resource capability to respond to those requests we are likely to see increasing and often unpredictable strains in bilateral relationships. Should the Philippine economic situation worsen, or even if it should fail to improve, we may see additional requests for higher fees for our military base rentals. In Liberia -- with severe its debt burden -- we may see similar requests against our extensive communications facilities. These problems will become especially tense if other nations perceive that we could help them further if we so wished. The Nigerians have already pointed out the generous assistance we have given Mexico and wondered why we have not done the same for them. More generally, our response to various debt crises will make explicit the implicit rank-ordering of countries on the scale of their political importance to the U.S., a problem which might be attenuated if the Europeans will take the lead in some countries such as Nigeria.

Critics of the IMP often argue that the adjustment programs imposed on borrowing countries often place a severe strain on their internal political systems. Unfortunately, while the criticisms are correct they are misdirected, since sooner or later these countries will be forced by economic circumstance to take corrective action and the longer action is postponed, the greater the eventual strains. Nevertheless, in countries such as Nigeria and Egypt, the possibility of the economic strains eventually producing widespread internal disorder cannot be ignored.

In Argentina, that nation's current economic difficulties could help elect a populist/nationalist government from one of the Peronist factions when elections take place. Likely continued economic instability will make it difficult for any democratic government to govern Argentina and may encourage the early return of military rule.

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It is generally believed that the Argentine military's desire to divert public attention from internal difficulties -- both political and economic -- was a contributing factor to the Argentine decision to invade the Falklands. Similar actions by Venezuelan against Guyana or new Argentine moves, perhaps this time against Chile, cannot be ruled out.

Cooperation with Western and Japanese Allies

In the short-term, most of the heavily indebted LDCs require financial assistance from both individual nations and from multilateral organizations such as the IMF and the BIS as well as debt rescheduling in the Paris Club. In the long-term they will find solutions to their problems only in so far as they increase their exports; for which they will need a congenial world environment willing to buy their products. While the U.S. can help these countries their problems in general are so enormous that significant remedial action will require assistance from our allies. To date, cooperation has been quite good. Most of the heavily indebted nations have undergone or are undergoing multilateral public and private debt rescheduling. Most have adopted IMF programs with support from the major Western nations and in several cases the Bank for International Settlements has also provided bridging loans often accompanied by swap agreements with the U.S. Treasury or Federal Reserve.

In the meantime, the IMF Interim Committee has agreed to an increase in the IMF quotas and the G-10 (now G-11 with Switzerland) has agreed to increase the resources available for the General Arrangements to Borrow. While such cooperation will likely continue, danger areas remain. Protectionism, which so far most major industrial nations have successfully avoided, may become increasingly difficult for individual countries to resist if the expected recovery does materialize or is short lived. Competitive devaluations such as that recently taken by Sweden could also become a problem. Such actions will not only hurt the industrialized nations but also threaten the recovery of the heavily indebted LDCs. These problems will likely be the subject of discussion at such forums as the Williamsburg Summit and the GATT.

It will also be important for the Western nations to develop a coordinated stance on the North-South issues to be discussed at the next UNCTAD meeting. If we are to successfully deflect initiatives for such ill-conceived ideas as a debt moratorium, we will have to make a convincing argument that we have made a major effort to help the debtor countries in the Paris Club, the IMF and GATT and that such efforts will deal adequately with the problem.

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Perhaps the most important contribution the Western industrialized nations could make to the LDCs is encouraging a worldwide economic recovery. Proposals to better coordinate domestic economic policies will also be the subject of the Williamsburg Summit and other forums.

The successful Western assistance effort for Yugoslavia is an example of effective collaboration among Western governments, central banks/BIS, the private banks and the IMF/IBRD to shore up a debt-ridden economy, thereby protecting vital Western political and strategic interests.

As the Yugoslav financial situation deteriorated in 1982, the post-Tito political leadership turned increasingly to the West, especially the U.S., for assistance. The USG initiated the multilateral "Friends of Yugoslavia" consultations which resulted, in January 1983, in an agreement by 14 concerned governments to provide \$1.3 billion of economic assistance. This assistance was designed to help Yugoslavia avoid a politically damaging rescheduling in 1983. In addition central banks and the BIS have committed \$500 million in bridge financing to help the GOY meet its immediate financial obligations during the seasonally weak first semester of 1983. The government economic assistance and bridge financing, as well as IMF disbursements under the Yugoslav stabilization program are conditioned on an agreement between the GOY and its private bank creditors to refinance \$1.4 billion in 1983 maturities and provide \$600 million in new loans. Indeed all elements of the Yugoslav assistance effort are interdependent and necessary for the package to fly. It is hoped that the combination of Western capital and real resources inflows will provide the GOY the financial cushion needed to pursue difficult economic reforms in a climate of political stability and independence. The IMF mandated reforms should push Yugoslavia further in the direction of a market-oriented economy and help strengthen trade/financial and political ties with Western countries and multilateral institutions.