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The Director of Central Intelligence

Washington, D.C. 20505

28 October 1985

Dear Cap,

I understand that one of the things at the NSC meeting this week deals with a proposal to authorize the President to restrict financial flows. I gather that the Attorney General and the NSC and Defense have bought this to give the President additional authority to restrict financial flows to countries whose policies we disapprove of who are stealing our technology, etc.

I will not be at the meeting but will ask John McMahon to attend. Here are some pieces of information and arguments on the issue which you may find useful.

Yours,

William J. Casey

The Honorable Caspar W. Weinberger
Secretary of Defense
Washington, D.C. 20301

Enclosures:
  Memorandum for the President
    dated 7 October 1985
  Memorandum-Refutation of
    Arguments against S. 812

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THE WHITE HOUSE

WASHINGTON

October 7, 1985

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT C. McFARLANE

SUBJECT: Senate Bill S-812 - The Financial Export Control Act

Issue

Whether the Administration should support legislation expanding discretionary Executive authority to restrict flows of financial capital to destinations to which U.S. exports are restricted.

Facts

On Thursday, September 26, the Senate began hearings on S. 812, the "Financial Export Control Act" -- a proposed amendment to the Export Administration Act (EAA) to authorize controls on the export of capital from the United States to destinations to which U.S. commodity exports are restricted (Tab A). The bill has seven co-sponsors (Senators Proxmire, Garn, Symms, D'Amato, Hecht, Mattingly and Bumpers) and is designed primarily to provide the Executive Branch with a mechanism, short of the International Emergency Economic Powers Act (IEEPA), with which to interdict financial flows to Soviet Bloc countries when deemed appropriate to do so.

Treasury and State (Tab B) and Commerce all oppose the bill on the grounds that (1) it will be ineffective when used; (2) any "non-emergency" restrictions on international capital flows are inherently against the national interest and (3) it conflicts with your commitment to improve the U.S.-Soviet dialogue -- particularly at this time. State and Commerce are particularly concerned that the timing of affirmative Administration action on S. 812 could send the wrong signal to the Soviets. Defense (Tab C) supports the bill as a measured response to the problem of bank lending to the Soviet bloc when contrary to U.S. interests.

Discussion

The hearings on this issue should help to raise public awareness of the potential for adverse impact on U.S. interests of bank lending decisions -- particularly in the East-West context. Beyond that, the policy question revolves around whether the President, acting through his agent, the Secretary of the Treasury, should have the authority to control capital flows to trade-controlled countries in circumstances short of "national emergencies"

cc Vice President

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as defined in IEEPA. Justice believes that over-reliance on IEEPA could trivialize this critical Executive Branch foreign policy tool and perhaps lead Congress to perversely attempt to remove some of your authority under it. Some of the measures available under IEEPA could be invoked under S. 812. Thus, that authority could be used to invoke credit controls against nations that support international terrorism or that threaten regional instability. In addition, the bill would provide the potential, under appropriate circumstances, to include financial flows within our present policy of differentiation with respect to Eastern Europe. Although this is an awkward time in the East-West context for S.812 to be debated, the three principal economic constituencies in your Cabinet would probably always oppose it on their respective grounds (State/diplomacy, Treasury/ economic orthodoxy and Commerce/business and trade interests).

Senate and Defense concerns reflect a growing range of other considerations. This matter surfaced on the Hill last winter, when U.S. banks began actively participating in the renewed flow of Western loans to the Soviet Bloc. In the wake of the Polish insolvency, and in consideration of subsequent commercial bank concerns over the ability of other Soviet Bloc countries to repay the remaining portion of the $80 billion in total outstanding hard currency loans, it was generally believed that Western lending to those countries would be curtailed as a matter of sound banking practice. The U.S. banks were criticized by some for having put at risk funds at low interest rates in totalitarian economies where the availability of financial information on which to base lending decisions is severely curtailed.

The issue has been further complicated by the following factors:

- The growing body of evidence revealing the true extent of Soviet dependency on Western technology and know-how and the realization that the ability of the Soviet Bloc to generate hard currency -- whether earned or through loans -- is a key determinant of its ability to operate effectively (both overtly and covertly) in Western economic and commercial environments.

- The deepening conflict between U.S. and Soviet interests in Central America and the perceived (by some in Congress and the Administration) cause and effect relationship between U.S. bank lending to the Bloc and its capability to underwrite policies in Central America and elsewhere at the direct expense of the U.S. national interest (e.g., loans to East Germany coincided roughly with announced East German and other Soviet Bloc credit lines to Nicaragua).

- The growing perception that many bank lending decisions are often subjective and not apolitically market-based,

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and that they can adversely affect U.S. interests -- particularly when these activities signify broad-based banking industry policy shifts. Thus, bank culpability in poor lending decisions regarding Latin borrowers in the past and cessation of voluntary lending to most of Latin America at present have adversely affected U.S. efforts to deal with the debt crisis in the region.

OMB argues that administrative action is preferable to legislative action to accomplish the purposes of S. 812, and that we should reject the Senate bill while promising to develop an Executive Branch mechanism to deal with Senate concerns. I suspect, however, that due to the opposition of those in the Administration to S. 812, that this approach probably would result in little or no action in this area without persistent encouragement.

Thus, the issues for your consideration can be broken down into two parts:

- o Whether you support the spirit and intent of S 812, which is to provide you with the legislative authority in non-emergency situations to control financial flows to destinations to which exports are restricted (primarily the Soviet Bloc).

- o If you do support the thrust of S. 812, whether you should direct OMB to work with the Senate on developing a mutually acceptable legislative solution or to reject S. 812 and ask your Cabinet to craft administrative procedures to achieve a comparable result.

Recommendations

OK	No	
___	___	That you agree with the spirit and intent of S. 812, which would provide you with authority to restrict U.S. financial flows in non-emergencies to destinations to which exports are restricted.
___	___	That you instruct OMB to inform the Senate of the Administration's intention to craft administrative procedures to achieve a comparable result.

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____ ____ That you instruct OMB to inform the Senate that the Administration is opposed to S. 812 (the need for legislation) but will work to develop administrative procedures to achieve a comparable result.

Attachments

Tab A	Bill, S. 812
B	Letter from the Department of the Treasury
C	Letter from the Department of Defense

Prepared by:
David G. Wigg

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REFUTATION OF ARGUMENTS AGAINST S. 812

David Mulford's memo on the Financial Export Control Act (S. 812) advances several arguments why the Administration should oppose the bill. All of his objections can be disputed, and most are not relevant to the upcoming NSC meeting. Below I have divided the arguments into two categories--those which can be raised at the NSC meeting when the issue is whether the president's discretionary authority under the Export Administration Act should be expanded to cover financial flows, and those which are appropriate when an actual decision to impose credit controls against a particular country is to be made.

NSC Meeting.

- o IEEPA authority is sufficient; controls are appropriate only in emergencies

  (Justice will dispute this on grounds that IEEPA authority is being degraded through overuse. DoD may also wish to argue that President needs to be provided greater EAA flexibility in use of foreign policy controls to meet the terrorist challenge.)

Decision To Embargo Credit.

- o controls damage U.S. economic and financial interests

  (The issue is not whether commercial interests are harmed by sanctions but whether the foreign policy/security gains outweigh the losses. A judgement on this cannot be made in the abstract but only when a specific foreign policy crisis is met).

- o unilateral controls have no impact; Soviet Bloc countries are viewed as prime borrowers so other banks will quickly fill the gap left by a U.S. credit embargo; Allies will not support capital controls against the Bloc.

  (U.S. unilateral controls can sometimes stimulate other countries into adopting similar measures, as in the case of the South Africa sanctions. The Commonwealth sanctions against the RSA ban new loans to the government, setting a precedent for the use of capital controls. In the Bloc, only the USSR, East Germany and

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Hungary are viewed as prime borrowers.)

o capital controls against any Bloc country would be ineffective; governments can forego non-essential imports or borrow from non-U.S. sources to meet hard currency needs.

(Generalizations about the impact of credit controls against particular countries are not useful to policymakers. In fact, even the USSR under certain scenarios--more rapid economic growth, low energy and grain production, and high energy demand from the Bloc--could become greatly dependent on foreign borrowing. U.S. policy and perceptions of Soviet creditworthiness will have a significant impact on the willingness of Western banks to make new credits available.)

o Export control laws covering technology can be adequately enforced without the new authority.

(The new authority could be used to encourage controlled countries to abide by U.S. export control laws or risk losing access to credit. Soviet-owned commercial enterprises located in the west that routinely engage in smuggling could find their access to credit cut off.)

o U.S. policy supporting non-srategic trade with the USSR would be undermined.

(Our policy would be unchanged until the President makes a decision to impose controls.)

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