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Central Intelligence Agency

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Washington, D.C. 20505

17 December 1984

NOTE TO: The Honorable Robert C. McFarlane
Assistant to the President for
National Security Affairs

Bud –

1. There has been a good deal of talk in recent months about the contrast between US opposition to the Sandinista regime and continued US trade with Nicaragua. In Central America itself, the Hondurans, among others, have focused on this. In this connection, the possibility of some sort of economic sanctions has been raised. 25X1

2. In the attached, we take a close look at Nicaragua's vulnerability to economic sanctions. I hope you will find this examination of the issue useful. 25X1

3. A list of the other addressees of this limited dissemination memorandum is also attached. 25X1

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Robert M. Gates
Deputy Director for Intelligence

Attachments:
As Stated

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Nicaragua: Vulnerability to Economic Sanctions

12 December 1984

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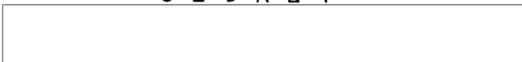

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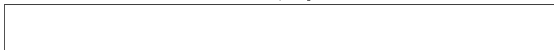

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Annexes

A. Economic Sanctions: A Historical Perspective
B. Nicaraguan Exports

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D. Nicaragua: Declining Levels of Foreign Assistance
E. Nicaraguan Imports

S E C R E T

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Nicaragua: Vulnerability to Economic Sanctions

Summary

Based on a review of the Nicaraguan economy and its trading patterns, US economic sanctions would likely cost Managua $25 million over the first 12 months of implementation in direct foreign exchange losses and impose even greater indirect costs in terms of disruptions and dislocations. While the impact would be unlikely to lead to any fundamental policy changes it would certainly place a burden on the regime. The projected loss in foreign exchange, for example, equals about eight-tenths of a percent of GDP and would directly offset about 10 percent of current Communist economic aid. On the import side, while Managua has already begun to diversify away from the United States, disruptions in basic consumer goods and spare parts for machinery could be expected.

The impact of US sanctions would not be limited simply to the pure economics. Any US action would almost certainly put additional strain on an already weak managerial structure. As it is, economic activity and living standards have deteriorated in Nicaragua--not because of lagging import capacity, but rather because economic mismanagement and inappropriate price signals have precluded the efficient use of resources. This has been compounded by a loss of business confidence, which has derailed private investment and reduced production efficiency.

If the experiences of past economic sanctions are a guide, the dislocations Managua would face should decline over time. There are, of course, a number of key political and strategic unknowns that could alter the effectiveness of sanctions against Nicaragua. To the extent that US allies--either in Latin America or in Europe--proved willing to actively join Washington's lead, the initial impact of economic measures would be both more severe and long lived. The prospects for US-West European joint action, however, are doubtful. Indeed, foreign reaction could work in the direction of offsetting US actions. Another unknown is how sanctions might affect the relative position of internal opposition to the Sandinista regime. If the FDN, for example, responded to US moves by disrupting key export producing areas and interdicting goods being smuggled out of the country, their tactical position could be strengthened. At the same time Sandinista actions to batten down the hatches could also sharply limit the existing flexibility of the political opposition.

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Economic Sanctions and Their Possible Impact

In assessing the potential impact of economic sanctions, it is important to understand the probable disruptions to the local

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economy--both in simple economic terms as well as from a managerial standpoint--from actions taken against exports, imports and financial flows. From a purely economic standpoint this means determining the cutback in foreign exchange a country will face and analyzing the ability of the economy to both cut imports and line up new markets. From a managerial standpoint, this involves assessing, even if in rough terms, the disruptive effects that could occur from overextending talent already in short supply.

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As far as simple economics are concerned, any nation has four major sources on which it can draw for hard currency. It can get the money it needs to pay for imports by:

- Exporting items to other countries.
- Lining up new loans from the international financial system.
- Drawing down foreign exchange holdings.
- Receiving aid, grants, transfers, and the like from foreign private and official sources.

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The Export Picture

Historically, when sanctions have been introduced, most emphasis has been placed on the trade side.[1] In general terms, Nicaragua exported about $390 million in goods in 1984, up some from the $370 million pace of 1982.[2] Looking at 1982--the last year for which complete reporting is

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[1] For a description of how economic sanctions have been used historically, and how successful they have been, see Annex A. For more detailed information on Nicaragua's export trade see Annex B.

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[2] The discussion of exports largely ignores services because we have little information on their magnitude and character. Even so, we believe they are small relative to commodities. Based on a review of what information we do have, Nicaragua's principal export service to the United States appears to be transportation via the national airline "Aeronica," which has five regularly scheduled flights to Miami each week. No US carriers provide service to Nicaragua. We have no hard information on Nicaraguan revenues from the service, but rough calculations suggest that they are probably on the order of about $10-12 million annually with net hard currency earnings probably totaling substantially less.

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available--nearly 70 percent of Nicaragua's exports went to the developed world. The United States' share of the total was 22 percent. The Communist world, led by Eastern Europe and China, accounted for another 12 percent of Nicaraguan sales, with the Central American economies totaling an additional 15 percent of Managua's export total.

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Zeroing in on specific commodities, Nicaragua's exports are dominated by foodstuffs. In 1982, food and food-related materials accounted for two-thirds of all Managua's foreign sales. As far as the specific items in this single category are concerned:

- Coffee and cocoa totaled 50 percent of total food-related exports.
- Meat, especially beef, and seafoods accounted for another 20 percent.
- Sugar totaled 12 percent.
- Fruits, mainly bananas, and vegetables accounted for another 5 percent.

As for the remainder of Nicaragua's exports, raw materials and manufactured goods--largely chemicals--dominate the picture, accounting for roughly 20 and 10 percent of total foreign sales, respectively.

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Potential Embargo Targets

In the event of a US action against Nicaragua, four exports--bananas, beef, seafood and tobacco--would likely draw the most attention because they dominate US-Nicaraguan trade. In general Nicaragua would have five basic ways to respond to any US-directed cutoff in trade. Specifically, it could:

- Simply accept the full loss of net foreign exchange.
- Try to divert previous US purchases to other hard currency markets, such as Western Europe.
- Try to increase its sales to the Soviet bloc, realizing that payment in hard currency would be far less likely.
- Ask the Cubans to sell the goods through their sales networks.
- Sell to middlemen in neighboring countries who, in turn, would try to sell the items in the United States or elsewhere.

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The exact choice or combination of responses would depend both on existing market conditions and on the specific good involved.

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Bananas

According to trade statistics almost all of Nicaragua's banana export crop is sold to the United States. As of mid-November 1984, Nicaragua was exporting an average of 110,000 boxes of bananas per week to the United States. All Nicaraguan banana exports are shipped from the port of Corinto on Nicaragua's west coast to Los Angeles. Although Nicaraguan bananas represent only 4 percent of total US banana imports, they constitute 19 percent of the West Coast market.

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If Managua continues to maintain its banana sales to the United States at its current pace, gross revenues from these exports in 1984 will probably total somewhere around $25 million. Recent US Customs Service data suggest that Nicaragua will earn $26 million from bananas this year. the total banana exports will probably run somewhere around 4.2 million boxes for the year and be sold at an average price of roughly $5-6 per box, suggesting export earnings in the same ballpark.

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A US ban on Nicaraguan bananas would not, of course, lower Managua's hard currency by the full amount of the gross revenue loss. To calculate the loss, hard currency costs--that is the amount of hard currency that Nicaragua must pay out in the process of raising and selling bananas--must be subtracted from the final sales price.

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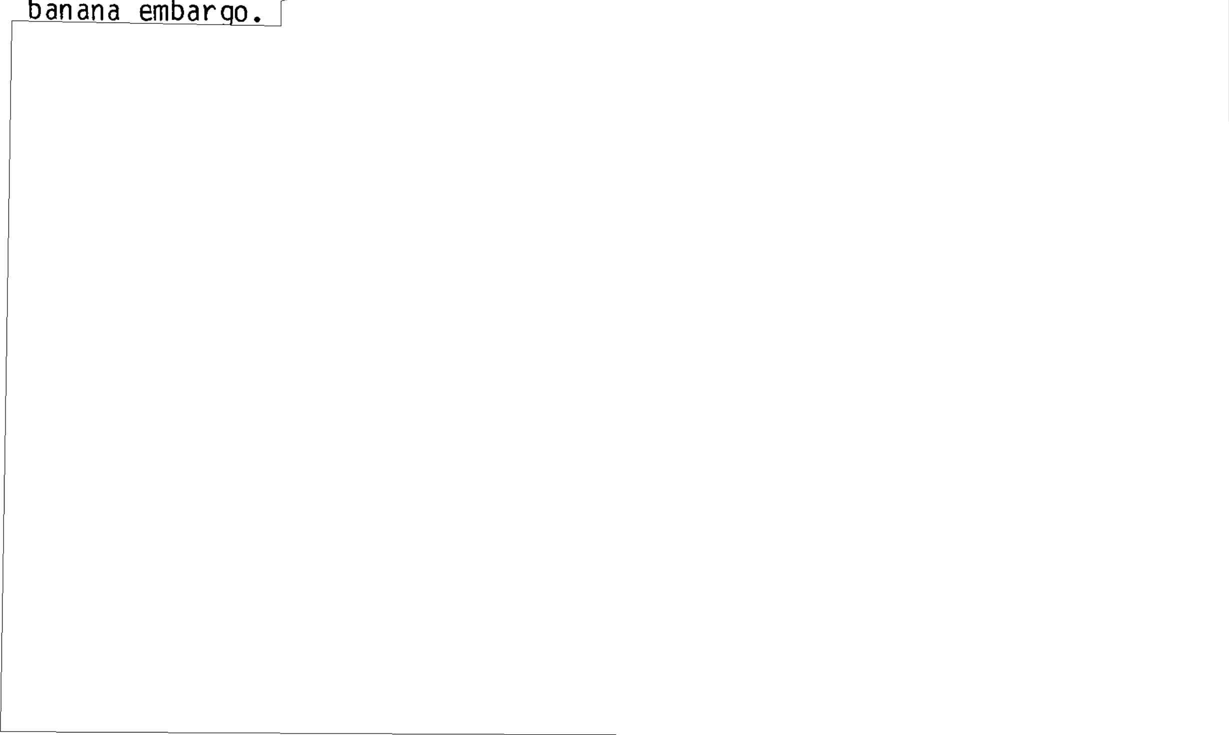
<u>Nicaraguan Reaction.</u> We do not know how Nicaragua would respond to a banana embargo.



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if bananas were sold to the East Europeans, the elimination of hard currency shipping costs is possible because most CEMA countries have their own ships. Moreover, West European shipping costs, now higher than to the United States, could also be reduced somewhat if Nicaragua successfully negotiated cost-saving contracts on chartered refrigeration ships, an opportunity greatly enhanced by the current worldwide glut of ships. It is doubtful, however, that Nicaragua could successfully circumvent a US embargo by smuggling bananas into Honduras or Costa Rica because both countries are major banana exporters in direct competition with Nicaragua.

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While we believe it is unlikely that Managua would simply let the banana industry die, it is also questionable whether a switch to European markets would reduce costs substantially. the higher costs would largely be offset by the higher price bananas command in Europe. A recent FAO study, for example, found that the landed price of bananas per box in West Germany, the only market where short-term sales could be readily made, has been running about a dollar above US levels. At least some of this difference would probably be negated as Managua found itself pressured to lower its price in order to make initial marketing inroads. Elsewhere in Europe, sales would depend on the ability of the Sandanistas to get a political nod since the market is already allocated among former colonies and other traditional purchases.

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Market Reaction. We have no information at present on whether West European or Bloc countries would buy bananas from Nicaragua, or if they would pay on a hard currency basis. In part, this would prove to be a political decision based on the circumstances surrounding any US actions. We do know from historical trends, however, that CEMA countries typically prefer to barter for agricultural commodities. Moreover, West Europeans already purchase all bananas produced in the eastern Caribbean under the Lome Convention.

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On balance it seems reasonable to assume a scenario under which:

- **Exports are totally disrupted for three months.**
- **In the subsequent three months, inroads are made in West Germany--the only EC country outside the Lome convention--and sales return to 10 percent of their previous level.**
- **During the second six months, Managua is able to raise banana sales to a third of their previous level.**

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Under these assumptions the hard currency loss to Nicaragua would range from $3-5.5 million at current export levels.

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Beef

During the final years of the Somoza regime, beef production in Nicaragua increased steadily. According to press reports, many cattlemen were concerned about both the stability of the national currency and the political future of Nicaragua and maintained high slaughter rates. After the Sandinista takeover, these high rates continued until, in 1981, the government instituted controls over slaughter to try to arrest the decline in the size of the herd.

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While most of the economy sagged in 1982, the cattle industry began to recover. We believe the upward trend in production would have continued in 1983, were it not for inclement weather. An unusually severe and prolonged dry season caused pastures to whither, even in the highlands. When the rains did not arrive in May as expected, the supplies of supplemental cattle feed began to run out, and cattle became very thin. This led to a suspension of slaughter and exports during June and July, according to Nicaraguan data. Although the number of cattle slaughtered in 1983 was greater than 1982, the average hoof weight was down considerably. This caused meat production to fall to 85 million pounds. Export volume was down slightly to 31 million pounds. Because of lower US beef prices, export earnings fell by more, to $29 million. During 1984, after the USDA temporary ban on meat imports because of noncompliance with health regulations, export earnings hit a low of $17 million.

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Had the USDA not stopped beef imports from Nicaragua from mid-February until the end of May this year, Managua would likely have earned about $22 million--$5 million more than we estimate for 1984. Although we have no reporting indicating how much of this amount would be net hard currency earnings, it seems that fixed hard currency costs--at least for feeding and grazing the cattle--would be minimal. Nicaragua, with its low population density and abundant pasturelands, is ideally suited for the cattle industry. Indeed, supplemental feed must only be provided during the dry season, according to industry experts. We also have no reporting on transport costs for beef, but according to transportation experts, they should not be too terribly different from bananas, as both would be transported in similar refrigerated carriers. Taking into account the fact that beef has a much higher value per pound than bananas and, hence, lower transportation costs per dollar of final value, we calculate that Nicaragua would have paid $1.2 million of the $22 million in earnings to ship the beef to the United States. Assuming supplemental feeding costs of about $1 million in hard currency, Nicaragua's net hard currency earnings from the United States would have been on the order of $20 million.

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Nicaraguan Reaction. We do not know precisely how Nicaragua would react to a US ban on beef, but, we believe, it is unlikely that it would simply stop exporting. Diverting meat from the United States to Europe is the most likely possibility, although transportation costs would be higher. Regional options also exist. Nicaragua's cattle country is primarily to the north of Lake Managua and the east of Lake Nicaragua. Beef could be smuggled north along the Pacific coast into Honduras or south along the coast into Costa Rica on the Inter-American Highway, as Honduran and Costa Rican beef is virtually indistinguishable from Nicaraguan beef.

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Moreover, smuggling of beef was a major source of effective capital flight in the last years of the Somoza regime,

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While the amount of beef that could be moved by smuggling is likely low relative to the volumes now being exported to the United States, the option exists for at least some transshipment in this manner. Certificates of origin can be easily falsified

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Concealing the smuggling would be made much easier by the fact the Nicaragua already ships at least $35 million of its export commodities each year to its neighbors via the trucking routes. For example, in 1983, Nicaragua exported, mostly by truck, $16 million worth of goods to Costa Rica, and $23 million to Mexico, Guatemala, El Salvador, and Honduras. Many additional millions in regional trade also cross Nicaraguan borders, and full cooperation from Costa Rican and Honduran authorities--including a willingness to prosecute their own businessmen--would be required to stop the transshipment of a substantial share of Nicaraguan exports to the United States. Even then, the ease of falsifying documents, and the probable willingness of businessmen in these countries to supply falsified certificates of origin make it most unlikely that all the trafficking could be stopped.

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Market Reaction. As in the case of bananas, shipping beef to Europe would logically be the easiest option, from an economical standpoint, for Managua to consider. We have no idea how Honduras or Costa Rica would respond to significantly increased smuggling by the Nicaraguans across their borders. Even if they were very unhappy, it is unclear whether Tegucigalpa or San Jose would be able to put a stop to any of the activity. While smuggling is possible from Managua's standpoint, the problem would be how much beef on the hoof could effectively be moved, to say nothing about the added costs of fake documentation and middlemen services.

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Taking all of these considerations into account it seems reasonable to assume that in the case of US actions against Nicaraguan trade we could have a scenario under which:

- -- All the beef which would have been exported to the United States in the first three months following any US action is completely halted.
- -- In the subsequent three months, a quarter of former US imports are shipped to Europe, and in the second half of the year this amount increases to between 40 and 60 percent of former sales.
- -- Within three months, an additional 5 percent of the herd is surreptitiously sold to the United States through middlemen in the region, but only with Managua paying 30 percent of current profits to the smugglers.

Moreover, taking into account the additional transportation fees to Europe, which would probably double these costs, and factoring in the difference in US/European beef prices--the price in London in late summer, for example, exceeds that in the United States by 15 percent--the total hard currency loss would run around $12.5-14.5 million.

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Seafood

Shrimp is the most important fisheries product in Nicaragua. Even so, shrimp production and export volume have deteriorated steadily since 1977, according to standard sources of trade data. The shrimp catch of 1981, for example, was down 43 percent from the 1977 level. Partial figures for 1982 indicate that the catch deteriorated another 17 percent that year. In 1983, Nicaragua estimates that production again fell, this time by 45 percent, according to the US Embassy in Managua. The Embassy reports that the declining shrimp catch is caused by the severe parts shortage in the fleet, which shows no clear signs of being resolved in the near future. Although export volumes have shown a similar pattern to the shrimp catch, the value of exports has held up remarkably well because average prices for exports have risen steadily.

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Spiny lobster is the second most important fisheries product in Nicaragua. Lobster production has followed a pattern very similar to that of shrimp production. The peak catch of nearly 2.9 million pounds was achieved in 1978, and has declined every year since then until 1983, when production rose by about 5 percent. Again, the lack of spare parts and equipment since the revolution is the principal cause of the poor performance. Like shrimp, rising prices have somewhat offset the output declines. Industrial fish production is very minor in Nicaragua and is primarily for domestic use.

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Based on recent trade statistics, we believe Nicaragua will earn $10 million in gross foreign exchange earnings for seafood this year from the United States. It is unclear how much of this amount is net hard currency earnings, but since the initial investment for boats has already been made, direct ongoing costs should be largely limited to spare parts and petroleum products. Fixed costs should be minimal. Given that the poor performance of this sector of the economy in recent years has been attributed to a lack of spare parts and machinery, the amount of capital investment probably has been very low. As long as the Soviets are willing to directly supply oil to Nicaragua, the only major hard currency costs of marketing seafood abroad would be transport costs and possibly brokerage fees. Although we have no reporting on what actual transport costs are, according to transportation experts, the calculations would be similar to those for bananas and beef because seafood must also be transported in refrigerated vessels. Assuming no brokerage fees, and making the same type of transportation assumptions we made for beef, but taking into account an even higher value per pound, Managua would net $9.5 million in hard currency from seafood. 25X1

Nicaraguan Reaction. Like beef, we believe it is unlikely that Managua would stop exporting seafood. If faced with a US ban, West and East European markets could provide a partial outlet. Transshipping the seafood might also be considered, but given the difficulty in keeping it fresh, the odds of successfully smuggling more than a small amount are quite low. 25X1

Market Reaction. We have no idea how neighboring states might respond to seafood smuggling by Nicaragua, or if they would even attempt to stop it. **If, however, we assume that the prospects for smuggling seafood are half as good as for beef, and that the European sales outlook is similar, then the net hard currency loss from seafood would be in the range of $6-7 million.** 25X1

Tobacco

Nicaraguan exports of tobacco leaf in the 1982/83 marketing year were approximately 1.3 million pounds, valued at $4.4 million. Of total leaf exports, $2.8 million worth--about 65 percent--went to the United States, with at least part of the balance going to Bulgaria. The destination of the balance of leaf exports is unknown. Cigar exports reached 1.8 million--$2 million worth--all of which were exported to the United States. Cigarette leaf exports in 1983/84 were expected to reach only 638,000 pounds, valued at $1.5 million. According to the Agriculture Attache, the decline in production is due to the country's overall poor economic health and its inability to import needed inputs. Cigar export projections for 1983/84 were not known, although most probably went to the United States. 25X1

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The United States imported $5 million worth of Nicaraguan tobacco products in 1984. This figure probably closely represents net hard currency earnings, as there appears to have been little Nicaraguan investment in the industry in recent years, and transportation costs for tobacco and its products, according to industrial publications, are apparently relatively low. While it overstates the case slightly in the event of a totally successful US ban, Managua would stand to lose close to $4-5 million in net foreign exchange earnings. 25X1

Nicaraguan Reaction. In our judgment, Nicaragua would probably not abandon tobacco production should a US embargo be imposed, if only because domestic consumption is heavy and probably could easily absorb most of the surplus. Moreover, Bulgaria has recently provided technical assistance to Managua in planting some 695 hectares of new fields, exclusively for export to Bulgaria, according to press reports. Bulgaria then, may be a viable alternative to the United States. Moreover, according to US Customs, Nicaragua could load the tobacco on ships making interim stops in Central America or the Caribbean before entering US ports. US customs agents would probably have a very difficult time distinguishing between the two varieties. Ships carrying falsely-labeled Nicaraguan products to interim stops before reaching the United States could probably be fairly easily detected by their unusual pattern of port calls, but proving in a court of law that products were actually Nicaraguan could be more difficult. The option of selling to Cuba and letting Havana handle the tobacoo through its marketing net is also one that Managua would almost certainly explore. 25X1

Market Reaction. Barring a ban on Nicaraguan tobacco by a broad range of countries, continuing export sales seem likely to us. **Assuming middleman and transportation costs wiped out 20 percent of net earnings, and the initial time required to line up new supplies delayed the sale of another 20 percent, the loss in foreign exchange would total somewhere around $1.5-2 million.** 25X1

TABLE 2
Foreign Exchange Losses Due to a US Embargo

Bananas:	$ 3-5.5 million
Beef:	$12.5-14.5 million
Seafood:	$ 6-7 million
Tobacco:	$ 1.5-2 million
Total:	**$23-29 million**

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Other Sources of Foreign Exchange

Manauga's ability to get foreign exchange to import goods is not simply limited to export earnings. Like any other country, hard currency funds can, at least in theory, be obtained from the international financial system and in the form of aid and grants from foreign individuals and governments.

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The International Financial System. In our view, the Sandinista regime would be hard pressed to come up with much, if any, additional currency through the international financial system. As it is, Nicaragua has fallen into arrears on interest payments to commercial banks Despite numerous debt reschedulings, Managua has been unable to keep current on its interest payments, and announced a one-year moratorium in June 1984, which has been since unilaterally extended to June 1985.

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In our view, not only would Managua find it very difficult to line up any additional new loans through the banking system, but it would also run into problems with international organizations. During the last two

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years, Managua has fallen $10 million behind on debt payments to the IMF. Moreover, the World Bank has recently declared Managua in default and suspended further disbursements of funds, according to IBRD reports.

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We believe Managua would also find it difficult to turn to its foreign exchange holdings as a source of funds to offset any sizable export losses. If the statistics Managua gives to the IMF can be trusted, the country probably has around $130 million in total foreign exchange holdings. At the same time, net foreign exchange reserves--that is foreign exchange less short-term obligations--were running in the red by around $450 million in 1983. As far as reserve holdings in the United States are concerned, we know, based on data compiled by US Government agencies, that the Nicaraguan government had $3.3 million in banks in the United States at the end of June 1984, while Nicaraguan banks--which the government fully controls--held another $4.6 million.

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Foreign Aid. From Managua's standpoint, the foreign aid situation is a bright spot in Nicaragua's overall financial situation.[5] Since 1982, foreign aid and grants have been a principal source of foreign exchange for Managua. During 1984, we project that Managua will receive a total of at least $760 million in official loans and grants--more than twice the amount earned through exports. More than half of this aid--$470 million--will come from Communist sources. While the Soviet Union accounted for the bulk, North Korea, Bulgaria, and Yugoslavia also contributed. Of the $760 million total, we project Managua will receive $510 million in loans--of which $100 million will finance military purchases--and $250 million in grants--of which $150 will be used for arms. If hard currency losses caused by a US export ban totaled the $23-29 million we roughly calculate, the Soviet bloc could offset this loss only if they were willing to increase total hard currency aid by about 5 percent or non-military aid by about 10 percent.

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The Import Picture

Assuming the Soviets were unwilling to offset more than a fraction of Managua's hard currency loss, and the regime did not dip into its foreign exchange, then the direct loss in imports caused by the export dropoff

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5 For more information of foreign assistance to Nicaragua see Annex D.

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would total about eight-tenths of one percent of overall GDP. If Nicaragua were a typical economy with flexible markets and a responsive manufacturing sector, the total loss, including direct and indirect costs, could reach something on the order of 1.5 percent of GDP, assuming no domestic offsets. In Nicaragua's case, however, the odds are that the loss would be greater both because of the nature of imports from the United States and non-economic factors that would be set into play.

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As far as imports are concerned, the picture is fairly straightforward. During 1982, the most recent year for which we have complete trade data, Nicaragua imported almost $824 million in total military and nonmilitary merchandise, with about $150 million of that coming from the United States.[6] When compared with earlier years, 1982 trade figures reflect a shift away from purchases from Managua's traditional trade partners, the United States and the Central American Common Market (CACM), and toward imports from Mexico, Europe, and Communist Bloc countries. Favorable trade agreements with these countries--at a time when most US export credits to Managua were being cut and CACM countries were experiencing foreign exchange shortages--have been mostly responsible for the change in import patterns. By 1982, Mexico had already replaced the United States as Nicaragua's main trading partner, although the United States still remains Nicaragua's largest single non-oil supplier. If anything, we expect that this shift away from the United States and CACM has continued since 1982.

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Focusing on Nicaraguan imports, US trade statistics show that US sales to Nicaragua will probably run about $120 million this year. This would represent a 13-percent share compared with 31 percent during 1975-77. If first-half 1984 trends continue, the main categories of imports from the United States during 1984 will be:

- chemicals, drugs, and fertilizers ($12 million)
- vegetable oils, eggs, and other foods ($8 million)
- agricultural and motor vehicle machinery and parts ($7 million), and
- cereals and soybeans ($6 million).

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6 For more information on Nicaragua's import trends, see Annex E.

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US firms will also export some services to Nicaragua. We have no hard information on their magnitude but expect their value to be small compared to commodity exports.[7]

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Assuming that the Nicaraguans were determined to continue purchasing US commodities, we believe that the government could, albeit with some delay, difficulty, and expense, arrange for middlemen in neighboring Central American countries or elsewhere to buy and transship most of them. The Nicaraguans would certainly receive coaching from the Cubans, who have over 20 years of experience in avoiding US trade sanctions and already possess an extensive network of front firms through which they could purchase goods for Nicaragua. Concealing purchases through cutouts would be eased because the goods Nicaragua imports from the United States are commonly traded on international markets, and Nicaragua already imports some $125 million annually from its Central American neighbors.

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Dependence on Imports

As far as Managua's vulnerability in specific import areas is concerned, we believe industrial and consumer goods top the list. Even with the Sandinista government's policy shift away from industry--which is generally pro-Western in outlook--manufacturing reportedly still counts for a little over 25 percent of GDP, according to Nicaraguan data. Thus, a successful cutback in imports of vital machinery and spare parts could in time further cripple industry--already operating at only about 40 percent of capacity--as equipment wears out.

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Managua would almost certainly consider expanding purchases with other countries, although this could result in higher prices. Mexican companies have already begun exporting pharmaceuticals using official trade credits Other Latin countries,

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[7] Most US-Nicaragua trade apparently takes place via direct contacts of US firms with companies in Nicaragua. We know of only one firm in the United States that acts as a trade broker--the Sandinista-owned World Commerce Corporation located in Miami. We have no information on its size or assets, but expect that it is small. Nicaragua also has a trade representative in New York and another in San Francisco. Closing down the small offices of the World Commerce Corporation would remove one avenue the Nicaraguans currently use to purchase US goods both for themselves and for transshipment to Cuba. We think that such an operation could be rapidly reestablished in Panama, however, albeit at some additional cost and some temporary disruption of supply.

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such as Brazil and Argentina, could rapidly supply Managua's requirements for vegetable oils, cereals, and soybeans at little additional cost. From Argentina, Nicaragua could draw on a line of credit set up last March.

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Imports of spare parts and machinery compatible with existing US-manufactured industrial equipment would present some obstacles. This certainly was the case for Havana when its trade was sanctioned by the United States and the OAS, according to historical accounts. In Nicaragua's case, however, Mexico produces a large quantity of agricultural and transport equipment similar to the older US-made equipment being used in Nicaragua. Compatible oil refinery equipment is produced by several Western countries.

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While Nicaraguan officials continue to stress publicly the need to reduce consumer imports, Managua remains dependent on overseas suppliers for basic items such as drugs, cooking oil, and cereals. A cutoff in imports of any of these essentials could aggravate general grumbling among Nicaraguans already frustrated by shortages of such "luxury items" as toothpaste and toilet paper.

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Managua so far has managed to insulate most of the domestic agricultural sector--which accounts for about 25 percent of GDP--from the need for Western-supplied inputs, such as fertilizer and irrigation equipment. The Soviet Union and East Germany supply the regime with tractors, trucks, and other heavy equipment. A cutoff of chemicals and fertilizer could, however, hurt Nicaragua's rice and cotton crops. The government has boosted acreage planted in cotton 20 percent this year, making a potential crop failure even more disappointing.

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Table 3

Type of Import	Impact of Cutback
Vegetable Oil, Cereals, Soybeans, Drugs	Increased consumer shortages; longer lines; higher costs to assure timely delivery from other suppliers.
Machinery and Parts	Strains on managerial staffs to search for compatible materials; lost production due to additional downtime of US-made equipment.
Chemicals and Fertilizers	Could hurt crop performance--particularly cotton and rice--which depend heavily on these inputs.

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Beyond the Simple Economics

The impact of US sanctions against Managua is not simply limited to the pure economics of hard currency loss and import cutbacks. The Sandinista regime is also vulnerable because of the basic nature of its political-economic system. 25X1

Any US action would most certainly put additional strain on Managua's managerial pool. Export cutbacks would have to be assessed, alternative markets located, middlemen sought out, prices and terms arranged, shipping organized, and delivery and export dates coordinated. At the same time, foreign loans would have to be sought and the distribution of import reductions would have to be determined and implemented. While coping with these direct impacts would be a challenge, dealing with the indirect effects and feedbacks would only add a new level of complexity to the situation. 25X1

Even without any US action, the Sandinistas are having problems managing their economic base 25X1 Production and living standards have deteriorated--not because of lagging import capacity, but rather because economic mismanagement and inappropriate price signals have precluded the efficient use of resources. This has been compounded by the loss of business confidence, which has derailed private investment and reduced production efficiency. 25X1

In dealing with the managerial complexity of economic sanctions, we believe Managua would also run the risk of overreaching, and thus intensifying problems. If history is any guide, most of the trade losses from sanctions are front loaded and temporary. Nevertheless, the Sandinistas would see a sudden dropoff in revenue and could respond by acting as if the losses were permanent. If Managua did this, we calculate the import cutback would be far greater than warranted, thus intensifying problems with spare parts and consumer goods. 25X1

Likewise, imposition of US sanctions could intensify the Sandinistas' siege mentality, with important consequences for the populace and the anti-Sandinista opposition. If this overreaction were to occur the regime would probably renew measures to mobilize the population to counter a perceived US invasion threat and would likely direct more manpower into the military and militia--further curtailing production. The Sandinista response could of course be even broader. In the past, the government has publicly used charges of disinvestment to seize private property and probably would take advantage of sanctions to accelerate nationalizations. While this would weaken the position of many private sector leaders, it would also directly increase the managerial problem facing the regime. At the same time, we judge that any moves that weakened the private sector would also have political ramifications. The

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political opposition draws much of its top leadership from the ranks of private sector professional and technical personnel, according to the US Embassy. As it is, the political opposition lacks depth and could be much weakened if a few key individuals were forced out.

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How Managua would deal with a sudden intensification of managerial problems is an open question. It could simply batten down the hatches and see the storm through. Alternatively, it could turn to the Cubans, asking for even more economic advisers to man talent-short economic positions in the ministries.

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Some Longer Run Effects

On balance, we judge that the economic disruptions initially caused will probably ease with time. If the experience of most other embargoed countries is any guide, circumventing sanctions will probably get easier as Managua finds avenues around trade sanctions. Indeed, given the relatively low level of US-Nicaraguan trade, it is possible that lost US markets could be replaced within two to three years. As the Sandinistas continue to redirect the economy away from the United States, they will need fewer embargoed US goods. Moreover, they should find any problems in getting spare parts eased as US equipment is replaced with machinery from other countries. The transition would be smoother if Communist patrons proved willing to offset at least part of the country's economic losses.

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Obviously, sanctions would provide more of a problem for Nicaragua if US allies--both in Central America and in Europe--joined in. As far as the Europeans are concerned, we judge the odds of any unified support to be quite low. Although increasingly disillusioned with the Sandinistas, most West European countries would have real political difficulty admitting they had been wrong in their earlier support. France, and Mexico for that matter, have publicly stated that they believe a rapid radicalization of the regime would occur if they abandon Nicaragua. In the face of sanctions, it would not be surprising to see at least some West European and Latin capitals opt to increase, even if quietly, levels of trade and aid.

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In the short run, joint sanctions by the United States, Honduras and Costa Rica would greatly compound Managua's problems. If illegal export routes could be successfully closed, transshipments, and much more importantly normal bilateral trade, would be curtailed. Over time, Managua could adjust to this by increasing its efforts to shift more of its trade to Europe, as well as both to and through Cuba.

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If authorities in Honduras and Costa Rica were willing to seriously enforce trade restrictions, they would find the region's geography working

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to their advantage. Costa Rica, for example, would really only have to close down the Inter-American Highway. Because of swampy terrain, Lake Nicaragua would offer few opportunities. Routing material down the eastern coast would be logistically difficult and time consuming. The most likely item that would move down the eastern corridor would be cattle. Honduras, for its part, would have to monitor the westernmost 100 kilometers of its border. This is the region with the most developed road network. To the east of this area, smuggling would probably be limited by insurgent activity. Indeed, any attempt to smuggle cattle or the like through FDN-controlled areas could only be viewed by the FDN as a windfall gain.

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A key unknown in any economic sanctions, of course, is how the Contra would respond. At a minimum, we believe sanctions would certainly boost the insurgents' short-term morale. If the FDN turned its attention to action against cattle ranches, banana areas, and the like, the costs to Managua could escalate. Attacks against the banana growing regions would, of course, prove difficult, since most growing takes place in the Corinto area, far from present insurgent operating areas. Cattle, which are raised just north of Lake Managua and east of Lake Nicaragua, could prove more vulnerable, although the insurgents would be hard pressed to sustain any prolonged activities in the region due to supply problems. From an FDN standpoint, the likelihood of a backlash against the insurgents for targetting economic activity would also have to be taken into account.

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Regardless of potential targets, it is clear that the insurgents' ability to interdict trade would enhance their threat to the regime. To the extent the Sandinista regime is unable to control the Contras, countering any economic sanctions would draw on managerial and technical talent, which would already be stretched thin.

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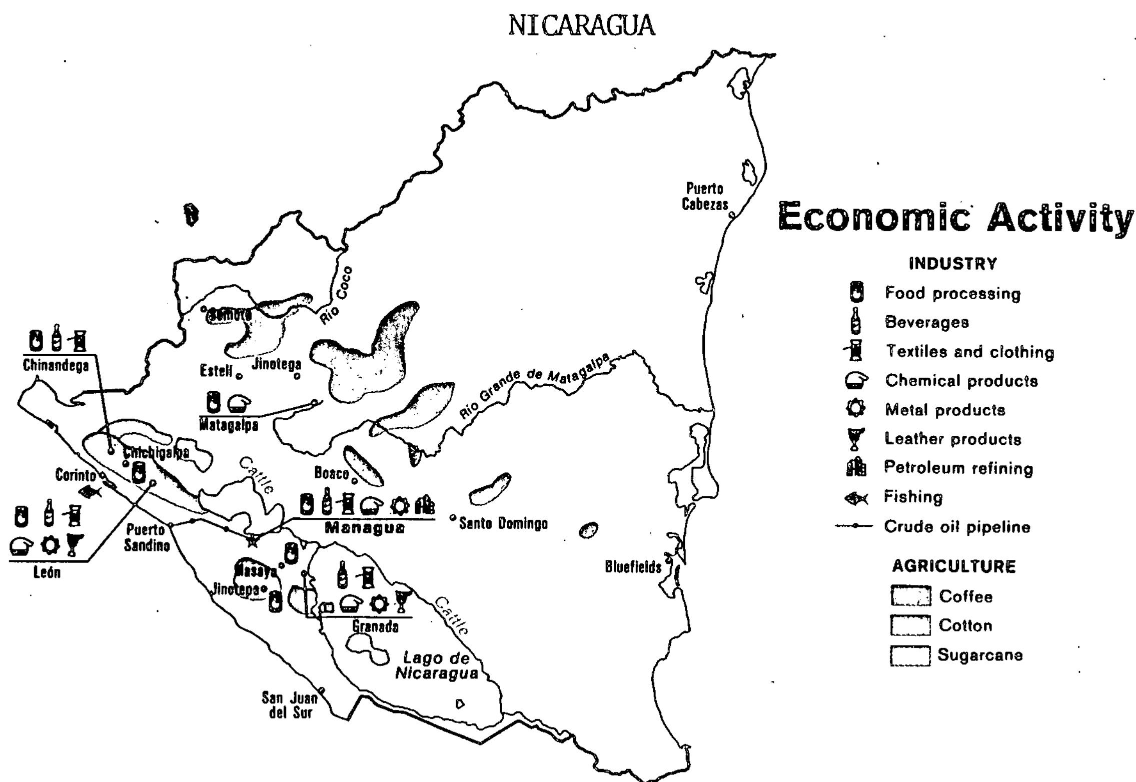
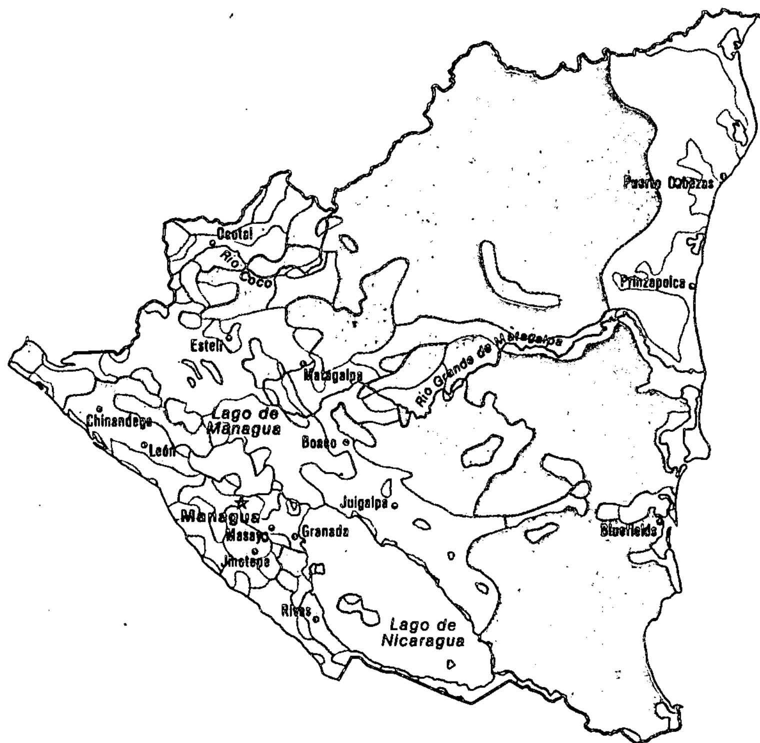


Land Utilization and Vegetation



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ANNEX A

Economic Sanctions: A Historical Perspective

Economic sanctions have often been turned to as a political tool in the diplomatic arena. From a broad perspective sanctions have traditionally been pursued to achieve one of three specific goals:

-- Forcing a major change in a country's behavior or causing a change in leadership.

-- Inflicting economic punishment for pursuing a given policy.

-- Signaling clear disapproval of another country's conduct.

In general terms, recent history has shown that most nations opted for sanctions initially in an attempt to change an adversary's policies. Indeed, [redacted] it was found that this was a stated objective in 9 of 13 major incidents of sanctions since 1935.* While governments have generally followed this most extreme option, it has at the same time proved the most fruitless. [redacted]

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If economic sanctions are to affect policy, they must have an impact on the country being targeted. From an economic standpoint, the impact can range from minor inconveniences to major economic dislocations. The degree of economic cost itself will be affected by:

-- The access that exists to alternative sources of supplies or markets.

-- The ability of the sponsoring country to enforce the sanctions.

-- The ability a country has to adjust internally. [redacted]

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In almost all cases sanctioned countries were able to secure alternative sources, supplies or markets for their exports. In this regard, two key studies in which the United States was involved are particularly enlightening:

[redacted]

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-- When the United States imposed sanctions on Iran in 1979/1980, Tehran was heavily dependent not only on imports, but also on goods from the United States. Iran relied on imports to meet most of its requirements for capital goods, industrial raw materials, military equipment, and consumer goods. Despite this dependence, Tehran managed to find alternative sources--albeit at a higher cost. Increased food shipments from France, Germany and Australia more than made up the loss in US foodstuffs. Several Western European, Japanese and even US firms traded embargoed goods through intermediaries Supplier arrangements covered a wide range of industrial goods, capital equipment, and chemicals, all of which were sanctioned. US involvement included the sale of goods such as engine parts, tires, appliances and drill rigs.

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-- When the Soviets invaded Afghanistan in 1980, the United States, in consultation with most of its allies, agreed to impose a partial grain embargo. As far as the allies were concerned each was mindful not to take a major stance on sanctions tougher than its neighbors did. Concerning grain, Moscow was able to line up all the grain its ports could handle in the 1980-81 period despite the embargo. The soybeans and soybean meal denied by the United States was fully replaced by Argentina and firms in Western Europe. In fact, EC, Canadian, and Australian grain exports to the USSR all increased in 1980 compared with 1979.

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Such an outcome is not simply limited to these two case studies. In almost all recent sanction situations, alternative sources have been found, if nothing else than from opportunistic middlemen and suppliers. For example:

-- When the United States imposed trade sanctions against Uganda in 1979 one-third of Kampala's trade was with the US. Uganda actively sought out new customers for their coffee and other products as they saw the sanctions coming. Official data shows they were quite successful--export receipts during the embargo were little changed from their level before the embargo was imposed.

-- When the French suspended their liftings of Algerian oil in 1971, Paris quickly found that US and British firms filled the exploration gap. Moreover, Sonatrach--the Algerian oil company--emerged from the embargo as the tenth most important oil producing company in the world.

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The fact that commerical considerations often compromise cohesion among allies in any prolonged sanction endeavor only makes the trade barriers that are put up all that more porous. Nations subjected to

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embargoes are also able to adapt to cutbacks in critical goods by adjusting internally. Increased self-sufficiency and a shift away from embargo items are the norm rather than the exception.

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Focusing on two pertinent case studies--US/OAS sanctions against Cuba and UK/UN sanctions against Rhodesia--underscore the problems that are involved with sanctions.

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The Cuban Experience. In 1960 the United States took largely unilateral actions against Cuba--American and British refineries refused to process Soviet crude, sugar imports were stopped, and US technicians and specialists were pulled out Cuba. In 1962 the screws were tightened. The US imposed a total prohibition on imports from Cuba, and exports to Cuba were banned, except for foodstuffs and medically-related goods. In July 1964 the Organization of American States (OAS) voted to follow the US lead by asking members to sever diplomatic and commerical relations with Havana. In addition, all air and sea services to and from Cuba were suspended and passport restrictions were imposed. Most OAS members adopted the measures, though they were not enforced rigorously by all.

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Cuba, in response, turned to the Soviet bloc for a trade outlet. By 1965 the East accounted for 76 percent of Cuban trade--up from less than 3 percent in 1957. This rapid shift, of course, was not without cost. Probably the single most damaging effect was Havana's inability to obtain needed spare parts for US-produced equipment. Other problems arose from a lack of complementarily between Cuban import needs and bloc export potential.

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Over time the enforcement of the sanctions became increasingly difficult. Not only did OAS members' resolve decline but the costs to Cuba fell. Cuba's capital base shifted to Soviet, East and West European, and Japanese equipment and machinery. Consumer goods were being produced locally and Havana had opened front companies which enabled it to obtain any needed US products. The political results were also far from what was originally desired. As the impact of sanctions diminished because of Soviet help, the Cubans became more of a irritant to the United States because of their efforts to export revolution and act as Moscow's surrogate in Africa.

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All of these changes, coupled with a shifting political climate, made it apparent by the mid-1970s that Cuban isolation was no longer possible. In August 1975 the OAS passed a resolution that allowed each member to determine the nature of its relations with Cuba. The US voted in favor of the resolution.

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The Rhodesia Experience. The Rhodesia experience is not terribly dissimilar from that of Cuba. Both nations turned to patron states--the

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USSR for Cuba and South Africa for Rhodesia--when faced with sanctions. Unlike the Cubans however Rhodesia had an advantage of multiple borders, albeit mainly with black neighboring states.

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After the Ian Smith government unilaterally declared independence in November 1965, Prime Minister Wilson of the UK imposed economic sanctions against Rhodesia that banned arms and capital, as well as sugar and tobacco which together accounted for two-thirds of Rhodesia's exports to the United Kingdom. The British imposed a second set of sanctions in December 1965 which, among other things, cut off several minerals (copper, chrome, asbetos) and foodstuffs (corn and beef), as well as petroleum and petroleum products. The UN followed suit with sanctions in December 1966 and May 1968 which banned all imports from Rhodesia and all export to the country save medical and educational supplies. The UN resolutions--232 and 235--included reminders that a failure to comply with the sanctions would constitute a violation of a member's obligation under the UN charter. Moreover a Security Council committee was established to gather information on any evasion of sanctions.

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In many respects Rhodesia appeared to represent a near ideal target for sanctions:

-- Exports were concentrated in a small number of primary products--tobacco, sugar, and a few minerals--and only three markets--the United Kingdom, Zambia, and South Africa.

-- Imports were concentrated in one product area--machinery and transport equipment--and were purchased largely from two countries--the United Kingdom and South Africa.

-- Overall foreign trade accounted for a sizeable portion of Rhodesia GNP.

-- The British economy was not critically dependent either on supplies of raw materials from Rhodesia or on a Rhodesian market.

Despite these advantages the sanctions quickly turned into shambles. South Africa continued to trade with Rhodesia and provided critical imports such as oil. We estimate that two-thirds of the goods moving between Rhodesia and South Africa ended up in world markets with false documentation. Other African countries also broached the embargo.

-- Disguised trade channels similar to those through South Africa were available to Rhodesia from Portuguese Mozambique until its independence in mid-1975.

-- Zambia--Rhodesia's largest 1965 export market--continued to trade with Rhodesia and to use its transport facilities until 1973.

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Then in 1978, after a five-year hiatus, transportation bottlenecks on the alternative Benguela and Tazara railroads forced Zambia to resume transshipments via Rhodesia. This probably enabled some Rhodesian goods--particularly white corn, light manufactures, and coal--to find their way to Zambian markets.

-- Other black African nations--Botswana, Malawi, and Zaire--maintained economic relations with Salsbury in spite of UN sanctions.

On the export side, only agricultural sales suffered badly during the sanctions. The embargo crippled tobacco sales, Rhodesia's single largest foreign exchange item. This was because tobacco was too easily traced to the source and could not, therefore, be passed through foreign middlemen to the world market. The sharp decline in tobacco earnings, as well as a need to reduce dependence on imported foods, caused the government to encourage growers to switch to corn and wheat production.

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From an aggregate standpoint, the impact on the Rhodesian economy was far from what the British had originally anticipated. Import substitution flourished. Manufacturing replaced agriculture as the leading sector of the economy. Total domestic investment climbed from 13 percent of GDP in 1964 to 20 percent of overall economic activity the first half of the 1970s. Overall GDP from 1965 to 1974 registered a healthy 6.5 percent average annual growth rate. As it turned out, Rhodesia was, in effect, so successful at internal adjustments that the sanctions left the country with a much stronger economy than before the sanctions.

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While the Cuban and Rhodesian case studies point out the problems of successfully imposing economic sanctions, this is not to say that successes have not been achieved. There is at least one major case where sanctions were imposed with the goal of changing the leadership of a regime--the Dominican Republic in 1961 and 1962--proved successful. There are also a number of cases where sanctions designed to inflict economic punishment or underscore displeasure also proved successful.

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As far as the Dominican case is concerned in 1961 the OAS initiated sanctions against the island because of its aggression against Venezuela. OAS members voted to break diplomatic relations as well as suspend trade in arms and military materiel. These sanctions were later expanded to include petroleum, petroleum products, trucks, spare parts, and other commodities. Moreover, in addition to joining the OAS sanctions, the United States unilaterally cut back its import quota of Dominican sugar.

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The sanctions hit the Dominican economy when already sagging economic performance was hampering adjustment and the Trujillo regime had turned its attention to survival. The Dominican's were able to circumvent some

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of the sanctions by purchasing arms, vehicles, and petroleum--though at a higher cost--from Canada, Western Europe, and the Middle East. Trujillo also managed to ship coffee to the United States disguised in Colombian bags, and he planned to build a Dominican refinery with French and US contractors. Even so, the sanctions clearly worsened the economic crisis as export earnings in 1961 were cut 21 percent and imports fell another 20 percent in nominal terms.

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The economic deterioration fostered political unrest in the middle and upper classes, the army and the church. The regime responded with increased repression and terror. An underground grew rapidly, and in May 1961 Trujillo was assasinated. By the end of the year his regime was toppled and the Trujillo family fled the country. Whether the sanctions were a key is, of course, an open question. It is impossible to determine if they play a critical role in building local opposition or whether the resistance would have followed the same course without OAS/US action.

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In a number of cases, sanctions were introduced, in effect, to underscore displeasure or inflict economic cost. For example:

- -- EC sanctions on Argentina were primarily intended to symbolize disapproval of Argentina's invasion of the Falklands and the European Community's solidarity with the British.
- -- The Arab League boycott of Israeli serves as a sign of opposition to Tel Aviv and as a propoganda device.
- -- Over time, sanctions against Cuba were seen as a way to punish Havana and Moscow by making them pay a heavy economic price for their alliance.

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In our judgment sanctions that either punish or symbolize disapproval have been employed in recent years for two basic reasons:

- -- Countries recognize that economic sanctions are unlikely to cause sufficient distress to change the conduct of the major powers, and even poor states are usually able to mitigate or withstand their impact.
- -- Mass communications and diplomacy conducted at international forums have placed a greater premium on adherence to universal norms of conduct. Sanctions may symbolize a country's compliance with these norms and highlight the deviation of another.

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While the individual cases of economic sanctions are diverse and full of pecularities, a review of their planning and implementation points out one key lesson--to be successful, the impact of the actions must be consistent with the objective being sought. In essence, then, the

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policymaking review must potentially consider:

-- The kinds of items to be withheld or markets to be boycotted.

-- The need and desire for multilateral sponsorship and the willingness of other states to participate.

-- The economic and political effects of sanctions on the offending country.

-- The degree of the target country's commitment to the action that triggered the sanctions.

Which of these elements must actually be considered depends heavily on the precise goals of the sanctions. If the objective is to demonstrate disapproval, only the first two are pertinent; punishment, in addition to the first two elements, requires assessment of the economic impact, while an attempt to change a country's behavior requires consideration of all four elements.

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While such a view is conceptually simple, in reality it proves extremely complex. Even the most careful planning process is unlikely to take fully into account all of the political and economic dynamics associated with the use of economic sanctions. If nothing else, the case studies of sanctions revealed that miscalculation, misunderstanding, or failure to take all of the key elements into account have caused sanctions to fail, sometimes with serious adverse economic consequences for their sponsor.

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ANNEX B
Nicaraguan Exports

Table 1
Nicaraguan Exports to the World, 1982

	Value ($ million)	% of Total
World	370.0	100.0
Top Ten Partners	299.0	79.1
US	82.0	22.0
West Germany	52.0	14.0
Japan	43.0	11.0
Costa Rica	25.0	7.0
China	20.0	5.0
France	19.0	5.0
Netherlands	16.0	4.0
Guatemala	14.0	3.7
Mexico	14.0	3.7
Spain	14.0	3.7

Nicaraguan Exports to the World, 1975-77

	Value ($ million)	% of Total
World	514.3	100.0
Top Ten Partners	428.1	83.1
US	140.0	27.2
Japan	63.0	12.2
W. Germany	57.3	11.1
Costa Rica	43.0	8.4
Guatemala	29.3	5.7
El Salvador	27.6	5.4
Netherlands	21.0	4.0
Belgium-Luxembourg	20.6	4.0
Honduras-Belize	15.0	2.9
Hong Kong	11.3	2.2

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Table 2
Nicaraguan Exports to the United States, 1982

Commodity	Value ($ million)	% of Total Exports
Meat	31.0	37.0
Fish	16.0	19.5
Sugar	13.0	15.8
Fruit	10.0	12.2
Tobacco	5.0	6.1
Processed Food	4.0	4.8
Coffee	3.0	3.6
Soybeans	1.0	1.2
Vegetables	Less than 1	Less than 1.0
Chemical Elements	Less than 1	Less than 1.0

Nicaraguan Exports to the United States, 1975-77

Commodity	Value ($ million)	% of Average Total
Sugar	39.3	28
Meat	32.6	23.3
Coffee	21	15
Fish	20.3	14.5
Tobacco	5.6	4
Fruit	5	3.6
Non-Ferrous Ore	3	2.1
Clothing	2	1.4
Fabrics	1.3	Less than 1.0
Cotton	1.3	Less than 1.0

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Table 3
Nicaragua Exports to the World by Commodity Group

Foodstuff Exports, 1982

	Value ($ million)	% of Total
World	247.0	100.0
Top Ten Partners	212.0	85.6
US	82.0	33.2
West Germany	46.0	18.6
Netherlands	16.0	6.4
Mexico	14.0	5.7
Spain	14.0	5.7
France	11.0	4.4
USSR	8.0	3.2
Costa Rica	8.0	3.2
Italy	7.0	2.8
Guatemala	6.0	2.4

Foodstuff Exports, 1975-77

	Value ($ million)	% of Average Total
World	280.3	100
Top Ten Partners	254.3	90.4
US	127.6	45.5
West Germany	47.3	16.8
Belgium-Luxembourg	19.0	6.7
Netherlands	18.6	6.6
Costa Rica	17.6	6.3
Japan	6.6	2.3
Guatemala	6.0	2.1
France	4	1.4
Italy	4	1.4
Mexico	3.6	1.3

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Table 3 (continued)
Manufactures Exports, 1982

	Value ($ million)	% of Total
World	30.0	100.0
Top Ten Partners	30.0	100.1
Costa Rica	15.0	50.0
Guatemala	6.0	20.0
El Salvador	4.0	13.0
Honduras-Belize	3.0	10.0
Panama	1.0	3.3
Cuba	1.0	3.3
Japan	less than 1	less than 1.0
US	less than 1	less than 1.0
West Germany	less than 1	less than 1.0
Netherlands	less than 1	less than 1.0

Manufactures Exports, 1975-77

	Value ($ million)	% of Average Total
World	82.5	100
Top Ten Partners	82.6	95.7
Guatemala	22.3	26.1
Costa Rica	22.0	25.8
El Salvador	21.6	25.3
Honduras-Belize	9.6	11.2
US	6.3	7.3
Venezuela	0.3	less than 1.0
Canada	0.2	less than 1.0
Panama	0.2	less than 1.0
Mexico	less than 0.1	less than 1.0

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Table 3 (continued)
Fuels Exports, 1982

	Value ($ million)	% of Total
World	4.95	100.0
Top Ten Partners	4.92	98.5
Costa Rica	1.88	38.0
Guatemala	1.71	34.5
El Salvador	0.79	16.0
Netherlands	0.19	3.8
Honduras-Belize	0.18	3.6
Cuba	0.13	2.6
Panama	0.04	less than 1
Mexico	less than 0.01	less than 1
US	less than 0.01	less than 1

Fuels Exports, 1975-77

	Value ($ million)	% of Total
World	1.56	100.0
Top Ten Partners	1.56	98.9
Costa Rica	1.21	77.0
Honduras-Belize	0.174	11.1
El Salvador	0.09	5.7
Guatemala	0.06	3.8
US	0.02	1.3
Panama	less than 0.01	less than 1.0
Finland	less than 0.01	less than 1.0
France	less than 0.01	less than 1.0
Greece	less than 0.01	less than 1.0

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Table 3 (continued)
Raw Materials Exports, 1982

	Value ($ million)	% of Total
World	87.9	100.0
Top Ten Partners	85.7	96.6
Japan	38.1	43.3
China	19.5	22.1
France	8.1	9.2
Taiwan	7.5	8.5
West Germany	6.5	7.4
Belgium-Luxembourg	3.0	3.4
Honduras-Belize	1.5	1.7
Italy	0.9	1.0
Guatemala	0.6	less than 1.0

Raw Materials Exports

	Value ($ million)	% of Average Total
World	146.8	100.0
Top Ten Partners	121.4	82.3
Japan	56.3	38.3
Taiwan	11.8	8.0
Hong Kong	10.9	7.4
West Germany	9.5	6.5
China (PRC)	8.2	5.5
Italy	6.4	4.3
US	6.3	4.2
Spain	5.9	4.0
Thailand	3.5	2.4
India	2.6	1.7

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ANNEX D

Nicaragua: Declining Levels of Foreign Assistance

While total foreign financial assistance to Nicaragua has continued to grow for a number of years, the level of aid from non-Communist countries has begun to decline. With a few exceptions, we believe that most developed and Latin nations will continue to scale back financing as their government leaders becomes more pessimistic about their ability to buy political moderation in Managua. Although Soviet and East European support is expanding substantially we do not believe that it will fully compensate for the loss of Western funds.

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Latin Support Tumbles

Financing from Latin America has fallen dramatically this year, largely due to concern among leaders in the region about the regime's repressive policies and its closer ties with Cuba and Eastern Europe. Their domestic financial crises also incline Latin leaders to take a harder look. We expect Latin American economic support to reach $148-158 million this year, compared to about $220 million in 1983. We project a further decline in the total again next year.

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Mexico, Nicaragua's largest Latin donor since the 1979 revolution, has slashed its aid from about $150 million in 1983 to at most $90 million this year. We believe President de la Madrid's cutback was prompted in part by a willingness to respond to bottom-line US concerns, in part by Mexico's own financial problems, and in part by his own dissatisfaction with the direction of the Nicaraguan revolution. The primary vehicle for the cutback has been the decrease in Mexican oil shipments, which until this year had been supplied on credits that neither side anticipated would ever be repaid. We expect that Mexican oil shipments this year will reach at most $80 million, down from roughly $130 million last year.

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Financing from **Venezuela** and **Brazil**, which were substantial donors in the early years of Sandinista rule, fell to about $10 million apiece in 1983 and will drop again to roughly $5 million each this year. Nicaragua's credit lines with Brazil are now exhausted and will unlikely be renewed.

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Brazilian economic officials also recognize that Managua has passed the limit of its

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creditworthiness. 25X1

Argentina is the only Latin American nation to have substantially increased its credits this year, and that also seems likely to be cut back after November. President Alfonsin, arguing that economic leverage might induce the Sandinistas to open the political process, agreed in March to a $45 million line of credit. Argentine aid had previously been limited to a credit line extended in appreciation for Nicaragua's support during the 1982 Falklands war for the year as a whole we expect Nicaragua to draw on this credit line for about $25 million. We believe that Buenos Aires expects some political liberalization for its money, however. Should the regime adopt more repressive tactics on civil liberties and political opposition after the November elections Alfonsin in turn would probably discreetly scale down disbursements under the current credit and take a harder stance in the future. 25X1

Slowdown from the West

Economic support from the West has probably also reached its peak, but will decline more slowly than has Latin financing. We estimate that assistance from Western industrial nations will total $84 million this year, down about $4-19 million from 1983, and that it will decline again next year. 25X1

Few leaders of Western industrial nations remain persuaded that their assistance can be used as leverage to induce the Sandinistas to adopt a different political course, and the regime's repeated failure to fulfill its promises regarding domestic liberalization is prompting several European countries to scale down their economic support. For some leaders, however, continuing financial gestures to the Sandinistas will remain a relatively cheap way to shore up their support from the left at a time when they are struggling to implement more important policies--such as austerity in France or NATO membership and US base rights in Spain--that face heavy leftist opposition. 25X1

The **Netherlands**, which in 1981 committed itself to a 5-year reconstruction program disbursing $10-$15 million per year, recently told US officials that it will phase out its aid almost completely after the program expires next year, largely due to the Hague's dissatisfaction with Sandinista political and military policies. At about the same time, Dutch officials decided to step up their assistance to neighboring democratic

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Costa Rica. Dutch aid to Managua has been largely concentrated on agricultural, road and port development projects. 25X1

Financing from **West Germany**, which averaged about $19 million annually between 1979-81, will also disappear. FRG officials have told the US Embassy that current programs will be allowed to expire, and that no new commitments will be made. Like the Dutch, German officials have told US diplomats that they have moved against Nicaragua in large part because of the Sandinistas' failure to allow political pluralism. 25X1

Spain has been one of Nicaragua's most consistent financial supporters, disbursing by our estimates, some $10-20 million in supplier credits and humanitarian aid every year since the 1979 revolution. Madrid also rescheduled Managua's $62 million bilateral debt in early 1981 on fairly easy terms, and forgave $2.3 million in overdue interest, according to the US Embassy in Managua. Madrid's current program--a $45 million, 3-year line of supplier credits--will expire in 1986. Nicaragua has been trying to negotiate a second, $5 million line from Madrid 25X1 25X1

We doubt that Madrid will grant the additional credits soon or be willing to renew the $45 million package after the current one expires. Since it was announced in mid-1983, we believe that Prime Minister Gonzalez has become increasingly disillusioned about the nature of Sandinista rule. Moreover, we believe that Gonzalez--like Argentina's Alfonsin--might discreetly slow the pace of disbursements should there be a return to substantially tougher domestic policies after the Nicaraguan elections. Thus, we project that Spanish financing in 1984 will probably reach $8-10 million, in contrast to an estimated $15-20 million last year. 25X1

We expect **French** support, by contrast, to remain at roughly constant or only slightly lower levels next year. We estimate French assistance at $18-22 million in both 1983 and 1984. Should plans for a new geothermal project go forward next year, Paris would lend $9 million toward its cost, and probably provide some $10 million in other assistance. We believe that emerging French concern over Nicaragua's political direction, however, will at a minimum preclude Paris from significantly increasing its financing, and perhaps induce a gradual decline. 25X1

France is the only West European power to have granted military assistance since the revolution--$16 million in a mix of credits and grants in 1981. There is almost no prospect that more such aid will be forthcoming. 25X1

Aid from **other Western nations** will remain roughly constant this year. $8 million in Austrian aid in 1983 will probably not be repeated

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this year. Canadian assistance may total $13 million, roughly double 1983 levels, but almost half the money is to go for a water purification project which does nothing to ease Managua's most pressing problems of paying for consumer and industrial imports.

25X1

Declining Multilateral Aid

Prospects of substantial funding from multilateral sources are becoming increasingly poor. Nicaragua is currently some $10 million in arrears to the International Monetary Fund, which this summer cut off Nicaragua's access to Fund resources until the books are cleared of arrearages. Similarly, Managua's roughly $6 million arrearages to the World Bank recently prompted Bank management to declare Nicaragua in default--the first such country in Bank history, according to US officials. Bank rules specify that no disbursements can be made to countries in default.

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In the year ended June 30, 1983, the Bank disbursed about $16 million to Nicaragua, and we believe that roughly $3 million in currently-approved Bank lending is being held up by the default. Disbursements from the Inter-American Development Bank will probably total some $20 million in the year ending June 30, 1985, down from the previous year's $33 million.

25X1

The Soviet Response

We expect total Communist financing to reach $470 million this year, compared to $270 million in 1983. Moscow and its Communist allies have increased their support substantially this year, in part to help compensate for the decline from other sources. The most important example is Moscow's decision to make up entirely for the decline in Mexican oil deliveries. We estimate that Soviet oil deliveries will total some $85 million this year, up from just $2 million in 1983. In a marked departure from usual Soviet policy, we believe that Moscow is requiring little or no immediate payment for the petroleum. It seems most unlikely that Managua will repay any substantial part of its debts to the USSR over the next several years. We expect disbursements of non-oil economic assistance from the Communist countries to reach some $135 million this year, down slightly from about $165 million in 1983. This aid is mainly supplier credits for manufactured goods, but also includes substantial technical assistance and some donations of foodstuffs and fertilizers. In addition, we have noted a few instances of actual loans or donations of hard currency from Cuba, but believe that these remain relatively small. We

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estimate that financial assistance for military purchases will reach $250 million. 25X1

In general, however, Communist help is a poor substitute for Western assistance. 25X1 25X1 The quality of technical assistance also appears to be inferior. 25X1

Uncertain Support From the Middle East

Although three Middle Eastern nations have provided some economic support in the past, we do not believe that any of them will be reliable partners in the future. In 1983, **Algeria** agreed to pay preferential prices for Nicaraguan sugar after the United States slashed Managua's sugar quota, an arrangement that should have netted the Nicaraguans roughly $14 million. 25X1 the deal has not been as remunerative as Managua expected, 25X1 and we doubt that Algeria will provide substantial new aid in the future. 25X1

In both 1982 and 1983, **Iran** lent Nicaragua roughly $27 million by allowing Nicaragua to resell a tankerload of Iranian crude and deferring payment from Managua until 1985 and 1986. 25X1 Iran has been very late in paying for some of its imports 25X1 from Nicaragua and the prospect of another oil loan next year is uncertain at best. 25X1 **Libya** lent Managua $100 million and since then may have contributed additional money for construction of a new sugar mill. Qadhafi's record in keeping promises of financial aid is poor, however, and we doubt that the regime is counting on much if any additional money from Tripoli. 25X1

Implications

On balance, even if the dollar value of Communist aid rises substantially, we doubt that it will fully compensate for the decline in aid from other sources. These trends will markedly affect both popular living standards in the short run and the country's industrial base over the somewhat longer term. 25X1

Discontent over worsening living standards erupted in a flurry of work stoppages in August and September, shortly after the regime restored the right to strike. The Sandinistas have taken a very hard line, however, threatening to declare one strike illegal and refusing to negotiate on several others until workers returned to work. Rather than

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again revoking the right to strike after the elections, and incurring additional international disapproval, we expect the regime to continue with the less visible, but still hard-line tactics it has used recently. The Sandinistas may also attempt a strategy of dividing the workers by providing substantial pay raises to non-strikers. As living conditions continue to worsen, however, and most wage hikes are wiped out by inflation that may reach 90 percent this year, we expect more labor unrest, and some additional marketplace disruptions. 25X1

The problem is exacerbated by the Sandinistas' unwillingness or inability to revive the economy. We foresee little if any change in domestic policies, which have consistently tended to increase the government's role in business decisions and to claim additional sectors of commerce and industry as the exclusive preserve of the state. 25X1

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Table 1

Projected Official Foreign Financing to Nicaragua in 1984

(million US $)

Total: 760-790

Western Europe	67-84	Western Hemisphere	148-158
Austria	2-3	Argentina	25
Finland	4	Brazil	5
France	18-22	Canada	13
Italy	2-4	Colombia	5-10
Netherlands	14-18	Mexico	90
Norway	8	Peru	5-10
Spain	8-10	Venezuela	5
Sweden	11		
West Germany	2-4		

Communist Countries	470	Other	47
For:			
Oil	85	Algeria	14
Weapons	250	Iran	27
Other	135	Japan	3
		Taiwan	3

Multilateral	26-31
World Bank	2-6
Inter-American Development Bank	20
European Economic Community	3-4
UN Food and Agriculture Organization	1

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ANNEX E

Nicaraguan Imports

Table 1

Nonmilitary Imports -- 1982
(Million US $ CIF)

	Total	Consumer Goods	Petroleum and products	Intermediate Raw Materials	Machinery and Transport
World	776	171	180	237	238
U.S.	148	37	5	56	50
W. Europe	103	45	0	57	1
Japan	18	0	0	5	13
Canada	50	8	0	3	39
Mexico	154	12	120	11	11
Central America	129	46	7	64	12
South America	57	3	38*	11	5
U.S.S.R	39	1	0	1	37
Other Comm.	50	11	0	21*	18

* Venezuela only.
** Cuba accounts for $17 million.

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Table 2

Composition and Trade Partners
(million US $)

	Average 1975-77		1982	
	$	% of Total	$	% of Total
CONSUMER GOODS of which:	128.6	---	171	---
FOOD	48.0	100	95	100
W. Europe	3.0	6.2	32	33.7
France	0	0	13	13.7
Ireland	0	0	8	8.4
Netherlands	0	0	6	6.3
United States	21.0	43.7	28	29.4
Latin America	22.3	46.4	18	18.9
Costa Rica	9.0	18.7	7	7.3
Guatemala	7.0	14.6	6	6.3
Cuba	0	0	5	5.3
OTHER FINISHED GOODS	80.6	100	76	100
W. Europe	13.3	16.5	13	17.1
Spain	2.0	2.5	6	7.9
W. Germany	4.3	5.3	3	3.9
Switzerland	2.6	3.2	3	3.9
United States	15.0	18.6	9	11.8
Latin America	49.6	61.5	43	56.5
Costa Rica	13.0	16.1	12	15.8
Guatemala	13.3	16.5	10	13.1
Bulgaria	0	0	4	5.2
PETROLEUM AND OTHER FUELS	82.6	100	180	100
Mexico	0	0	120	66.6
Venezuela	68.6	83.0	38	21.1
Panama	3.0	3.6	6	3.3
United States	4.6	5.5	5	4.1

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	Average 1975-77		1982	
	$	% of Total	$	% of Total
INTERMEDIATE RAW MATERIALS	217.3	100	237	100
Latin America	75.3	34.6	86	36.3
Guatemala	19.3	8.8	26	10.9
Costa Rica	22.6	10.4	22	9.3
W. Europe	42.6	19.6	57	24.0
France	2.0	0.9	17	7.2
W. Germany	18.3	8.4	12	5.0
Italy	2.3	1.0	8	3.4
Spain	1.0	0.5	7	2.9
United States	71.6	32.9	56	23.6
Cuba	0	0	17	7.2
Mexico	4.3	1.9	11	4.6
Japan	16.6	7.6	5	2.1
MACHINERY AND TRANSPORT GOODS of which:	174.3	---	188	---
MACHINERY	114.3	100	138	100
United States	55.3	48.4	44	31.8
W. Europe	30.0	26.2	35	25.4
W. Germany	13.0	11.4	11	7.9
Italy	4.6	4.0	11	7.9
Spain	4.6	4.0	6	4.3
USSR	0	0	16	11.6
Mexico	2.6	2.3	7	5.0
E. Germany	0	0	6	4.3
Japan	13.3	11.6	5	3.6
TRANSPORT GOODS	60	100	50	100
USSR	0	0	21	42.0
Japan	20.3	33.8	8	16.0
United States	17.6	29.3	6	12.0
W. Europe	17.0	28.3	4	8.0
Spain	9.0	15.0	2	4.0
W. Germany	3.0	5.0	1	2.0
Mexico	2.6	4.3	4	8.0
E. Europe	0	0	2	4.0
E. Germany	0	0	2	4.0

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Table 3

Composition of Imports
(in percent)

1979	1980	1981	1982	1983 [1]		
Total Imports	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	
Consumer Goods	**27.0**	**29.1**	**24.3**	**20.6**	**20.1**	
Nondurable	21.6	24.2	19.6	15.0	14.7	
Durable	5.4	4.8	4.7	5.6	5.4	
Intermediate Goods [2]	**39.1**	**38.3**	**35.2**	**34.6**	**33.7**	
Inputs for agriculture	4.3	7.0	5.6	4.5	5.0	
Inputs for industry	30.7	28.0	26.3	24.1	24.8	
Construction materials	4.1	3.3	3.4	6.0	3.9	
Petroleum Products	**21.0**	**19.6**	**19.8**	**23.0**	**22.2**	
Crude and partially refined		18.2	16.7	17.3	19.1	15.6
Derivatives	2.8	2.9	2.5	3.9	6.6	
Capital Goods	**12.8**	**12.4**	**20.1**	**21.5**	**23.9**	
Agriculture	1.2	2.7	3.0	3.2	4.5	
Industry	8.7	6.9	12.1	14.0	15.0	
Transportation equipment	2.9	2.8	5.0	4.3	4.4	
Other	**0.1**	**0.7**	**0.6**	**0.1**	**0.1**	

(Source: IMF Statistics)

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1 Projections.
2 Excluding petroleum products.

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