SECRET

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OPTIONS FOR ACTION TO REDUCE TENSION IN THE ANDES

1. Unilateral Action by the U.S. Government

2. Multilateral Action by American States

3. Action by the OAS

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1. Unilateral Action by USG

A. General

1) Improve our capability for assessing alarmist reports such as those which came in during December.

2) Avoid well intentioned USG probes into possible-war situations in the Andes, which tend to reinforce the development of fears of war there.

B. Actions to Remove Root Causes of Tension

1) Demonstrate to the two smaller nations as well as the two larger ones our active concern for peace in the area.

2) Approach arms suppliers to agree to limit sales to areas of possible tension.

3) Restrain Soviet arms sales by introducing Latin America into the detente picture. ?

4) Consider modification of arms sanctions against Chile, providing human rights performance improves. ?

5) Approach Peru on arms limitation but also the other countries.

C. Actions in Event of an Imminent Outbreak of Hostilities

1) In face of a real threat, warn Peru by private demarche.

2) Follow up demarche to Peru with talks with Chileans, Ecuadoreans and also Bolivians; emphasize consequences of breaching a frontier and of Soviet/Cuban involvement on the Peru side.

3) Go quietly on record with concerned parties that US will not tolerate Cuban military intervention; if necessary, warn Cuba directly not to meddle.

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4) Press Peru to accept an early visit by OAS Secretary General as a peacemaker and to allow him to ascertain troop movements. ?

2. Multilateral Action by American States

A. General

1) Reject or delay multilateral measures in favor of unilateral USG measures which we can control better. ?

B. Actions to Remove Root Causes of Tension

1) Stimulate multilateral effort on the part of Peru, Chile, Ecuador and Bolivia to stop the arms buildup. ✓

2) Have a third-party group approach Peru, Chile, Ecuador and Bolivia to help them find an acceptable formula for armament ceilings. UN? OAS?

3) Stimulate a multilateral effort to induce arms suppliers to limit sales. ✓

4) Suggest a multinational collective security guarantee to Peru, Ecuador, and Chile, within or outside of the OAS. ?

5) Have several nations guarantee a formula for access to the sea for Bolivia and, with a significant USG input, offer economic aid and perhaps some investment in the economic development of a restructured Peru/Chile/Bolivia border region once a political agreement is reached. ?

6) Organize a multilateral consultative process involving US, Argentina, Brazil, Colombia and Venezuela:

-- To share information

-- To trigger restraining collective or concerted representations in moments of acute uneasiness

-- To induce contending parties to accept inspections of border military dispositions

-- To serve as good-offices forum for area problems

-- To serve as a "lead group" of states to act within the OAS if and when necessary.

Initiate above by secretly sounding out Colombia and Venezuela first, then arrange for Colombia (not Venezuela) to make the pitch to Brazil. Let the existence of the ad hoc informal consultative group be known to Bolivia, Chile, Ecuador, Peru and the OAS.

C. Actions in Event of Outbreak of Hostilities

1) Have Colombia and Venezuela, as an Andean Pact initiative, urge moderation upon their Andean neighbors (suggested by Venezuelan President Perez). before war

2) Encourage Brazilian, Argentine, Colombian and Venezuelan demarches direct to the conflicting parties.

3. Action by the OAS

If OAS takes action

A. General

1) Defer OAS action to a later stage and then simply to endorse and lend legitimacy to an agreement already reached with our coaching.

B. Actions to Remove Root Causes of Tension

1) OAS to recommend solution of the Bolivia corridor issue.

2) OAS to focus on Andean region disarmament initiatives.

C. Actions in Event of Outbreak of Hostilities

1) OAS to demand conflicting parties to agree to respect present borders.

2) Andean states to be asked to inform neighbors and OAS of major military movements.

3) Engage OAS in a fact-finding role.

4) Initiate OAS peacemaking machinery.

File
Peru
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Articles

PERU: RENEGOTIATING ITS IMF STANDBY UNDER STRESS

Sunday night's announcement of further austerity measures needed to secure a new IMF standby agreement has led to sporadic public violence in Lima and other major cities. The military government had hoped to forestall the political impact of increased belt-tightening by deferring some measures until after the 4 June constituent assembly election. Even if the government stays with the IMF-mandated program, Peru will have to reschedule debt to official donors to get through 1978. Stopgap financing will be needed to stay current with the private external debt, and the next several months will be characterized by an intense foreign exchange squeeze.

Grudging Steps to Austerity in 1977

Following a decade in which Peru lived beyond its means, the military regime last year was compelled to take steps toward austerity. By early 1977, Peru's foreign creditors had become weary of the government's huge arms purchases and failure to restrain consumption and public expenditures. They refused to extend vital balance-of-payments support until Peru (a) obtained an IMF standby loan and (b) implemented IMF financial guidelines through at least one three-month evaluation period. Military resistance to cuts in arms purchases and violent leftist-organized civilian protests against reduced consumer subsidies delayed agreement on the standby.

A $105 million, two-year agreement with the IMF was finally signed in late November. By then Peru's arms buildup was largely complete, and the military was willing to accept a moratorium on new foreign arms contracts. Essential support from Peru's strong political parties was gained by announcing a timetable for returning to civilian rule by 1980. The harsh government-IMF package was designed to halve the current account and central government deficits and to cut inflation from 37 percent to 20 percent in one year, all without cutting real GNP.

Struggling With the Standby

Several steps were taken by early 1978 to implement the standby: Lima (a) devalued the sol by 38 percent; (b) increased commercial bank reserve requirements one-third to cut private credit expansion; (c) raised tax rates and revalued business, commercial, and farm assests to increase tax revenues; and (d) reduced subsidies on nongasoline petroleum products and numerous other consumer goods. These restrictive policies were inadequate, however, to achieve IMF first quarter financial targets even though real GNP had been lowered in the process.

[redacted] 25X1

Grain Imports

China

The Chinese purchased 1 million tons of US wheat and 200,000 tons of Argentine corn in April, bringing scheduled grain imports in 1978 to nearly 6 million tons. Rumors of substantial additional grain sales to China by the United States, Canada, and other suppliers continue to circulate in the market. The new purchases will make up for lagging shipments from Canada and Australia, where port congestion and harvest problems are causing delays. The United States is China's only potential source of large additional amounts of wheat until the fall, when Canada should be able to provide some additional amounts. The Chinese had a disappointing grain harvest last year, and supplies are tight in some areas. [redacted] 25X1

USSR

The USSR has already purchased US corn for delivery in the year beginning in October. [redacted] 25X1 It is too early to forecast confidently overall Soviet grain import activity in the October 1978 - September 1979 year, but CIA believes that during the current 12-month period of the US-Soviet grain agreement, the Soviets have spent about $2.7 billion in hard currency for 24 million tons of grain, 15 million, of which is of US origin. [redacted] 25X1

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The IMF in mid-March informed Lima that it had failed to meet standby conditions and was ineligible for the second loan installment. The principal IMF criticism was that public sector credit expansion exceeded its first quarter target by 7 percent because of inadequate reduction in the budget deficit. Once the IMF withdrew its support, an international commercial bank consortium postponed a $260 million credit designed to permit debt repayments due the banks this year.

Meeting the targets—particularly paring the budget deficit—would have been difficult under any circumstances. Other developments under the program—for example, devaluation and import reductions—compounded the problem by spurring inflation. Local currency requirements for external debt service, for example, have risen 76 percent because of devaluation alone. Overall, sol requirements for foreign interest and amortization obligations have been running 160 percent above last year and now account for one-fourth of expenditures by the central government and almost 90 percent of its foreign currency spending. The steep decline in real national production is lowering the tax base, further militating against reducing the budget deficit.

New Measures Taken

Wednesday of last week the military government announced economic measures necessary to open negotiations for a new standby. These measures include (a) an immediate 7-percent devaluation of the sol to be followed by further downward adjustments, (By Monday the sol had fallen another seven percent.), (b) a 10-percent import surtax; (c) a 17-percent take hike on traditional exports, (d) a sharp increase in most sales taxes, and (e) higher income taxes.

To gain the confidence of the international banking community—as well as to eliminate key Cabinet opposition to additional tough measures—the government named two civilians to Cabinet economic posts last Friday. Prominent bankers replaced army generals as the heads of the Ministry of Finance and the Ministry of Industry and Commerce.

This past weekend, Lima announced further draconian measures which (a) reduced military perquisites and (b) raised the price of gasoline 67 percent, public transportation 50 percent, bread 47 percent, and milk 42 percent. When gasoline prices were last raised in June 1977, national protests resulted in 20 deaths and required massive security action. The government had hoped to defer the unpopular measures taken on Monday until after the 4 June constituent assembly election, the first national election since 1963.

Isolated spontaneous demonstrations and looting erupted in major cities throughout Peru following these latest announcements. In an effort to partially defuse the situation Lima decreed a substantial wage hike of about 10 percent on Monday.

The announced austerity measures almost certainly will enable Peru to reach an accommodation with the IMF. Compliance with any renegotiated standby will prove difficult, and repressive enforcement measures may compromise the scheduled return to civilian rule.

The 1978 Financial Gap

We expect import cuts and moderate export growth to (a) produce a $50 million trade surplus this year, the first since 1973; and (b) halve the current account deficit.

New petroleum exports of $130 million and a higher volume of mineral exports should boost sales 10 percent, despite lower coffee and fishmeal earnings. Elimination of oil imports, the cumulative devaluation of the sol (down roughly 45 percent since

Peru: Foreign Financial Gap

	1973	1974	1975	1976[1]	1977[1]	1978[2]
			Million US $			
Trade balance	79	−403	−1,098	−740	−438	50
Exports, f.o.b.	1,112	1,506	1,291	1,360	1,726	1,900
Imports, f.o.b.	1,033	1,909	2,389	2,100	2,164	1,850
Net services and transfers	−271	−404	−442	−452	−505	−524
Current and account balance	−192	−807	−1,540	−1,192	−943	−474
Debt amortization	−352	−338	−284	−284	−391	−686
Financial gap	−544	−1,145	−1,824	−1,476	−1,334	−1,160
Autonomous medium- and long-term capital inflows	690	1,236	1,418	866	719	620
Direct investment	65	201	342	196	69	60
Project loans	625	1,035	1,076	670	650	560
Support loans and debt relief	Negl	Negl	210	580	12	540
Net short-term capital[3]	−62	309	−305	−107	503	Negl
Change in reserves	84	400	−501	−137	−100	Negl
Other financial items:						
External debt, yearend[4]	1,491	2,182	3,066	3,563	4,165	4,600
			Percent			
Debt service ratio[5]	31.6	24.3	27.5	27.9	29.2	41.8

[1] Estimated.
[2] Projected.
[3] Includes errors and omissions.
[4] Medium- and long-term, public and public-guaranteed debt.
[5] Debt service divided by exports of goods and services.

October, counting the latest move), and budgeted reduction in public sector imports should cut the dollar value of imports 15 percent and the volume perhaps 20 percent.

Soaring debt amortization costs this year will allow only a small reduction in Peru's financial gap, even with a halving of the current account deficit. Scheduled external debt repayments have jumped 75 percent to nearly $690 million this year, as grace periods on development loans and arms purchases ended. With scant foreign exchange reserves to draw on, Peru will need $1.2 billion in foreign funds to meet its external obligations. Only one-half this amount is lined up.

Even if Lima complies with the terms of a new standby, additional debt rescheduling will be needed to span the gap. Peru has already rescheduled $70 million due the USSR this year and hopes by fall to reschedule $170 million due non-Communist governments. Lima will also require a substantial amount of short-term rollovers since commercial banks are unwilling to provide medium-term financing until Peru has demonstrated compliance with any new IMF standby. Altogether, Peru will require $540 million in balance-of-payments support loans and official debt relief this year to cover its remaining external obligations.

Impact on the Economy

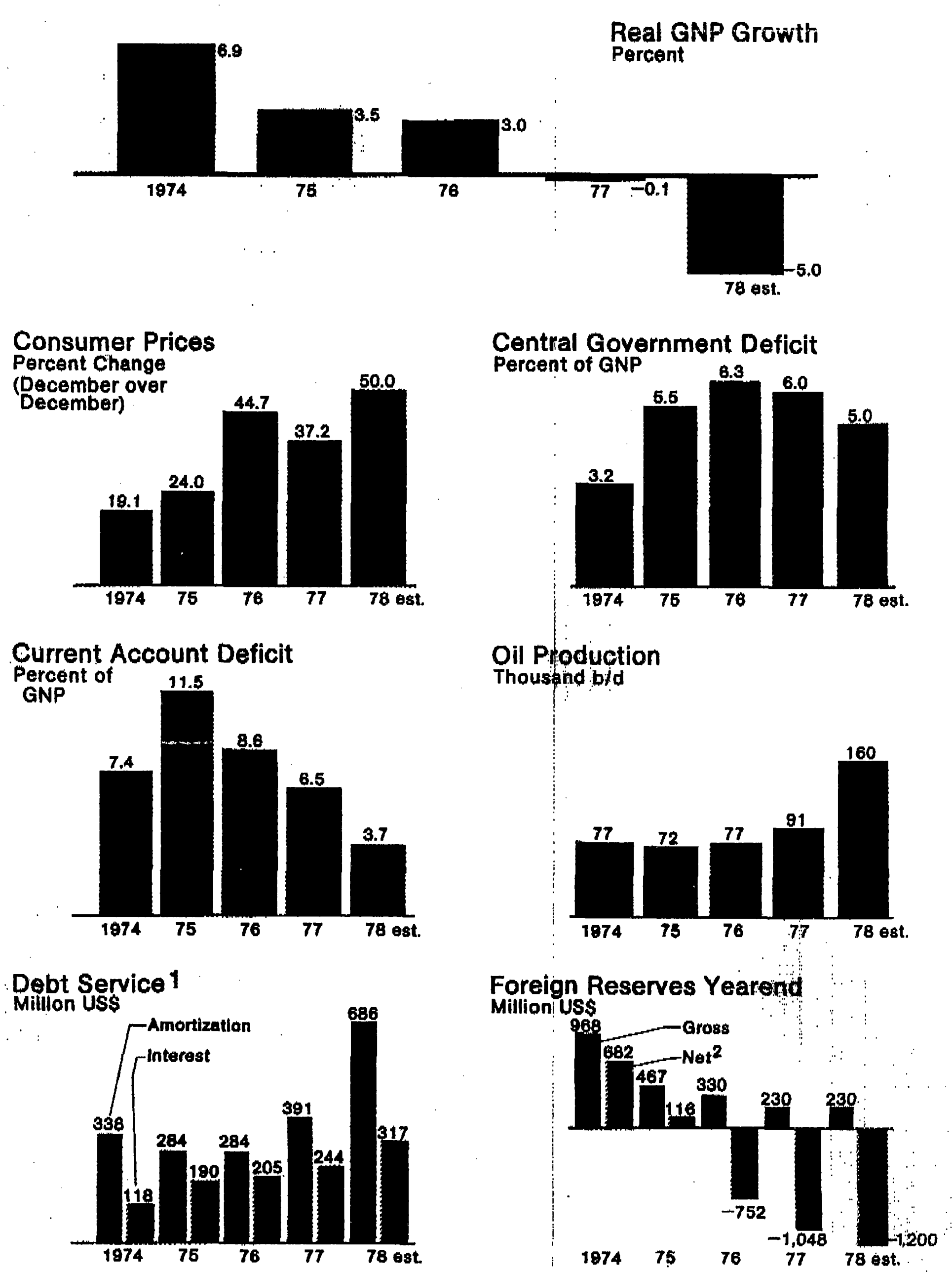
The combination of past austerity measures and the current foreign exchange crunch has already been reducing domestic output and eroding business confidence. Even if Lima obtains the $540 million needed to avoid default, Peru will continue experiencing an acute foreign exchange squeeze until bridge financing can be arranged. As it is, essential private sector imports are being slashed as the government skims off foreign exchange to service debt obligations.

For 1978 as a whole, we expect at least a 5-percent decline in real GNP and an 8-percent cut in real per capita income. Tight domestic credit controls have already taken a heavy toll on business investment, while raging inflation, falling real wages, and rising unemployment are undermining real consumption. As a result, output in all major sectors except mining will probably decline, the steepest drops coming in construction and manufacturing.

Outlook for 1979

Peru will need to maintain strict austerity at least through 1979. Weak world demand for minerals is expected to hold down real growth in exports, despite added capacity in export goods (minerals, agricultural commodities, and fishmeal). In these circumstances, the government will need to restrict import growth to meet moderately

Peru: Economic Indicators



1. Medium- and long-term, public and public guaranteed. 2. Short-term external assets minus short-term external liabilities.

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rising debt service requirements. Even if real imports remain at the 1978 level, the financial gap is expected to hover around $1 billion. As a result, Lima will almost certainly have to renegotiate $150 million due Western governments in 1979; the USSR has already rescheduled debts due through 1980. (Confidential)

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COFFEE PRICES: PROBABLE DOWNWARD DRIFT

Barring a recurrence of frost in Brazil, world coffee prices are expected to work gradually downward this year because of reduced consumption and improved global production. In turn, producers can be expected to continue actions aimed at defending prices and preventing the erosion of export earnings. These countermeasures will not be successful without full support of all producers—an unlikely prospect. Low world coffee stocks will make prices unusually sensitive to supply fluctuations in the months immediately ahead.

Production: Slight Recovery

World production of coffee in the 1977/78 marketing year beginning 1 October 1977 is estimated at 68.5 million bags by USDA—11 percent above the previous year's

World Coffee Production

Million 60-kilo bags

	1974/75	1975/76	1976/77	1977/78[1]
Total	**80.5**	**71.6**	**61.5**	**68.5**
Angola	3.0	1.2	1.2	1.4
Brazil	27.5	23.0	9.3	17.0
Cameroon	1.7	1.4	1.3	1.6
Colombia	9.0	8.5	9.3	9.8
Costa Rica	1.4	1.3	1.3	1.4
Dominican Republic	0.8	0.9	0.7	1.0
Ecuador	1.3	1.1	1.4	1.3
El Salvador	3.3	2.0	2.7	1.8
Ethiopia	2.1	2.1	2.1	1.9
Guatemala	2.5	1.9	2.5	2.0
Honduras	0.8	0.8	0.7	1.1
India	1.6	1.6	1.8	1.9
Indonesia	2.7	3.1	2.8	2.9
Ivory Coast	4.5	5.0	4.8	3.3
Kenya	1.1	1.3	1.5	1.5
Mexico	3.9	3.8	3.8	4.1
Nicaragua	0.7	0.7	0.9	0.9
Uganda	3.0	2.8	2.7	2.6
Zaire	1.1	1.1	1.4	1.5
Others	8.5	8.0	9.3	9.5

[1] Estimate of US Department of Agriculture for marketing year beginning 1 October 1977.

low level. Brazil's production increased almost 83 percent to 17 million bags. Production in Colombia is estimated at 9.8 million bags—up 5 percent over the 1976/77 level. Other producers expected to have substantial increases in production are Cameroon, Costa Rica, the Dominican Republic, Honduras, Angola, and Mexico. However, weather-related losses in some Central American countries and continuing political turmoil in Africa reduced the initial world harvest estimate by 2 million bags.

We expect production for the 1978/79 marketing year to be the largest in four years despite a severe drought in Brazil. Initial trade estimates of Brazil's upcoming harvest* have been reduced by three million bags, to 18 million bags, because of the drought. Longer term prospects could also be reduced if damage proves severe to younger coffee trees. Nonetheless, increased harvesting of high-yielding coffee trees in Colombia and Mexico and a recovery of production in El Salvador, Guatemala, and Ivory Coast should increase total world production.

Consumption Off

World coffee consumption in 1977 fell sharply in the wake of higher prices. Roastings in the United States fell 25 percent below the 1976 level and roastings in Europe were down more than 10 percent. Consumption in coffee producing nations was down only slightly. World consumption for the 1976/77 marketing year dropped 12 percent, to 70 million bags.

Some recovery in northern hemisphere coffee consumption occurred in first quarter 1978 but roastings were still below 1977 levels. Roastings in the United States were off 7 percent from year earlier levels. West European consumption was up slightly; even so, roastings were still about 8 percent below last year. Trade estimates indicate a reduction of about 4 percent in world coffee consumption for the 1977/78 marketing year.

Stocks and Prices

Coffee stocks were at a record low entering the 1977/78 marketing year. Brazilian stocks (35 million bags in July 1975) had been reduced to 6.6 million bags, and stocks in most other producing countries were at minimum levels. Stocks in major importing countries were also down sharply. For example, US stocks of 2.2 million bags on 31 March 1978 were 64 percent of the year earlier level.

Coffee prices are currently in the neighborhood of $1.70 per pound after peaking at $3.40 per pound in April 1977. Prices have hovered in the range of $1.70 to $2.10

* Because of a statistical convention, the Brazilian harvest of April through August is counted in the world marketing year beginning the following October.