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INFORMATION

*6-18-69*

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *HAK*

SUBJECT: Background on the Dispute with Peru

Attached is a memorandum sketching some of the background to the current IPC issue in Peru. You may find this of interest.

The memorandum states that the dispute between the United States and Peru stems from the convergence of three historically distinct phenomena: 1) the unique status and history of IPC in Peru; 2) growing Peruvian nationalism and 3) the legislative restrictions placed on US economic and military assistance. The memorandum's thesis is that any one of these three factors would independently have exacerbated our relations with Peru, and each has on a number of occasions in recent years. In combination, the three have made for the present serious impasse. The paper discusses only the first two.

The peculiar status of IPC as the only foreign company operating in Peru with a claim to ownership of subsoil wealth, the long history of nationalistic efforts to correct this anomaly, the public relations posture and labor policy of the company through its history, which left something to be desired in early years--all combined to sensitize the Peruvian public to the company. The memorandum traces the history of the dispute from the purchase of the concession by the International Petroleum Company to the present.

Growing nationalism has since the end of World War II caused a gradually evolving movement away from uncritical following US leadership. US economic power is so visible and preponderant in Peru that it has become a target for nationalism, and a creator of resentment over the years.

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NSS, State Dept. reviews completed

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The memorandum concludes that these two factors have converged to the point that most of Peru's military and present leaders are "determined to move the country out from under the US shadow."

Attachment:

Tab A. - Memorandum containing background on IPC-Peru

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**CENTRAL INTELLIGENCE AGENCY**

WASHINGTON, D.C. 20505

4 JUN 1969

**MEMORANDUM FOR:** Dr. Henry A. Kissinger  
Assistant to the President for  
National Security Affairs

**SUBJECT :** Background on the Dispute with  
Peru

Attached is a memorandum on the dispute with Peru which you requested from Mr. Smith on 22 May. As you know, this dispute stems from three distinct phenomena--the unique status of the International Petroleum Company; growing Peruvian nationalism; and the legislative restrictions placed on US assistance. The paper we have prepared addresses itself to the first two of these problem areas.

*Edward W. Proctor*  
EDWARD W. PROCTOR

Acting Deputy Director for Intelligence

Attachment

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No. 1571/69  
4 June 1969

MEMORANDUM

Background of the Current Dispute with Peru

The dispute between the United States and Peru stems from the convergence of three historically distinct phenomena: (1) the unique status of the International Petroleum Company (IPC); (2) growing Peruvian nationalism; and (3) the legislative restrictions placed on US economic and military assistance. Any one of these would independently have irritated US-Peruvian relations. In fact, each of them has done just that on a number of occasions in recent years. In combination the three have made for the present serious impasse. This paper discusses the first two.

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**SECRET**The International Petroleum Company (IPC)

The IPC has been the only foreign company operating in Peru--or, for that matter, in any major Latin American country--to claim actual ownership of subsoil wealth. Rights to subsoil deposits in Latin America have traditionally been reserved for the nation.

The IPC appears to have acted in good faith when it acquired title to the subsoil deposits in the La Brea y Parinas oilfields. The rights were originally acquired by a Peruvian in 1826, transferred to a British company in 1889, and sold by that company to the IPC in 1924. Two years earlier--in 1922--an international arbitration award had settled a dispute between the British and Peruvian governments over taxes to be applied to the oilfield exploitation. The award confirmed that the property included the subsoil deposits. Even in 1922, however, private ownership of subsoil deposits was an anomaly in Peru. Very recently, and with the advantage of hindsight, a British oil company official commented: "We sold the IPC a timebomb in 1924, and they never learned how to defuse it."

As long ago as 1943 there were political pressures in Peru to nationalize new fields being developed by IPC in the La Brea y Parinas area, but successive Peruvian governments did not officially challenge IPC's title to the subsoil deposits until 1963. In that year the Peruvian Congress, at the urging of newly inaugurated President Belaunde, unilaterally abrogated the international award of 1922. Then, in 1967, the Congress passed more legislation declaring that state ownership of the La Brea y Parinas deposits had been "recovered" by the 1963 legislation and authorizing expropriation of related above-ground installations. IPC's operations were not immediately affected. Political leaders, however, used nullification of the titles to claim that IPC had been guilty over the years of "unjust enrichment" and that its "illegal" operations in La Brea y Parinas had resulted in a debt to the Peruvian nation.

Negotiations between the company and the Belaunde government ensued and, after many fits and starts, a comprehensive settlement was reached in

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August 1968. Key provisions of this "Act of Talara" were recognition by the IPC of the state's ownership of the La Brea y Parinas subsoil rights in return for release of IPC from any debts to the state for its prior operations in La Brea y Parinas. This settlement might have been made to stick in 1963, or perhaps even in 1967, but August 1968 was too late. Belaunde's "sell-out" to the IPC grew into a major political controversy and promised to be a hot issue in the developing campaign for the presidential election, then scheduled for June 1969. Even Belaunde's own political party split over the issue. "The Act of Talara," and the political crisis it produced, became the pretext for the military coup of 3 October 1968.

On 4 October, the new military government decreed the nullification of the "Act of Talara," and on 9 October, in another decree-law, it announced the expropriation of the IPC's Talara refinery and related installations. These acts were greeted with widespread popular support from all segments of Peruvian society.

When it took these actions, the military government recognized the principle of compensation for the expropriated refinery and related installations, but not for the subsoil rights at La Brea y Parinas. It stated that the government would evaluate the expropriated surface assets and offset them by the "debt" which IPC had incurred by "illegally" operating the oilfields for the past years. In February 1969 the "debt" was formally declared to be \$690 million. Meanwhile, a special government commission evaluated IPC's refinery and related above-ground facilities at \$54.7 million.

For more than three months after the October decrees, the IPC continued its marketing and distributing operations in Peru by ad hoc arrangements with the state petroleum agency. This arrangement came to an end on 28 January 1969 when the state took over full operational management of the

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company. The company's assets that had not been included in the October expropriation were seized and are to be auctioned off to satisfy an alleged \$14 million debt incurred by the company for the products drawn since October from the Talara refinery for distribution through its marketing facilities.

During its 44 years in Peru, the IPC has had a variety of other difficulties with the Peruvian Government. One of the most troublesome related to the tax system that was to apply to exploitation of the oil and gas deposits. In 1951 the company's status for tax purposes was altered so that it became one of the country's biggest taxpayers.

The IPC's public relations posture, its labor policies, and its tactics in dealing with government were probably neither better nor worse than those of other comparable foreign companies operating in Latin America. These company policies apparently left much to be desired in the 1930s and 1940s, when the company's Talara complex is reputed to have been something akin to a foreign enclave on Peruvian soil. Peruvians still tell stories about prominent government officials or military officers being denied entry to the complex by overzealous IPC officials. It is pertinent to note that President Velasco was born and raised near Talara. It is likely that his current attitude toward the IPC was shaped in part by his early impressions of company practices.

During the 1950s, the IPC launched an effort to improve its local image and to bring more Peruvian nationals into company operations. Its public relations effort was evidently not the most effective, but its policy of training Peruvians in technical and managerial positions in the company does seem to have been successful. One high company official remarked recently: "We trained them too well; now they can run the business without us." Another official testified that at the time of the seizure "we had 4480 employees, of which only 45 were North Americans."

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The attitude toward IPC among other American businessmen in Peru is revealing. The US Embassy found very little sympathy for IPC when it canvassed the American business community in Lima early this year. Most businessmen were critical of the IPC's handling of its problems with the government over the years and some were even skeptical of the company's good faith in seeking negotiations. It has been reported that many American companies in Peru feel they will be hurt by the effort of the US Government to protect one.

### Growing Peruvian Nationalism

The history of Peruvian foreign relations since the end of World War II reveals a gradually evolving movement away from the former pattern of uncritically following the US lead in world affairs. Geographic proximity to the US and US economic power had argued for a close alliance with the US. But most Peruvians--at least those in the upper echelons of government and society--had traditionally felt a much greater affinity for the Latin countries of Western Europe than for the Anglo-Saxon society in the US. In a period of expanding international horizons after World War II many Peruvians came to feel that their country's national interests were not necessarily identical in all instances with those of the United States, and that if Peru were to play a role in the United Nations and elsewhere on the world scene it should make and pursue its own policies.

The first official reflection of the trend toward a more independent foreign policy came during the second administration of President Manuel Prado (1956-1962). Whereas some Latin American countries had begun to look to the Afro-Asian "third world" or to the Soviet bloc in pursuit of a more independent policy, Peru under Prado looked to Western Europe. The Belaunde administration (1963-1968), though it was forced to concentrate on domestic issues most of the time, moved further along the road toward an independent policy. It was cautiously approaching diplomatic and commercial ties with the Soviet Union prior to its overthrow last October.



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In this period of widening international interests, Peruvian policymakers have felt themselves hemmed in and their options limited by the dependence of the Peruvian economy on US economic power. US firms dominate many of the country's export industries and have been increasing their influence in domestic trade. In 1968, the US purchased 39 percent of Peru's exports and supplied 38 percent of its imports. From fiscal years 1961 through 1968, the US authorized Peru a total of \$354 million in economic aid and Export-Import Bank loans and \$82 million in military assistance. Actual disbursements have been below these figures. In addition, international lending agencies in which the US is influential have authorized some \$250 million in loans, and Peru has also received large loans from private US banks.

US economic power is so great in Peru that what may seem to be a relatively minor decision in Washington can have very serious repercussions there. A dramatic example of this took place in 1958 when Washington decided to cut Peru's quota for lead and zinc exports to the US--a move that would have had a serious impact on the Peruvian economy. An angry President Prado authorized a protest demonstration. The Peruvian Congress passed a resolution censuring the US action and instructing the Peruvian Government to sell the country's lead and zinc to any market it could find, including Communist countries. The US subsequently decided to ignore the quota system and to buy Peru's entire 1958 production of these minerals. The incident did, however, strengthen the argument of those Peruvians who had been maintaining that Peru must, in its own self-interest, reduce its dependence on the US market by expanding commercial ties elsewhere in the world.

Peruvian resentment over US economic power has been latent most of the time in recent years, but it peaks suddenly whenever the United States consciously or unconsciously uses economic pressures to influence Peruvian policy. There have been a number of occasions in recent years when the US has

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threatened or actually used economic pressure in response to actions taken by the government in Lima.

- a. Immediately after World War II the Bustamante administration bucked strong domestic opposition and reversed a wartime decision to nationalize new oilfields developed by IPC--because it feared a cutoff of US aid.
- b. In 1962, the US broke diplomatic relations with Peru and suspended economic assistance until the Peruvian military, which had seized the government, gave assurances that it would restore democratic processes.
- c. In late 1965 and early 1966, a large portion of the US developmental assistance that Peru was expecting was held up when it appeared that the Belaunde government was moving toward expropriation of the IPC.
- d. In 1967, US economic aid was suspended after the Peruvian Government, against US wishes, purchased French-built Mirage supersonic jet fighters.
- e. Periodically since 1947 attempts by Peru to enforce its claimed 200 mile territorial waters limit have resulted in seizures of privately owned US tuna boats operating without the required Peruvian licenses. US protests have often been regarded as threatening in Peru, and, on 18 February 1969, the US suspended foreign military sales to Peru because of the seizure by Peru of two US boats four days earlier.

To a Peruvian nationalist, these US "threats" and "reprisals" are unacceptable infringements of sovereignty. The Peruvian military men who came to power in October 1968 are all fervent nationalists, and many of them harbor particularly strong resentments over US actions during the Mirage episode. Moreover, the IPC issue--which has now directly involved the US Government--provided the military regime with its *raison d'etre*, and no member

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of that regime can reasonably be expected to back down in the face of threatened US sanctions. The Peruvian military are not a monolith, and there are some officers who are privately critical of the present government's course. On the whole, however, it must be presumed that many Peruvian officers feel a special sense of gratification over their courage in standing up to the United States and over the high degree of public approval their actions have generated. The indications are that Peru's present leaders remain determined to move the country out from under the US shadow.

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**ACTION**  
**June 16, 1969**

**MEMORANDUM FOR DR. KISSINGER**

**FROM: Viron P. Vaky**

**SUBJECT: Memorandum on Background to IPC Case**

In the last Review Group meeting on the Peru paper, you mentioned that you were not sure if the President was aware of the history and issues of the IPC case. CIA volunteered to prepare a brief memo and has now done so. The memorandum is very brief and what is in it had been included in greater detail in the early IG papers on Peru.

The President may find this shorter version of interest, however, if he has not seen the earlier studies.

**RECOMMENDATION:**

That you sign the attached memorandum to the President.

**Attachment:**

**Tab A - Memorandum from HAK to the President**

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