The original documents are located in Box C51, folder "Presidential Handwriting, 11/8/1976" of the Presidential Handwriting File at the Gerald R. Ford Presidential Library.

THE WHITE HOUSE

WASHINGTON

November 8, 1976

MR PRESIDENT:

Emergency Balance of Payments
Assistance for Portugal

Staffing of the attached memorandum prepared by Brent Scowcroft resulted in the following recommendations:

Jack Marsh, Phil Buchen (Ed Schmults) agree with recommendation of NSC, State & Treasury.

Bill Seidman agrees with OMB and comments further. "If we do not hold out we will not get the proper actions. This could be New York City all over again."

NSC is asking that your decision be made as soon as possible.

Jim Connor

ITEM WITHDRAWAL SHEET
WITHDRAWAL ID 00952

Collection/Series/Folder ID No.	:	004700214
Reason for Withdrawal	:	NS,National security restriction
Type of Material	:	MEM,Memo(s)
Creator's Name	:	Brent Scowcroft
Receiver's Name	:	President
Description	:	Aid to Portugal.
Creation Date	:	11/06/1976
Volume (pages)	:	3
Date Withdrawn	:	05/23/1988

portions exempted

MEMORANDUM

5994

THE WHITE HOUSE

WASHINGTON

ACTION

~~SECRET~~

November 6, 1976

MEMORANDUM FOR: THE PRESIDENT

FROM: BRENT SCOWCROFT BS

SUBJECT: Emergency Balance of Payments Assistance for Portugal

Secretary of State Kissinger has written at Tab A requesting that you approve a three stage financial assistance package for Portugal. Secretary of the Treasury Simon concurs in this request (Tab B).

The Portuguese balance of payments ran a $1.1 billion deficit in 1975 and a $1.4 billion deficit is expected in 1976. Disposable foreign exchange reserves will be exhausted by the end of November. Secretary Kissinger concludes that the Portuguese success story threatens to unravel within weeks unless the recently installed democratic government receives prompt assurances of balance of payments assistance.

The first stage of the proposed assistance package would offer a six month $300 million gold loan from the Exchange Stabilization Fund (a "gold swap") to be implemented this year. The second stage is a U.S. contribution of $550 million to a $1.5 billion US/European/ Japanese medium-term market rate balance of payments loan to be disbursed over a three-year period, with the IMF monitoring Portuguese compliance with the conditions of the loan. The third stage consists of full reliance on normal sources of private capital and if necessary an IMF standby agreement. The Portuguese Government will be expected to develop satisfactory and increasingly tough stabilization programs during each stage of the assistance package.

Secretaries Kissinger and Simon request your consent to consult immediately with key Congressmen concerning U.S. contributions to the second stage of the program. Discussions with other potential donors would begin after initial contacts with the Congress. Discussions with the Portuguese would be held prior to November 15, when their 1977 budget is presented, and the entire package would be announced during the week of November 22.

DECLASSIFIED - E.O. 12356, Sec. 3.4
With PORTIONS EXEMPTED
E.O. 12356, Sec. 1.3 (a) (5)
MR 89-31, #1 NSC ltr. 9/8/89
By KBH, NARA, Date 10/17/89

~~SECRET~~ (XGDS-3)

The urgency of the Portuguese situation requires action prior to your FY 1978 budget review of U.S. foreign assistance programs, now scheduled for late November. It should be noted that your approval of the Portuguese package will increase the difficulty of meeting other priority aid requirements within budgetary constraints. A favorable decision on this proposal does <u>not</u> constitute approval of other assistance programs to Portugal, ... Budgetary details of the financial aid package will be developed by concerned agencies in cooperation with OMB.

OMB concurs in the recommendations of the Secretaries of State and Treasury to provide $550 million to Portugal as part of a consortium loan to be disbursed as follows: $300 million in the current fiscal year, $130 million in FY 1978, and $120 million in FY 1979 (see Tab C).

OMB has reservations concerning the economic reform program that Portugal will be asked to adopt to qualify for the consortium loan. OMB believes that greater IMF participation and more stringent austerity measures during the second stage will be necessary to make Portuguese economic reforms successful since:

-- the longer the new Socialist Government delays reforms the more they will be faulted for the pain of severe measures;

-- politically it does not make sense to heighten psychological apprehensions by proposing increasingly drastic austerity measures; and

-- Portuguese President Eanes is pressing Prime Minister Soares for rapid economic reforms.

State and Treasury believe that the proposed plan provides maximum feasible economic reform at this time considering Portugal's political situation since:

-- negotiations with the IMF could delay needed economic assistance; and

-- the stringent reforms required by the IMF for Portugal's socialist oriented economy would be politically unacceptable unless they are phased in more slowly.

I concur with the State/Treasury view.

RECOMMENDATION

That you approve U.S. participation in the aid package to Portugal as proposed by State and Treasury and authorize consultation with Congress concerning legislative aspects of the program.

APPROVE ________ DISAPPROVE ________

Or, alternatively,

That you approve U.S. participation but with the proviso that every effort should be made to reach agreement with the IMF in the second stage of Portugal's economic reform program (OMB view).

APPROVE ________ DISAPPROVE ________

approved + discussed in detail at NSC

A

THE SECRETARY OF STATE

WASHINGTON

5994
7622555

November 1, 1976

~~SECRET~~

MEMORANDUM FOR: THE PRESIDENT

From: Henry A. Kissinger K

Subject: Emergency Balance-of-Payments Assistance for Portugal

The Portuguese success story threatens to unravel within weeks unless the recently installed democratic government receives prompt assurances of balance of payments assistance. To meet this unacceptable political risk we believe a three-stage financial package for Portugal would be appropriate.

As the first stage, Treasury would offer a short-term commitment from the Exchange Stabilization Fund for a maximum period of six months in the form of a gold transfer to Portugal. The second stage of this integrated program would be a medium term (three years) balance of payments assistance credit involving U.S. participation with several other countries, followed in the third stage by full reliance on normal sources of private capital backed by the International Monetary Fund's regular resources in case of need. Each phase of this integrated financial package is based on the assumption that Portugal is committed to developing and implementing a satisfactory economic program.

Treasury Secretary Simon and I request your consent to consult immediately with key Congressmen on a new legislative program as part of a multilateral, $1.5 billion three-year assistance program in which the U.S. share would be between 30% and 40% of the total. The program would require legislative authorization and appropriation of about $300 million in fiscal year 1977, $130 million in FY 1978 and $120 million in FY 1979. The funds would be loaned for ten years. The

DECLASSIFIED
E.O. 12356, Sec. 3.4.
State ltr. 7/20/89 MR 89-32 #2
By KBH NARA, Date 8/2/89

~~SECRET~~
XGDS-3

interest rate would be at least at the cost of money to the U.S. Treasury. Fuller details are attached (Tab 4).

Assuming the Congressional response is favorable, we would then immediately discuss the proposal with other countries that might participate in the multilateral arrangement, first with the FRG and then with Japan, France and probably others.

We have arrived at this proposal only after carefully concluding that: (a) prospects for consolidating Portugal's fledgling democracy and for attaining full economic recovery are good, provided there is a solid economic program supported by the package outlined above; (b) recourse to IMF resources alone would be insufficient; (c) recourse to resources of other governments is also likely to be inadequate unless the U.S. participates directly; and (d) the Congress would probably respond positively to a comprehensive program for Portugal, and would not understand a failure to propose such a program in the present circumstances. A fuller analysis and justification, including tables on Portugal's budget, its balance of payments, and assistance received to date, is attached (Tab 5).

It is essential that we initiate discussions with the Portuguese government on the medium term package and on the short term commitment before November 15, the date on which it will present its 1977 budget and its development program to the parliament. We should be prepared to announce publicly our proposals for the entire package sometime during the week of November 22-26. An announcement at that time would avoid a potential political upheaval that would disrupt the present democratic process and threaten a return to the chaos of 1975.

Secretary Simon is writing you separately to confirm his full support for our balance of payments assistance proposals for Portugal.

Recommendation:

That you approve U.S. participation in the medium-term multilateral assistance package outlined above and that you authorize us to consult immediately with the Congress on the legislative aspects of the program.

Approve __________ Disapprove __________

Attachments:

Tab 1 - Proposed Financial Package for Portugal

Tab 2 - Possible Short-Term Financial Assistance to Portugal: Gold Loan to Portugal

Tab 3 - Short-Term Financial Assistance (Gold Loan) for Portugal: Intermediate Policy Assumptions.

Tab 4 - Specifics of the Medium-Term Financial Assistance Proposal

Tab 5 - Justification for Special Financial (Balance of Payments) Assistance and Review of Options

PROPOSED

FINANCIAL PACKAGE FOR PORTUGAL

The objective of this three stage financial package is to provide money and time for Portuguese policies to promote a balance of payments position, that can be financed through private channels and normal access to IMF facilities.

STAGE I. Short-Term Financial Assistance -- Gold Deposit

The first stage of the financial package would consist of a six month gold deposit arrangement (Tab 2) associated with appropriate Portuguese intermediate policies. These policies would consist of specific financial and economic measures congruent with political realities.

An outline of the proposed short-term policies is attached (Tab 3).

STAGE II. Medium-Term Political Rehabilitation Credit

The second stage of the financial package would consist of a $1.5 billion medium-term credit with participation of other countries and with Congressional authorization for U.S. participation. Funds would be disbursed over a period of several years in accordance with the success and needs of Portugal's economic policies. An outline of the proposed medium-term package is included as Tab 4.

This stage would involve a comprehensive Portuguese economic program worked out and agreed with the IMF and monitored by a continuing IMF mission in Lisbon (other competing program advisers would depart). A U.S. Government internal mechanism would also be created to coordinate U.S. participation in this program.

STAGE III. Access to Full IMF Tranches

As the Portuguese economy responds satisfactorily to this second stage, Portugal would become eligible for normal access to the credit facilities of the IMF.

00955

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM: Possible Short-Term Financial Assistance to Portugal

Gold Loan to Portugal

The Exchange Stabilization Fund (ESF) would make a loan of gold to Portugal, which would be repaid with the same number of ounces of gold. The gold loan would increase Portugal's reserves just as a loan of dollars would increase their reserves.

The loan would be in the form of a general deposit by the ESF of gold with the Bank of Portugal, with the gold held in the Federal Reserve Bank of New York. By this deposit, the Bank of Portugal would have legal title to the gold which it could then use like any other reserve holdings. The general deposit would be fully matched by gold from Portugal's reserves, to be held in a special custodial deposit in the N.Y. Fed. Portugal would continue to hold title to this gold but would agree to transfer title to the ESF should that be necessary to repay the gold loan from the ESF. Accordingly, there would be no risk of loss to the ESF.

This financing technique not only would increase Portugal's reserves, but would provide credit in a way that will allow Portugal to sell gold without having an immediate decline in its own gold reserves below the level prior to the loan -- sales which the Government of Portugal has indicated it would like to undertake.

This financing technique thus has the advantages of providing credit to Portugal, without risk to the U.S., in a manner that allows for the appropriate use by Portugal of its existing gold reserves.

Prior to agreement on any such arrangement, there would need to be consultations with appropriate members of the Congress.

~~CONFIDENTIAL~~

SHORT-TERM FINANCIAL ASSISTANCE (GOLD LOAN) FOR PORTUGAL

INTERMEDIATE POLICY ASSUMPTIONS

U.S. participation in this program is based upon the assumption that the Government of Portugal will continue to implement the following policies:

1. Treasury Budget

Expenditures for the 1977 central government budget, to be submitted on November 15, will be limited to a ten percent increase over the 1976 nominal level of E124 billion. The Government has already announced a 15 percent ceiling on central government wage increases. Other expenditures will be contained even further. With current rates of inflation of 25 percent, this budget limit will result in a real cut in public sector expenditures of an estimated 15 percent. (One technique of contributing to this would be to place a ceiling on central government hiring for 1977.)

The deficit for the 1977 central government budget will not exceed the 1976 level of E46 billion. (This deficit level and the 10 percent increase in nominal expenditures implies a 16 percent increase in nominal revenues.)

Within the Treasury budget, investments* will be increased by at least 25 percent in nominal terms, which would maintain or slightly increase their value in real terms.

Net domestic banking sector financing for public sector enterprises and public sector agencies, such as the Social Security Fund and the Supply Fund (which subsidizes consumer prices) will not exceed the nominal level of 1976. (With the announced 25 percent rate increases for transport rates and the 15 percent ceiling on wage increases, the stage should already be set for significant reductions in the subsidies to the transportation agencies.) Efforts should also be made to diminish credit to non-viable enterprises, whether in the public or private sector.

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*The investment budget as defined here excludes transfers to the state enterprises. State enterprises include, among others, public transportation (railways, airlines, merchant marine, municipal transportation), energy, and industrial and consumer goods enterprises.

2. Financing the Central Government Deficit

A major effort will be launched during the first quarter 1977 to finance an increasing portion of the central government deficit by non-banking sources.

3. Credit Guidelines

A ceiling on total domestic credit expansion would not be effective given the low credit demand from the Portuguese private sector. The interest rates now controlled by regulations will, however, be increased gradually by 2-4 percentage points over the next six months. The first increase of one percentage point will be undertaken at once. (Current interest rate levels for 3 month loans vary from 4.5 to 7.75 percent, compared with the Eurodollar rates for 3 month paper of 5.3 percent.) As the demand for credit increases from present abnormally low levels, the growth of the money supply will be watched closely so as to avoid further increases in inflationary pressures.

4. Wages and Prices

The 15 percent limit on the "Wage Bill" for the central government, announced by Prime Minister Soares in his September 9 speech, will be extended to the public sector as a whole. Efforts will also be made to establish the same norm for the private sector.* To enforce this, the government may restrict credit facilities to firms that do not comply with this limit.

The Portuguese Government will eliminate a number of price controls on luxury products within the next few months. The initial step might be to eliminate controls on 10 percent of the total number of all items currently on the price control list. Simultaneously, the government will announce its intention to take additional similar action in the future.

The government has already announced its intention to liberalize rent controls.

*This is important because all recent major wage negotiations in Portugal have involved arbitration by the Labor Minister. In effect, this measure will tend to revitalize labor-management negotiations and diminish labor tendencies to seek government involvement in wage negotiations.

5. Labor/Management Relations

The government has already taken significant administrative and legislative measures to alter labor management relations, particularly in terms of restoring management authority. Additionally, it has announced its intention to submit legislation on such major questions as large reductions in force for economic reasons and labor's role in management.

6. External Sector

Consideration of the exchange rate, the import surcharge, the import deposit scheme and other measures affecting the exchange system will be undertaken in 1977 when IMF advice is available. We have noted that the Portuguese Government has recently increased the import surcharge and imposed a prior deposit on selected items. We will express our belief that such restrictive measures tend to impair the medium and long-term recovery of the Portuguese economy.

Attachments: Central Government Revenues, Expenditures and Deficit 1973-1977

Expenditures and Deficit

1973-1977
(billions of Escudos)

	1973	1974	1975	1976	1977 P
Revenues	45.2	52.2	58.3	77.8	90.2
Expenditures	47.6	61.9	87.4	124.1	136.5
Current	41.8	54.2	74.1	103.6	110.9
Investment	5.8	7.7	13.3	20.5	25.6
Deficit	- 2.4	- 9.7	-29.1	- 46.3	- 46.3
GDP	281	338	373	500 1/	655.0 2/
Expenditures/GDP	16.9	18.3	23.4	24.8	20.8
Deficit/GDP	.9	2.9	7.8	9.3	7.1

Source: Bank of Portugal Annual Report, 1975, p. 164 for 1973-1974. Lisbon 6603 for 1975-1976.

1/ Assumes 3 percent real rate of growth and 30 percent increase in prices.

2/ Assumes 6 percent real rate of growth and 25 percent increase in prices.

In addition to the E 46 billion Central Government deficit, the social security system, the Supply Fund and public enterprises have deficits as follows:

Portugal's Estimated 1976 and Projected 1977 Public Sector Deficits (billions of Escudos)

Central Government Deficit	46
Social Security System	15
Supply Fund (of which E 9 billion is investment, the remainder for food subsidies)	14
Public Enterprises	10
Total Public Sector Deficit	85

These deficits, which total E 85 billion, amount to an estimated 17 percent of Portugal's 1976 GDP, but which, if contained in nominal terms, would decline to 13 percent in the 1977 projected GDP.

OASIA/IMA
10/26/76

ITEM WITHDRAWAL SHEET
WITHDRAWAL ID 00957

Collection/Series/Folder ID No. ..... : 004700214
Reason for Withdrawal .... : NS,National security restriction
Type of Material .... : BRP,Briefing Paper(s)
Creator's Name .... : Henry Kissinger
Receiver's Name .... : President
Description .... : Specifics of the medium-term financial assistance proposal for Portugal.
Creation Date .... : 11/1976?
Volume (pages) .... : 3
Date Withdrawn .... : 05/23/1988

PORTUGAL

JUSTIFICATION FOR SPECIAL FINANCIAL (BALANCE OF PAYMENTS) ASSISTANCE AND REVIEW OF OPTIONS

PROBLEM

The Portuguese success story -- highlighted by President Ford's recent comments -- threatens to unravel within weeks unless the newly installed democratic government receives immediate balance-of-payments assistance. Without such support there is a likelihood of military intervention, resurgence of Communist and/or ultra-right influence, and an eventual return to chaos paralleling that of 1975. With prompt assistance, which should be linked to a medium-term program with conditions designed to assure a successful long-term economic stabilization program, we stand a good chance of consolidating the pro-West democratic turnaround.

This paper explores options for providing immediate balance of payments assistance tied to a longer term economic stabilization effort.

DISCUSSION

Situation

Portugal's liquid foreign exchange reserves in August were approximately $630 million, of which $250 million are required by the banking system for day-to-day transactions. Further foreign exchange losses in September, October and November are expected to be $50 million, $150 million and $150 million, respectively, leaving disposable reserves virtually exhausted by the end of November. (Table at Annex A)

European sources already have lent Portugal $1 billion against gold collateral -- $250 million in 1975 and $750 million in 1976 (Table at Annex B), and are unwilling to make further loans at this time. Theoretically the Portuguese could sell some of their remaining untied gold (about $1.7 billion in bullion at current prices), but for psychological reasons -- including fear of a loss of gold on the part of the unsophisticated military -- they are unable to do so at this time. There also are reasonable prospects for negotiating private bank loans to the government and extended commerical credits, but this will take more time than the Portuguese have at the moment, and will depend heavily on evidence of continuing U.S. support and on further implementation of promised stabilization measures.

The armed forces, still uncertain about the minority Socialist government's ability to bring about economic recovery under democratic rules, are closely watching the reserves situation. If the reserves approach exhaustion we could expect the worst results politically and economically: a likely military takeover plus draconian measures that in the end would set back economic stabilization while playing into the hands of the resurgent ultra-right and the still-dangerous Communists. Measures might include:

-- direct controls incompatible with any renewal of private sector activity, e.g. a block on remittances and royalty payments abroad, massive surcharges on international transactions, and a multi-tier exchange rate system;

-- uncontrolled drops in consumption;

-- surges in the prices of basic necessities (and more unemployment, already 15%).

Conditions would be ripe for a return to scenarios similar to the events of 1975.

There are other reasons for U.S. action as well. The Europeans feel they have done a great deal and they want to see the U.S. do its part. Moreover, we have repeatedly assured the Portuguese of our support if they would take politically difficult actions; now they are looking to us to make good on our assurances.

Perhaps most important, there is a strong likelihood that we could consolidate the Portuguese success story and set the stage for a recovery that would obviate the need for further aid after two or three years more if we provide immediate balance of payments assistance under conditions that would assure faithful execution of the full stabilization program which Prime Minister Soares has already acknowledged is necessary.

Soares' political record in confronting the Communists and keeping Portugal pointed toward NATO and Western Europe is good. Communists have been ousted from key positions in ministries dealing with education and information, they are being weeded out of lower bureaucratic levels throughout the government, and they are being challenged head-on in their agricultural strongholds as well as in the labor movement.

In his two-and-one-half months in office Soares has stretched his present political writ to the limit to deal courageously and forthrightly with the economic situation. He has instituted politically unpopular measures to restore labor productivity, decrease consumption and contain government expenditures. He plans other strong measures, probably including devaluation and an increase in interest rates once productivity shows signs of recovery and an incomes policy is in place. He must also deal with three political obstacles:

-- a Socialist Party congress scheduled for October 30 - November 1 at which Soares says he can bring his party's left wing under control if he receives concrete evidence of U.S. support;

-- municipal elections on December 12 which are billed as a kind of referendum on the minority Socialist government; and

-- a forthcoming labor congress in late December or early next year which probably will lead to a split between the Communist-controlled and the democratically-controlled unions.

General Approach to Assistance

Help for Portugal will be most constructive and will have the best chance of success if it addresses both immediate and medium-term needs. As the preceding section shows, an immediate loan (perforce short-term, given the limited instrumentalities available) is essential if Portugal's democratic experiment is to survive until adequate longer-term resources can be made available. Soares has asked for $300 million. On the other hand, without the prospect of adequate medium term help, Soares is likely to reject the conditions we want to attach to our immediate assistance; in that case the immediate help would cut motivation to take further stabilization steps now; there would be little prospect the loan could be repayed when it came due; we would, in effect, only throw good money after bad.

A U.S. initiative on medium term help would be well received. Soares has already asked us to take the lead in arranging a consortium that would provide $1 billion next year. Key officials in Lisbon have hinted that they would welcome some external pressures to carry through on their stabilization program if the pressures are accompanied by meaningful balance of payments assistance.

The assistance must be medium term because foreign exchange shortfalls will continue for some time. On the basis of reasonable assumptions (footnote in attached balance of payments table, Annex A), the overall deficit in Portugal's 1977 balance of payments is estimated at about $700 million. A 15% increase in oil prices would raise the deficit to about $800 million. Given its lack of disposable foreign exchange reserves, and having exhausted for the moment its official borrowing capacity, Portugal has no prospective financial sources available to cover this projected deficit.

After 1977 we can expect Portugal's deficits to be covered increasingly from non-public sources if there is an effective stabilization program. Such a program would take some time to correct the basic structural problems occasioned by the economic disorganization of the past two years, the attempts to effect a major redistribution of income, the enlargement of the public sector, the loss of overseas territories, and the influx of over 600,000 refugees (9% of the population).

OPTIONS ON IMMEDIATE ASSISTANCE

The Europeans have said they will loan Portugal no more this year. The political constraints on Soares' government are such that he probably could not arrange to draw more than a first extended credit tranche -- about $49 million -- by the end of the year, a totally inadequate amount. Sufficient private credits could not be negotiated in time, especially if it becomes obvious that the governments which have supported Portugal's democratic evolution so far, suddenly are not supporting the Portuguese government.

The U.S. is Portugal's sole remaining hope. To provide immediate relief, we must rely on non-appropriated resources. These are, in theory: (a) a currency swap with the Federal Reserve; (b) a Federal Reserve loan against gold collateral; (c) a loan from the Exchange Stabilization Fund (ESF) of the Treasury Department; or (d) a gold deposit or loan from the ESF which would permit Portugal to sell at current market prices the gold that it borrowed. (Description of the gold deposit arrangement is at Annex C.)

Neither the currency swap nor the ESF cash loan is possible without a clear guarantee of repayment when the loan is up in six months. No such guarantee is in sight. Portugal probably will not be able to negotiate an IMF stand-by to permit a full drawing against all credit tranches for at least a year. Similarly, a gold collateral cash loan is unacceptable in the Portuguese view because we would have to value the gold at the official $42.00 per ounce instead of at market value ($110-$120 per ounce); and unacceptable from the U.S. view because it runs counter to our efforts to demonetize gold.

Consequently, we have chosen the gold deposit in which we lend our gold against a Portuguese pledge of their gold. The deposit will allow Portugal to mobilize more of its gold reserves at current market prices without the psychological backlash that would arise in Portugal if the country were selling its own reserves.

OPTIONS ON MEDIUM TERM ASSISTANCE

There are basically two options:

(1) We could urge Portugal to seek as soon as possible a stand-by agreement with the IMF for access to Portugal's four "expanded" credit tranches ($195 million), or to an equivalent amount under the IMF's extended Fund Facility (latter offers longer-term repayment), and hope that such an arrangement attracts enough additional private or European public financing to keep Portugal going. There also would presumably be some gains in net official reserves from some turn-around in the Portuguese balance of payments as a result of Portuguese stabilization measures.

(2) We could sponsor a major multilateral assistance effort ourselves, still keeping the IMF involved as the sole mentors on the stabilization program. We would begin to seek immediately the necessary Congressional authorization and appropriations. The short-term gold deposit would be repaid as soon as enough appropriated funds to cover the value of the gold became available.

(If the Congress had ratified U.S. participation in the OECD Financial Support Fund, that fund would have been a third option for medium term assistance to Portugal. It is understood that the proposal for U.S. participation in this fund will be resubmitted to the 95th Congress. However, given the imperative of having to address Portugal's medium term balance of payments needs now, we cannot regard potential use of the OECD Support Fund as a realistic third option at this time.)

Option One Advantages

-- Simple to effect because no Congressional authorization or appropriations needed.

-- Provides maximum pressure to take the most drastic kinds of austerity measures in Portugal. which, if they succeeded, would probably lead most quickly to an enduring recovery.

-- Politically neutral in terms of assistance conditions since the U.S. would not be dictating specific policy measures to the Portuguese but would be relying on the discipline provided by an agreed or contingent IMF stand-by agreement.

-- Allows maximum scope for additional private banking loans to Portugal.

Option One Disadvantages

-- Stabilization measures sufficiently stringent to satisfy the IMF probably could not be effected in Portugal before the end of 1977 without military intervention, setting the political process back by two years.

-- Resources likely to become available in the next nine months probably would be insufficient to prevent another foreign exchange crisis that would reproduce the same critical immediate issues as are faced now in Portugal.

-- U.S. failure to participate directly would be seen in Portugal as deliberate refusal to make good on assurances of support made repeatedly to democratic forces over the past two years.

-- The Portuguese would probably force an immediate renegotiation of U.S. bases rights in the Azores with the intention of forcing support at much higher levels than we now contemplate.

Option Two Advantages

-- Balances economic necessity with political reality in Portugal, providing the best available chance for full economic recovery under a democratic regime.

-- Recognizes our political commitment to Portugal.

-- Takes advantage of favorable Congressional attitudes.

-- Retains substantial political neutrality on assistance conditions by keeping the IMF in the forefront as the external mentor of Portugal's economic program while the country is recovering to the point where it would be politically feasible to adopt the more stringent conditions customary in IMF multi-credit tranche stand-by agreements.

-- Retains the present favorable atmosphere for extension of our existing Azores rights.

-- Provides a basis for broader-based balance-of-payments support in conjunction with our major allies; i.e., the support is likely to be sufficient.

-- Would facilitate Portuguese economic planning and have greater likelihood of attracting additional investment capital from abroad.

-- Permits necessary economic adjustments to take place over a longer time frame and thus softens the political impact of the changes in relative and absolute incomes which are associated with economic stabilization programs.

Disadvantages of Option Two

-- Requires Congressional approval which will be time-consuming at best, and not forthcoming at worst.

-- Might jeopardize further the changes of Congressional ratification of the OECD Financial Support Fund Agreement in the 95th Session. (Why have a multilateral financial safety net if weaker countries can be bailed out through special bilateral loans?)

-- Other countries receiving U.S. assistance through project and sector loans will want to be switched to "balance of payments loans", and some countries seeking massive U.S. assistance (e.g., Italy, UK, Mexico) will also want the more liberal terms possible through special appropriations. (Currently A.I.D. loans go only for programs. Ex-Im and CCC loans are tied intrinsically to U.S.exports.)

-- Congress might refuse to appropriate both balance of payments money (even though loaned at its cost to the U.S. Treasury) and funds for assistance through A.I.D. and the FMS program (latter necessary for a new Azores agreement).

Recommendation

The Department of State and the Treasury Department conclude that the high political and economic risks of Option One are unacceptable. They therefore recommend Option Two.

(Millions of U.S. Dollars)1/ ANNEX A

		1973 2/	1974 2/	1975 2/	1976 E	1977 P
I	Current Account	346.8	-823.4	-839.4	-1,085	-1,057
	A. Merchandise	-902.1	-1,988.7	-1,607.2	-1,727	-1,920
	1. Exports	1,843.0	2,288.4	1,938.9	1,973	2,370
	2. Imports	-2,745.1	-4,277.1	-3,546.1	-3,700	4,290
	B. Invisibles	1,248.9	1,165.3	767.8	662	863
	1. Tourism	320.0	257.9	148.2	140	230
	2. Transportation	-71.0	-144.7	-155.3	-155	-175
	3. Insurance	-11.9	-17.9	-4.7	-5	-7
	4. Investment income	85.5	129.1	-10.5	-83	-95
	5. Transfers	1,096.6	1,110.5	923.7	925	1,100
	6. All other	-170.3	-169.6	-133.6	-180	-190
II	Capital Account	-273.4	198.2	-341.2	-295	350
	A. Short term (net)	-131.9	-74.1	-178.0	-95	115
	B. Medium & Long term	-141.5	272.3	-163.2	-200	235
	1. Private sector	-37.2	354.5	-76.4	-160	175
	2. Public sector	-104.3	-82.2	-86.8	-40	60
III	Errors and Omissions	267.2	-8.0	120.0	-	-
IV	Total Deficit	340.6	-633.2	-1,060.7	-1,380	-707
V	Deficit Financing					
	A. IMF reserve position	-	-	32.9	-	-
	B. Banking sector	5.2	0.5	4.9	-	-
	C. Change in reserve assets	-345.8	632.7	1022.9	1,380	707
	1. Bk. of Portugal	-336.2	614.8	1044.9 3/	1,380 4/	707
	2. Treasury	-3.9	-23.7	0.9		
	3. Other institutions	-23.5	56.9	-12.5		
	4. Relations with former escudo area	17.8	-15.3	-10.4		

1/ Exchange rates:
$ U.S.1 = 24.673 escudos (annual avg. of mkt. rates) for 1973
$ U.S.1 = 25.408 " " " " " for 1974
$ U.S.1 = 25.553 " " " " " for 1975
$ U.S.1 = 31.126 " " " " " for 1976
$ U.S.1 = 38.908 " " " " " for 1977
2/ Source for 1973-1975: Annual reports of the Bank of Portugal
3/ Includes loans of $250 million from Bank for International Settlement and $50 million from Swiss National Bank.
E Estimates based on six month data
P Projections based on following assumptions:
(1) Escudo devaluation of approximately 25 percent; (2) Adoption of an aggressive export drive and imposition of relatively few import restrictions on the private sector; (3) A small increase in domestic interest rates; (4) Restoration of labor productivity; (5) Continued rapid progress toward political stability; (6) Further increase in public sector investment; (7) GNP growth of 6 percent; and (8) No oil price increase.
4/ Includes gold-secured loans of $250 million from the Bank of International Settlement, $250 million from the German central bank, and $250 million from a consortium of European central banks led by the Germans. In addition, the Portuguese drew $174 million from the IMF this year.

5/ A 15% oil price increase would add another $90 million to the projected 1977 balance of payments deficit, bringing the total to $797 million.

10/27/76

ANNEX B

US ASSISTANCE TO PORTUGAL (FY 75 - 78)

($ MILLIONS)

	Grants	Loans	HIGs	PL480	CCC	EXIM	TOTAL
FY 1975*	.75	14.25	20	-	-	24	59
FY 1976 & TQ*	43.5	29	20	25	67.8	-	185.3
FY 1977 **	2	53	-	50	75	#	180
FY 1978 ***	5	45	10	50	#	#	110
TOTAL	51.25	141.25	50	125	142.8	24	534.3

* Agreements signed, disbursements in progress or complete

** Planned

*** Tentative

To be determined

FOREIGN ASSISTANCE TO PORTUGAL (SINCE 1975)

($MILLIONS)

EEC Project Loans	410	(under 100 disbursed)
EFTA Industrialization Loan	100	(no disbursements to date)
BIS Loan	500	($250 m loaned 5/75, disbursed rolled over in early 1976, and another $250 m added 5/76; due May, 1977)
FRG Development Loan	27	(Disbursed)
FRG Central Bank Loan	250	(Disbursed; repayable 2/77 but there is possibility of roll-over)
Swiss Central Bank Loan	50	(should have been repayable 8/76)
European Central Banks	250	(made 8/76; $75 m disbursed)
IMF	174	(disbursed)
Bilateral aid	30	(approximate)
	1791	(presumably at least $975 million disbursed)

ANNEX C 00959

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM: Possible Short-Term Financial Assistance to Portugal

Gold Loan to Portugal

The Exchange Stabilization Fund (ESF) would make a loan of gold to Portugal, which would be repaid with the same number of ounces of gold. The gold loan would increase Portugal's reserves just as a loan of dollars would increase their reserves.

The loan would be in the form of a general deposit by the ESF of gold with the Bank of Portugal, with the gold held in the Federal Reserve Bank of New York. By this deposit, the Bank of Portugal would have legal title to the gold which it could then use like any other reserve holdings. The general deposit would be fully matched by gold from Portugal's reserves, to be held in a special custodial deposit in the N.Y. Fed. Portugal would continue to hold title to this gold but would agree to transfer title to the ESF should that be necessary to repay the gold loan from the ESF. Accordingly, there would be no risk of loss to the ESF.

This financing technique not only would increase Portugal's reserves, but would provide credit in a way that will allow Portugal to sell gold without having an immediate decline in its own gold reserves below the level prior to the loan -- sales which the Government of Portugal has indicated it would like to undertake.

This financing technique thus has the advantages of providing credit to Portugal, without risk to the U.S., in a manner that allows for the appropriate use by Portugal of its existing gold reserves.

Prior to agreement on any such arrangement, there would need to be consultations with appropriate members of the Congress.

~~CONFIDENTIAL~~

B

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

~~SECRET~~

MEMORANDUM FOR THE PRESIDENT

Subject: Possible Financial Assistance for Portugal

The political grounds for U.S. participation in an integrated program of financial assistance to Portugal have been presented to you in a separate memorandum from Secretary Kissinger. I believe the proposed financing package also makes good sense from a broad economic and financial viewpoint. The Portuguese Socialist government has begun to attack the serious problems of inflation, decolonization, and erosion of labor discipline and productivity that resulted from the near takeover by the extreme left in 1975, and is making gradual progress in these directions.

The political and economic problems of the past few years have, however, created such distortions and disequilibria in the Portuguese economy that the piecemeal approach to assisting Portugal which we have been pursuing, up to now, using small amounts from agricultural and other programs, carries high risks of failure. With the right kind of financial help, Portugal has good prospects for resolving its problems over time in such a way as to become an effective part of an open international economic system, and in such a way as to offer reasonable prospects for repayment of its external debts.

To accomplish this, we believe a three-stage financial package for Portugal, conditioned on sound economic policy undertakings on the part of the Portuguese authorities, is appropriate. As the first stage of this integrated package, Treasury would negotiate with Portugal a short-term commitment from the Exchange Stabilization Fund, for a period of six months, in the form of a gold deposit with Portugal, to be repaid by a retransfer to the Exchange Stabilization Fund by Portugal of the same physical weight of gold.

~~SECRET~~

The second part of this program would be a multilateral package of medium-term balance of payments assistance totalling about $1.5 billion phased over three years, in the form of loans repayable over ten years. This would involve negotiating with several other countries (initially Germany, France and Japan), with a target for the United States share between 30 percent and 40 percent of the total amount. U.S. participation in this medium-term credit would require legislative authorization and appropriations of approximately $550 million, with $300 million to be disbursed in 1977, $130 million in 1978 and $120 million in 1979. The interest rate should at least cover the cost of money to the United States Treasury.

We would urge the Portuguese to develop and implement an economic stabilization and recovery program in cooperation with the International Monetary Fund. We would also like to see the IMF monitor this program for the duration of the second stage financing, even though the money provided would come from a group of countries and not from the IMF itself. As the Portuguese Government begins to meet the full range of criteria in the financial and economic sphere which is necessary for medium-term assistance under the regular credit tranches of the Fund, Portugal would also be able to draw on those regular resources of the Fund, if needed, to supplement private capital imports. This would constitute the third and final stage of the three-stage program.

Each year of the multilateral financing program would be based on undertakings by Portuguese authorities to develop and implement a satisfactory economic stabilization program, so designed as to restore Portugal's financial viability, to pursue an open and liberal international transactions regime, and to continue to restore the private sector of the economy, thus enabling it to participate fully in future Portuguese economic progress.

Secretary Kissinger and I are requesting approval of this proposal and in particular of the legislative program for medium-term financial assistance. If you concur, we would consult with all possible speed with key members of Congress. If the Congressional response to the proposed legislative program were judged to be favorable, we would then begin discussions with officials of foreign countries that might participate in this medium-term financing

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SCHEDULE OF EXECUTIVE ORDER 11652
EXEMPTION CATEGORY 5-B-3
~~AUTOMATICALLY DECLASSIFIED ON~~

The timing of our actions is vital. We need to be able to outline this package of short-term and proposed medium-term credits to the Portuguese Government before it presents its 1977 budget to its Parliament in mid-November. We wish to emphasize the need for Portugal to adopt economic and financial policies for the future that could justify a large financial commitment by other countries.

In my view such financial assistance would not have a lasting effect unless the Portuguese pursue economic and financial policies that would justify such a commitment of funds. The participation of other countries is also crucial.

Under such conditions, I would join Secretary Kissinger in recommending your approval to our proceeding along the lines suggested herein.

William E. Simon

Attachments

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EXEMPT FROM GENERAL DECLASSIFICATION
SCHEDULE OF EXECUTIVE ORDER 11652
EXEMPTION CATEGORY 5-B-3
~~AUTOMATICALLY DECLASSIFIED ON~~

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

NOV 4 1976

~~SECRET - GDS~~

MEMORANDUM FOR: THE PRESIDENT

FROM: James T. Lynn

SUBJECT: Budget Increases for Portugal

State and Treasury are proposing a special emergency financial package for Portugal which would necessitate a budget supplemental of $550 million in 1977 (attached). OMB has reviewed the proposal and concurs that for both political and economic reasons, Portugal urgently needs substantial additional assistance.

The proposal envisions three separate steps:

- an immediate gold swap of $300 million,
- a $1.5 billion three-year medium term loan by a consortium of donors, and
- an ultimate standby agreement with the IMF.

OMB believes that some measures along the above lines are necessary to give the current government a chance of survival, but that the proposed measures by no means assure Portugal's economic recovery or political stability. In addition, OMB has serious reservations about several aspects of the proposal.

A. Role of the IMF

The State/Treasury proposal would utilize the IMF as a program monitor in the second stage, but assumes that the consortium loan should not be conditional on Portuguese adoption of the major economic reforms which the IMF would require as part of a standby agreement. Instead, the consortium loan would be conditioned only on a milder set of reforms, with the need to reach a standby agreement with the IMF postponed for at least another year. It may be possible to convince the IMF to accept this role, but it does not place them in the leadership role. IMF involvement and leadership will be critical to the chances for success of the Portuguese aid package.

DECLASSIFIED
E.O. 12958 Sec. 3.6
MR 93-5, #11; NSC letter 11/27/95
By lit NARA, Date 5/22/96

~~SECRET - GDS~~

In addition, several considerations argue against the State/Treasury proposal for delaying the difficult reforms:

- The Portuguese public knows the economy is in a shambles and needs drastic remedial measures. If basic reforms are taken promptly, their necessity can be attributed to the chaos of the revolutionary period. The longer the Socialist Party delays, the more responsible for the current state of the economy they become, the more they will be faulted for the pain of severe measures, and the more reluctant they will become to take the necessary reforms.

- Psychologically and politically it makes good sense to get the toughest measures over at the outset, rather than presenting the public with the prospect of a protracted set of increasingly difficult measures.

- The Portuguese President (a military man) is pushing the democratically elected Socialist Government to move more rapidly on economic reform.

B. Congressional Considerations

The current proposal is to ask Congress for entirely new authority to make a one-of-a-kind balance of payments loan to Portugal. The $550 million U.S. share of the $1.5 billion consortium loan would be sought in a single supplemental and disbursed as follows: $300 million in the current fiscal year, $130 million in FY 1978, and $120 million in FY 1979.

- While the Congress is favorably disposed toward Portugal, it may be extremely reluctant to create a new, precedent-setting program.

- Annual appropriations under the existing supporting assistance program may ultimately prove to be the preferred vehicle for the loan.

C. Budget Decisions

The urgency of the Portuguese situation does not permit waiting until your FY 1978 budget review of U.S. foreign assistance programs, now scheduled for late November. The present proposal assumes that the consortium loan will be in addition to all other assistance programs proposed for Portugal in FY 1978. You should be aware that:

- The sum of agency proposals for economic assistance already exceeds OMB planning guidelines by over $2 billion, thus making difficult reductions in other foreign aid programs inevitable.

- Decisions on the rest of the aid package to Portugal are premature given the pending negotiations on bases in the Azores, although State wants to make the package fully additional to proposed 1978 programs.

Recommendation

I recommend that you approve the proposed Portuguese financial package, based on the following understandings:

1) Favorable decision on this proposal does not constitute approval of other assistance programs for Portugal, which will be taken up in the course of the regular budget review.

2) Final decision whether to go to Congress for separate authority or under supporting assistance authority will be made on the basis of congressional soundings and further consideration within the Executive Branch.

I also believe that you should instruct State and Treasury to make a strong effort to bring the IMF and the Portuguese Government together, so that a standby agreement could be reached simultaneously with agreement on the consortium loan. We should try to have the major necessary Portuguese economic reforms agreed to at the time we sign the loan and this is more likely if the consortium loan is directly linked to the IMF standby. Consultations with Congress and potential donors could begin now as long as the ultimate IMF role is left open.

Attachment

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: November 6, 1976 Time:

FOR ACTION: ✓ Phil Buchen
✓ Jack Marsh
✓ Max Friedersdorf
✓ Bill Seidman
✓ Bob Hartmann

cc ~~(for information)~~:

FROM THE STAFF SECRETARY

DUE: Date: Monday, November 8 Time: 3:00 p.m.

SUBJECT:

Scowcroft memo (11/6) re: Emergency Balance of Payments Assistance for Portugal

ACTION REQUESTED:

___ For Necessary Action

___ Prepare Agenda and Brief

_X_ For Your Comments

_X_ For Your Recommendations

___ Draft Reply

___ Draft Remarks

REMARKS:

Marsh - approve NSC
Hartmann - no comment
Friedersdorf - go with Marsh
Buchen - Approve NSC
Seidman - see note

SECRET ATTACHMENTS

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor
For the President

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.:

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___ Draft Remarks

REMARKS:

SECRET ATTACHMENTS

Agree with recommendation of NSC, State & Treasury. —

[signature] 11/8/76

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Jim Connor
For the President

NOV RECD THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: November 6, 1976 Time:

FOR ACTION: Phil Buchen ~~cc (for information)~~:
Jack Marsh
Max Friedersdorf
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Bob Hartmann

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ACTION REQUESTED:

___ For Necessary Action X For Your Recommendations

___ Prepare Agenda and Brief ___ Draft Reply

X For Your Comments ___ Draft Remarks

REMARKS:

If we don't hold out we won't get the proper actions. Agree with OMB.

SECRET ATTACHMENTS LWS

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Jim Connor
For the President

THE WHITE HOUSE

ACTION MEMORANDUM — WASHINGTON — LOG NO.: NOV 6 1976

Date: November 6, 1976 — Time:

due: 11/8 3:00

FOR ACTION: Phil Buchen
Jack Marsh
Max Friedersdorf
Bill Seidman
Bob Hartmann

~~cc (for information)~~:

FROM THE STAFF SECRETARY

DUE: Date: Monday, November 8 — Time: 3:00 p.m.

SUBJECT:

Scowcroft memo (11/6) re: Emergency Balance of Payments Assistance for Portugal

ACTION REQUESTED:

___ For Necessary Action — X For Your Recommendations

___ Prepare Agenda and Brief — ___ Draft Reply

X For Your Comments — ___ Draft Remarks

REMARKS:

SECRET ATTACHMENTS

Approve

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor
For the President

11/6/76 - 12:30 pm

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: November 6, 1976

Time:

FOR ACTION: Phil Buchen
Jack Marsh
Max Friedersdorf
Bill Seidman
Bob Hartmann

~~cc (for information)~~:

FROM THE STAFF SECRETARY

DUE: Date: Monday, November 8

Time: 3:00 p.m.

SUBJECT:

Scowcroft memo (11/6) re: Emergency Balance of Payments Assistance for Portugal

ACTION REQUESTED:

____ For Necessary Action

X For Your Recommendations

____ Prepare Agenda and Brief

____ Draft Reply

X For Your Comments

____ Draft Remarks

REMARKS:

No comment

RTH

SECRET ATTACHMENTS

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If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor
For the President

THE WHITE HOUSE

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: November 6, 1976 Time:

FOR ACTION: Phil Buchen
Jack Marsh
Max Friedersdorf
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Bob Hartmann

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____ Draft Reply

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____ Draft Remarks

REMARKS:

SECRET ATTACHMENTS

Defer to Jack Marsh

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

Jim Connor
For the President