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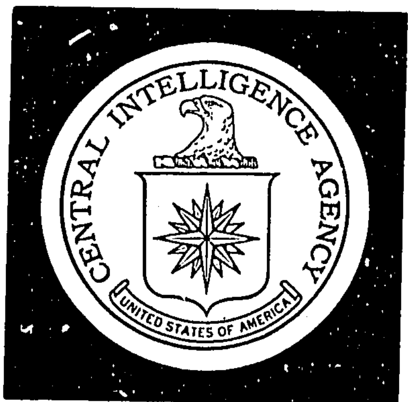

DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

International Finance Series No. 30

Less Developed Countries: Initial Reaction To The New US Economic Policy

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ER IM 71-186
September 1971

Copy No. 91

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
September 1971

INTELLIGENCE MEMORANDUM

LESS DEVELOPED COUNTRIES: INITIAL REACTION TO THE NEW US ECONOMIC POLICY

Introduction

1. When President Nixon announced the new US economic policy on 15 August, the less developed countries (LDCs)* responded with a mixture of understanding and relief that long-needed action is now being taken, fear of the consequences of this action for their own economies, and anger at what they consider the injustice of having to pay for a rich-nation crisis not of their making. The health of the US economy and the dollar is of paramount importance in a major part of the less developed world. Most of the LDCs have formally or informally pegged their currencies to the dollar. Large shares of their reserves – 70% in the case of Latin America – are held in the form of foreign exchange, mainly dollars. Many rely heavily on the United States for imports, and US demand in turn significantly affects the size of their exports and trade deficits. Finally, US capital – both official and private – is crucial to their development programs, as it has been throughout the postwar period.

2. Although the LDCs will suffer from the 10% cut in foreign aid (except for Latin America) and the depreciation of their foreign exchange reserves held in dollars, their most vocal criticism has centered around the 10% import surcharge. This memorandum discusses the major points of concern to the LDCs and describes their initial responses to various aspects of the new economic policy.

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* *In this memorandum, the term* **less developed countries** *refers only to Free World countries and, in accordance with the definition followed by the Economic Intelligence Committee of the US Intelligence Board, embraces all countries in Africa (except South Africa), the Near East, South Asia, the Far East (except Japan), and Latin America, together with Greece, Portugal, Spain, and Turkey.*

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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Discussion

Latin America as Leader of the Opposition

3. Except for Latin America, official LDC reaction to the new US economic policy so far has been low keyed. Only a few protests have been made, and all these have emanated from individual countries. Latin American criticism, on the other hand, has been highly vocal. Moreover, these countries have taken the lead in trying to unify opposition to the US moves and gain full participation for the LDCs in all consultations and negotiations concerning reform of the international monetary system. Latin American nations in fact seem to be gaining considerable satisfaction from the progress made in taking coordinated action to oppose the US program. The Latin American Manifesto of 5 September that resulted from the emergency session of CECLA (Special Coordinating Commission for Latin America) has provided the basis for a unified LDC position both at the annual session of the Inter-American Economic and Social Council which began meeting in Panama on 13 September and in current plenary sessions of the UN Conference on Trade and Development.

4. Latin America's position on major issues on which it is attempting to gain LDC consensus is as follows:

- The United States should completely exempt Latin America and other LDCs from the import surcharge.
- The United States should promptly extend general trade preferences to LDCs, with special consideration given to Latin American exports.
- The foreign aid cutback, while not contributing significantly to solution of US balance-of-payments problems, aggravates already serious problems confronted by the LDCs and compromises completion of ongoing development programs.
- Because the present world monetary situation intensifies economic difficulties in many LDCs, developed nations and international financial organizations should facilitate debt refinancing and soften assistance terms.
- Suspension of gold convertibility of the dollar has adversely affected the value of monetary reserves and the foundations for international trade and capital movements.

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- The International Monetary Fund is partly to blame for the present world monetary uncertainty in that it has been unable to force developed nations to take necessary measures to correct their fundamental disequilibria and has therefore allowed discrimination in treatment between developed nations and LDCs.

- The LDCs should participate fully in the present and future decision-making mechanism and in the reform of the international monetary system.

Current Exchange Rate Situation

5. With the dollar floating, the various LDCs have been forced to decide whether to allow their currencies to move with the dollar, to maintain parity with some other hard currency, or to use the occasion as an opportunity to devalue relative to the dollar as well as other currencies. The great majority of the LDCs have chosen the first course and probably will continue to follow it. By maintaining parity with the floating dollar, their exports suffer no exchange-rate disadvantage in the United States (in many cases, their most important market) and reap the same advantages as US goods in third-country markets. The second course appeals to some countries that export goods for which world demand is relatively inelastic and whose imports are predominantly from the United States. Ex-colonies with close monetary ties with France, the United Kingdom, or the Netherlands also are attracted to this course, but the trade disadvantages attending revaluation create strong counterpressures to float with the dollar. The third course is appropriate for those countries suffering persistent balance-of-payments problems before the dollar float, but political opposition to devaluation may be so strong in some, such as Uruguay, as to prohibit taking advantage of even present circumstances to put their badly overvalued currencies in order.

6. The Far Eastern nations have reacted variously to the dollar float: Taiwan, South Korea, and the Philippines maintained parity with the dollar; Malaysia, Singapore, and Hong Kong are allowing their currencies to float along with the British pound; and Indonesia devalued its currency by almost 10% relative to the dollar for reasons essentially unrelated to the new economic policies. In the South Asian area, India, Thailand, and Ceylon have announced that they would maintain parity with the dollar, while Pakistan permitted its official rate to float upward slightly after an eight-day closure of its currency exchanges. Burma has made no announcement but is maintaining its previous parity with the dollar, as is the case with Cambodia, Laos, and South Vietnam. The currencies of Afghanistan and Nepal, being closely tied to those of Pakistan and India, respectively, are expected to behave accordingly.

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7. In the Near East and North Africa, most currencies have remained pegged to the dollar. Israel, however, has devalued its pound by 17% -- an action that had long been contemplated to help rectify chronic balance-of-payments deficits and that probably still leaves the pound overvalued. Algeria remains pegged to the French franc and Jordan to the British pound, while Lebanon continues its standing practice of allowing its currency to float. Libya, which is paid its oil revenues in dinars, has revalued its currency slightly upward, but Saudi Arabia, other Arab oil producers, and Iran are continuing to maintain parity with the dollar. The oil-producing states, however, may demand some readjustment of contracts with the companies, depending upon final resolution of international monetary relationships.

8. Among sub-Saharan African countries, Botswana, Lesotho, Swaziland, Congo (K), Rwanda, and Burundi are maintaining parity with the dollar, while Kenya and Uganda remain pegged to the pound. Nigeria has established a two-market system with an "official" market handling all merchandise trade and associated service transactions, while a "financial" market handles capital transactions and tourist exchange. The "official" rate is regulated to correspond to the dollar-sterling rate in London, and the "financial" rate is allowed to float. A two-tier system identical to that of France has been adopted by the 14 African countries within the franc zone. Tanzania, Somalia, Gambia, Angola, and Mozambique are reported to have revalued their currencies with respect to the dollar.

9. Most Latin American nations thus far have chosen to maintain parity with the dollar. Some governments are considering using the current international monetary confusion as a politically opportune time for major devaluation. As a means of offsetting the expected reduction in the purchasing power of dollars received from oil sales, the Venezuelan government is weighing the alternatives of increasing oil prices or revising the special exchange rate at which oil companies must convert dollars to bolivares to cover taxes and local costs. A few Caribbean islands with close relations with France, the Netherlands, or the United Kingdom (and semi-independent nations such as Surinam, French Guiana, and British Honduras) are maintaining parity with European currencies. The Jamaican dollar, however, was untied from its legislated sterling par value on 24 August, and the groundwork has been laid for not following the British pound should it revalue substantially.

10. Among the less developed countries of Europe, Greece and Turkey remain pegged to the dollar. Spain and Portugal are nominally maintaining the par values of their currencies but are allowing the exchange rate to move beyond the margins agreed upon with the International Monetary Fund. Both currencies have undergone a slight upward revaluation.

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Repercussions of the Import Surcharge

11. In its role of self-proclaimed spokesman for the developing world, Latin America has depicted LDC inclusion under the 10% import surcharge as perhaps the most hotly resented feature of the new US policy. Although the surcharge was aimed mainly at Japan and Western industrial nations, its effects in fact fall most heavily on Mexico, South Korea, Taiwan, Hong Kong, and Haiti -- all in the less developed category (see the table). Latin American nations point out that their trade deficit with the United States has more than doubled and that of the LDCs as a group has increased substantially in the last five years – a period when the developed nations either reduced their deficits or created surpluses in their US trade. Only about 6% of total LDC exports will be affected by the import surcharge, but an average of some 31% of their sales to the US market is included. Even in those countries where the overall impact on sales to the United States is small, the negative effects on industrialization and export diversification efforts can be significant because the surcharge falls mainly on manufactured and otherwise processed goods. In some countries, like Brazil, these industries have shown the greatest dynamism in recent years and in other countries, like Argentina, they were expected to be helped the most under long-discussed generalized trade preferences for the LDCs.

12. Only about 23% of Latin American sales to the United States and 8% of the region's total exports come under the surcharge, because export goods such as coffee, sugar, and petroleum are exempt under quota arrangements and others such as mineral ores are not dutiable. In general, however, Latin American countries are incensed by the surcharge as a betrayal of their "special relationship" with the United States and, in particular, by expected negative effects on their diversification efforts. Moreover, Argentina views the surcharge as discriminatory in that fresh beef exports shipped under quota from competitors such as Australia, New Zealand, and Canada will not be affected, while its canned and preserved meats may become non-competitive in the US market because of the surcharge (Argentine fresh beef is denied US entry on sanitary grounds). Mexico, with 43% of its total exports affected, is the hardest hit of all countries in the world and has already moved to offset the surcharge by increasing subsidies and reducing export duties on some of the affected goods. Brazil also has provided various new tax advantages to its exporters of non-traditional products. Convoked by Argentina, the emergency meeting of CECLA brought forth a demand for exemption from the surcharge for all LDCs and a decision to carry the case to the UN, OAS, GATT, and other international bodies. Many Latin American governments also have itemized their specific complaints in bilateral communications with Washington.

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Countries Most Affected by the Import Surcharge
(Based on 1970 Trade Data)

	Percent of Exports to US Affected	Percent of Total Exports Affected
Less developed countries		
Total	*31*	*6*
Mexico	50	43
South Korea	95	41
Taiwan	92	35
Hong Kong	82	31
Haiti	35	30
Philippines	35	16
Israel	83	16
Barbados	70	15
Turkey	86	12
Spain	73	11
Paraguay	62	11
Greece	88	8
Portugal	80	8
Honduras	14	8
Dominican Republic	9	7
Uruguay	86	7
Argentina	71	7
Malagasy	32	7
Nicaragua	16	6
Ireland	50	6
Nepal	95	5
Peru	14	5
Developed countries		
Total	*60*	*8*
Japan	94	28
Iceland	54	17
Canada	25	16
West Germany	94	9
Italy	86	9
United Kingdom	72	8
Switzerland	86	8
Sweden	93	6
Belgium-Luxembourg	84	5
Denmark	51	4
Austria	95	4
France	82	4

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13. Despite the fact that most of their exports to the United States will come under the surcharge, the response of most of the Far Eastern LDCs has been low-keyed. For many products subject to the surcharge, there are no direct substitutes produced in the United States. This is true even for many of the manufactures sold by Taiwan, South Korea, and Hong Kong. Moreover, even in the case of products that compete with US output, the Far Eastern manufactures generally are either much cheaper or of a greatly different quality. Taiwan, South Korea, and Hong Kong hope to maintain export growth by cutting costs, trimming profit margins, and diversifying markets. Malaysia and Indonesia, which export mostly raw materials not affected by the surcharge, will see little effect on their trade. The Philippine government – one of the most vocal in the area in its protests against the surcharge – is requesting a complete exemption. However, even in this case, the adverse impact of the surcharge is not expected to be substantial, particularly since the rate applied to many items will be reduced to 8% under preferential treatment granted by the Laurel-Langley Agreement.

14. In South Asia, India has protested the surcharge, and Pakistan is preparing to do so, although the exports of neither country will be affected very much. Other countries in the area are not greatly concerned, because of the small volume of their trade with the United States. A similar situation exists in Africa, where less than 1% of total exports comes under the surcharge. Israel is the only Near Eastern country to be seriously affected by the surcharge, which covers some 83% of its exports to the United States and 16% of its total exports. The recent 17% devaluation will, of course, do much to counteract the effects of the new US policy. The United States is not an important market for other Near Eastern countries, and in any case the area's major export – oil – is exempt from the surcharge.

15. The less developed countries of Europe in general will be hit somewhat harder by the import surcharge than the highly industrialized nations in the same area. Among the most vulnerable are Spain, with 11% of total exports affected, and Turkey, with 12% affected. About 8% of the total exports of Greece and Portugal are included under the surcharge. Except for Iceland, no developed European country has more than 9% of its total exports affected and many run below 5%. Nevertheless, of the less developed European countries, only Turkey has formally requested an exemption from the surcharge.

Reaction to Foreign Aid Cut

16. As might be expected, major recipients of US aid have shown considerable concern about the economic impact of the announced 10% cut in the program. Although at this point they can do little more than

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speculate about the likely extent of a reduction in funding and the projects most likely to be curtailed, most of the countries issuing statements of any kind on the subject point to the integral role of foreign financing in their overall economic programs. Since Latin America recently was exempted from the aid cut, the measure will have its greatest effect on several Asian countries, such as South Vietnam, India, Indonesia, and South Korea, which have sizable US-aided development projects under way or in the offing.

17. The more radical LDC governments can be expected to take advantage of the obvious propaganda opportunities presented by a further reduction in foreign aid. Despite its exemption from the aid cutback, Latin America probably will continue to repeat its now familiar assertion that developed nations take out from the LDCs more resources than they bring in. In particular, countries like Chile – with large foreign debts and reduced foreign assistance prospects – can be expected to take advantage of present circumstances to increase their demagoguery and perhaps decrease repayments.

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