

Foreign Policy, [10/76-1/77] [2]

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FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
Memo	Watson to Pres. Carter, 4 pp., w/attachments, Re: Foreign Policy issues <i>SA 117260 1/17/13</i>	11/11/76	A
Memo	Aaron (NSC) to Pres. Carter, w/attachments, 6 pp. Re: Remarks by Brezhnev <i>opened 1/6/93</i>	11/18/76	A
Memo	Watson, Eizenstat, Aaron to Pres. Carter, 1 p. Re: Meeting with George Bush <i>OPENED 1/17/13</i>	11/18/76	A
Memo	Eagleburger (DOS) to Lake, 1 p. Re: Philippines <i>opened, 10/3/11, MR-08-289</i>	11/19/76	A
Memo	Italian Ambassador to Aaron (NSC), w/attachments, 3 pp. Re: Message from Pres. Andreotti	11/22/76	A
Memo	Brzezinski to Pres. Carter, w/attachments, 2 pp. Re: Middle East	11/23/76	A
Memo	Sen. Ribicoff to Pres. Carter, w/attachments, 6 pp. Re: Middle East <i>opened 1/6/93</i>	11/76	A
Memo	Eizenstat to Pres. Carter, 1 p. Re: Israel <i>opened 1/6/93</i>	11/30/76	A
WHCA Transmittal form	Aaron (NSC) to Pres. Carter, w/attachments, 13 pp. Re: Turkey	11/30/76	A

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For: President-Elect Jimmy Carter

From: Senator Abe Ribicoff

Personal and Private Background Notes on the Middle East
For President-Elect Carter, Vice President-Elect Mondale,
and Secretary of State-Designate Vance Only.

The following are some summary notes on the Middle East
drawn from discussions in Israel and Egypt.

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PER 8/2/92 NLS HRE MR-4K-91-66
BY Jay NARS, DATE 1/6/93

ISRAEL

Political/Economic Issues

This is a difficult period in Israel. The economy is unhealthy and is burdened by a high rate of inflation and heavy defense costs. Political unity is at a low ebb with strikes prevalent and political leaders already looking toward the elections a year from now. Nonetheless, Israel is very strong militarily and has bargaining chips for a settlement. Prime Minister Rabin informed the delegation that 1977 would certainly bring a peace initiative, and Israel was ready to cooperate. Rabin's description of the Israeli approach to peace had three main points:

- (A) The Israelis hope to move to peace through negotiations;
- (B) If real peace cannot be achieved, Israel would like to reach intermediate goals by taking some steps toward peace;
- (C) Israel would not discuss peace with preconditions.

The current Israeli leadership is reticent to move quickly towards serious negotiations but probably fears the domestic political ramifications of not doing so. Prime Minister Rabin said that he looked to peace negotiations to bring an end to the state of war "with all its legal and practical implications" - meaning normal diplomatic recognition, treaties, and territorial settlements. Israeli reluctance to move quickly towards a settlement was reflected in the tenor of our talks. Rabin warned against creating expectations which could bring an outbreak of war. Moreover, he clouded the essential (such as territory and the Palestinians) by adding peripheral points (such as the necessity for open boundaries and free movement between Israel and her neighbors). News accounts after our return to the United States suggested that the Israeli Government was uncomfortable with the "peace initiative" thrust of our delegation.

Although there is a strong approach-avoidance in Israel to taking a long-term perspective to a peace agreement, there are reasons to be optimistic of progress. One is that Israel cannot afford to appear opposed to a serious Arab peace initiative -- and it looks like the Egyptians and moderates are serious now. Secondly, Rabin is in political trouble and would have an extremely difficult time running for re-election on domestic issues. Since he is threatened by the hawks (both Peres and Likud), there is room for him to gain the higher ground by moving toward a peace settlement. Third, the combination of a favorable climate among the Arab moderates and a serious initiative by the Carter

administration would leave Rabin in the position of having to be positive and creative in approaching negotiations. His call for a Helsinki-type conference on the Middle East in response to what he called "...some voices in the Middle East -- communicated through the media and by visitors to a certain Arab capital..." reinforce the point that Rabin is taking the present momentum seriously.

Rabin has described what he considers the lessons learned from the Helsinki conference. The theme must be dialogue, detente, and coexistence, not the threat of war. The initiative must come from the regional parties to the dispute, with the great powers only offering guarantees later rather than trying to impose a solution. And cultural, trade, and human cooperation need to be added to the borders and territories issues.

Almost as important as substance is the question of timing. Rabin told Joseph Kraft that Sadat's call for negotiations is "...part of a propaganda snow job designed to impress inexperienced American legislators and put pressure on President-elect Carter to plunge into talks before he is well prepared." Rabin thinks it will be March or April before the U.S. sorts out the Middle East, after which Rabin would come to Washington and then approach the Arabs. I think that timetable is not bad -- it shows that Rabin has already planned to put negotiations well in progress before his elections, and that he is assuming that Carter will have the Middle East sorted out by springtime. Things could be much worse. Three possible points for President Carter in this regard are the following:

1. Since Secretary of State-Designate Vance knows the Middle East, an early initiative is quite possible. There would be merit in raising this with the Israelis well before the Labor Party convention at the end of February.
2. Although the United States will be the key to a settlement, it need not be out front right at the start. Vance could recognize Rabin's request for the "regional parties" to take the initiative by telling Rabin that they can take the first move by agreeing to go to Geneva without preconditions to meet with an Arab delegation.
3. However, all parties basically rely only on the United States to work out the formula.

Nuclear Issues

Israel has considerable need for more energy in future years and is willing to accept serious safeguard controls. The Israelis are cynical about the effectiveness of the IAEA,

especially since the PLO has been granted observer status. But Israel is willing to accede to whatever reasonable controls the United States proposes. This cooperative attitude is understandable both in light of the benefits of nuclear power and because Israel has separated the obtention of atomic weapons from domestic, civil uses of power. The delegation was not permitted to visit the Dimona nuclear research facility and has no way of knowing whether Israel has nuclear weapons. The decision as to approve or disapprove sale of a nuclear reactor will have to be made recognizing two important points: Israel may already have some nuclear bombs, and the sale of the proposed reactor would be isolated from and not support that fact of life. It appears that most members of the delegation favor licensing a strongly safeguarded reactor.

EGYPT

Political and Economic Issues

The candid and constructive meetings with President Sadat and Foreign Minister Fahmy underscored the importance to Egypt of ties with the United States after a dramatic break with the Soviet Union. As in Israel, the key role of the United States in the peace process was stressed. Sadat and Fahmy said that never have political events been so ripe in the Arab world for peace negotiations. The Egyptians think that all interested parties -- Syria, Jordan, Egypt, and the PLO -- are ready to go to Geneva to discuss peace. There seemed to be willingness to blur the position of the PLO as a government in exile, to consider it as part of an overall Arab negotiating group, and to eliminate extremists. Sadat and Fahmy said that no preconditions are necessary for negotiations to restore territories, to end belligerency, in respect of the PLO, Jerusalem, or for the future of conventional arms and nuclear weapons in the area. Both took the position that Egypt and moderate Arab states will meet without preconditions, but that all of these issues would have to be negotiated thoroughly at Geneva. For the first time the Egyptians are willing to recognize the right of Israel to exist as an independent, viable, and secure Jewish state.

It is clear that no Arab leader could sign an agreement with Israel unless there is a political settlement regarding the Palestinians. The delegation report will review the presently weakened state of the PLO and its implications for a settlement. The PLO represents a threat to the Arab countries as much as to Israel.

President Sadat is the only Arab President who has said that he is prepared to sign a peace agreement (not a treaty). Sadat has no objections to giving Israel any kind of security guarantees it wants: United Nations,

American, or other. Sadat asks that the same security guarantees be given to Egypt.

Egypt recognizes the need to press on with development priorities. There will be 75 million Egyptians in the year 2,000. The Government has invited international investment and reorganized its administrative structure to advance economic development. Foreign Minister Fahmy noted that a poor country such as Egypt must make serious efforts to develop; the state of no war, no peace retards this important work.

Without question Sadat is a central force in the Arab world. His replacement by another Arab leader would be a real blow to the prospects for peace. Sadat's present working relationships with Syria and Saudi Arabia present a potentially effective combination.

In weighing the role of Egypt in peace talks, the following points may be useful:

1. Although President Sadat has had a close and personal relationship with President Ford and Secretary Kissinger, he appeared ready to adjust and carry on with the new administration. Some use of Kissinger -- at the very minimum assurances to Sadat and Fahmy that Vance would back them up and continue the close ties -- is essential given the nature of personal trust in the Middle East.
2. Fahmy was bitter over President Ford's sale of cluster bombs and other equipment in the closing days of the election, so President-elect Carter is not stepping into a situation of unbounded affection for the previous administration.
3. The political strength of Sadat is a prime asset for peace talks, but his economic difficulties and personal health suggest that we cannot count on being in this paramount position for years to come.
4. The PLO is weaker now than it has ever been. The Palestinians after their experience in Lebanon will not be able to press their demands as forcefully as they have.
5. The overall combination of Saudi Arabia, Syria, Egypt, the PLO, and possibly Jordan represents one of those rare moments when the moderates are in the right places and disposed to talk peace.

6. On December 2nd the Egyptians submitted a draft resolution to the General Assembly asking the Secretary General "to resume contacts with the parties to the conflict" in preparation for convening the Geneva conference and ordering a report by March 1st. There was no mention of the PLO. This resolution was submitted with a second, more traditional and strident resolution which would obviously have to be opposed by the United States. Egyptian diplomats confirmed that their strategy was to offer a sufficiently moderate statement to gain American backing. The importance of all this is that the Egyptians are following through on the pledge made public through our delegation to go to Geneva for discussions without preconditions.

Nuclear Issues

Egypt presented convincing arguments for buying a nuclear reactor. A meeting of the Minister of State for scientific research and the Minister of Electricity reviewed Egypt's development plans. The Government has prepared a comprehensive briefing paper on the need for nuclear power generation in Egypt. The Egyptians agreed to complete safeguards for the proposed plant, offered to place all facilities in Egypt under IAEA safeguards, and in response to a question stated that Egypt had no interest in reprocessing license under these conditions.

MEMORANDUM

NATIONAL SECURITY COUNCIL

November 18, 1976

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MEMORANDUM FOR THE PRESIDENT ELECT

FROM: DAVID AARON

SUBJECT: Further Indications of Soviet
Interests in Good Relations

Attached is a report from the State Department on a gesture by Brezhnev during the Kremlin reception for the October Revolution (November 7). He apparently took the U.S. Charge in Moscow aside to make some positive comments about U.S. -Soviet relations. The comments were not particularly remarkable, but the gesture of taking him aside was; and the State Department thought that this might be brought to your attention.

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PER SL/NSX H/RE MR-NLC-91-66
BY Jay NARS, DATE 1/6/93

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MEMORANDUM

A report from our Chargé in Moscow states that at the Kremlin reception on October Revolution Day, November 7th, the Chiefs of the Diplomatic Missions, as is the custom, filed by Brezhnev and members of the Politburo to shake hands. It is usually completely formal, with only brief greetings. Brezhnev, however, stopped our Chargé for a few moments to state that he and all the members of the Soviet leadership hoped that US/Soviet relations could be further improved, and he asked the Chargé to convey to his government that this was the firm Soviet attitude. In reply, our Chargé assured him that the US leaders shared the desire for improved relations.

Brezhnev further remarked that if we did not achieve improvement, this would be bad not only for our two countries but also for the entire world.

Although there was nothing unusual in Brezhnev's remarks, it was significant that he interrupted the formal hand-shaking procedures to make them. His greetings to all the other Ambassadors, including the Chinese, were normal perfunctory expressions.

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Objectively there exist necessary prerequisites for the onward development of Soviet-US relations. And here the changes for the better already achieved in the course of the recent years as a result of vigorous efforts of both sides are of great importance.

The main result of the development of relations between our countries for the last several years is the fact that the danger of the outbreak of a nuclear war has been reduced to a certain extent, first practical steps have been made on the road of strategic arms limitation. We are convinced that this equally meets fundamental interests of the Soviet and American peoples as well as of all the other peoples of the world.

The Soviet Union is ready to move further along the road of improving relations with the United States and this our line is not of a tactical but of a principled character. This was quite clearly declared by L.I. Brezhnev at the 25th Congress of the CPSU as well as at the recent plenary session of the Central Committee of our party. Moscow counts on a similar approach to the relations with the Soviet Union on the part of the new US leadership.

Further steps aimed at the limitation of strategic arms is one of the most urgent tasks facing our countries. Successful completion of negotiations on the basis of the already existing understanding and the hard and difficult

work performed by the sides would be a great and important step in the field of a further limitation of the arms race. The achievement of an agreement on this problem would also be of great importance for the entire complex of Soviet-US relations from the viewpoint of their long-term prospect.

The task of preventing the spread of nuclear weapons in the world is considered as urgent in the Soviet Union. We come out in favor of further efforts of our two countries both in terms of strengthening the existing, and adopting additional measures with a view to making more effective the regime of non-proliferation. Taking into account the attention which Mr. Carter on his part gives to these questions Moscow believes that in this matter there exist also possibilities for finding appropriate practical solutions.

There are other questions related to the cessation of the arms race, which await their solution. As is known the Soviet Union has put forward a broad program of concrete measures which embraces both mass-destruction weapons and conventional types of armaments, the global and regional questions of disarmament. We count on the productive interaction with the United States in these questions on the basis of mutual interest and are ready to examine possible considerations of the US side.

The course of events itself poses, among international problems of paramount importance, the task of achieving a cardinal peaceful settlement in the Middle East. Moscow

believes that the continuation of a dangerous situation there - and it is dangerous indeed - carries a great threat to peace and cannot but negatively affect the relations between the USSR and the United States, whether we wish it or not. The settlement of the Middle East conflict should be sought within the framework of a mechanism specially created for this purpose - the Geneva Peace Conference - by adopting there decisions which would take into account both the legitimate interests of the Arabs - including the Palestinians - and the interests of Israel. There are known concrete proposals of the Soviet Union in this regard and we expect that the US side will pay due attention to them.

Now we have thought it advisable to express some preliminary considerations and only on a number of questions which, for understandable reasons, should be constantly in the center of attention of the leaders of both countries. We hope that after the inauguration of Mr. Carter a concrete exchange of opinions will take place between us for the discussion of the entire complex of the questions related to Soviet-US relations and of the important problems of world policy.

Of course, Moscow will study with interest the thoughts of Mr. Carter.

C

L.I. Brezhnev sends his greetings and congratulations to Mr. Carter in connection with his election as the President of the United States.

General Secretary of the Central Committee of the Communist Party of the Soviet Union familiarized himself with interest with the views of Mr. Carter communicated through Mr. Harriman. He proceeds from the assumption that the relations between our two countries will develop in a positive, constructive spirit as it was also expressed by Mr. Carter. We regard with due understanding the statements by Mr. Carter in support of continued efforts with a view to promoting friendly Soviet-US relations, in favor of a further progress in various fields. Moscow shares the viewpoint that the questions of mutual limitation and ending of the arms race should be in the center of these relations.

The statements of Mr. Carter in favor of cooperation between the Soviet Union and the United States in the settlement of important international problems are also consonant with the views of Soviet leaders.

The understanding in principle concerning the main directions of our relations, ensuing from the objective role and responsibility of the Soviet Union and the United States in maintaining international peace, is a necessary prerequisite for a stable advance of Soviet-US relations. We are ready to cooperate fully in this matter with Mr. Carter as the new President, guided by the principles of equality and mutual advantage of the sides.

L.I. Brezhnev regards positively Mr. Carter's idea of the importance of a personal meeting between them. Such a meeting would undoubtedly be useful both for strengthening relations between our two countries and for promoting the settlement of appropriate international problems.

CARTER - MONDALE
TRANSITION PLANNING GROUP

P.O. Box 2600
Washington, D.C. 20013

MEMORANDUM - November 30, 1976

TO: Governor Carter
FROM: Stu Eizenstat
RE: Message from Rabin

On November 30, 1976, Ambassador Dinitz, the Israeli Ambassador to the United States asked that the following message be conveyed to you from Mr. Rabin, whom he had just seen on his visit to Israel:

1. Mr. Rabin wants 1977 to be a year of progress and movement toward peace in the Middle East.

a. Progress and movement is now possible due to the conclusion of the Lebanese war, which has seen the P.L.O. weakened, Arab influence diminished, and a coalition formed between Syria, Egypt and Saudi Arabia.

b. The Israeli election in 1977 would not be a hindrance from the Israeli standpoint in moving toward a peace settlement.

c. A prerequisite to any progress should be higher consultation between the United States and Israel so that no action is taken by either party without prior knowledge. In this regard, Mr. Rabin would like to come to the United States early next year, perhaps in March, to meet with you and discuss possible steps that could be taken toward a peaceful settlement.

2. Mr. Dinitz will continue serving as the Ambassador indefinitely.

3. Mr. Rabin would like to maintain the direct contact that he has had with President Ford, rather than dealing simply and only through ambassadors.

4. Mr. Rabin extends his best wishes to you.

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E.O. 12356, Sec. 3.4

PER SHG NKC HZ RE MR-NLC-91-66
NARS. DATE 11/6/93

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This was sent by
Henry Hall Wilson
You may want to read
it before Monday's meeting.
GS

C ✓

PRIORITIES IN FOREIGN ECONOMIC POLICY

Eugene R. Black, Jr.
1 Rockefeller Plaza
New York, N. Y. 10020

October 1976

High on the list of priorities in the foreign economic field will be the forging of the closer nucleus with our principal industrial partners. We must also deal promptly, but cautiously and practically, with the problem of the widening economic gap between the developing and developed nations. Certainly we should make collective moves in reference to the worldwide energy shortage, and attempt to bring the principal oil importers into more meaningful cooperative actions. We must face the significance of the West's greatly increased trade with the Eastern Bloc, and the Bloc's use of our capital markets to finance that trade and its own internal development. And, finally, reorganization and consolidation of foreign economic matters within our own government should receive priority attention.

Equally important, but less pressing priorities, include a comprehensive review of our trade patterns and policies. A more effective dealing with the OPEC cartel, particularly in the field of encouraging the careful investment of their monetary reserves held abroad, primarily for the sake of the LDC's should be encouraged. And, of course, we must be continually concerned with the proper functioning of the international monetary system, and in particular the rules and management of the present fluctuating exchange rates.

* * * * *

Closer Ties With OECD

The initial thrust of our foreign economic policy should be to form a stronger nucleus with our principal industrial partners, not only to concert programs to further our mutual interest, but to enhance our ability to invoke sanctions against those who would utilize exportable inflation, unfair trade policies and cartels to gain an artificial advantage. In an interdependent and swiftly transforming world there can be great danger in letting such tactics go unanswered. The unity of the industrial powers can act as a catalyst for better world accord.

In case of another oil embargo, for example, it is improbable that the United States can take effective unilateral action in the economic field against the OPEC cartel. Sanctions on U. S. exports to OPEC would bring about more exports from Europe, Japan on the Eastern Bloc, making up the gap. Our only hope for effective sanctions lies in collective action with our principal allies who are the principal oil importers.

The Rambouillet and Puerto Rico meetings are steps in the right direction towards cooperative economic action, but more frequent meetings with cabinet level officers should be instigated, and the number of industrial countries consulted frequently should be increased beyond the six convened at those meetings.

Two examples of poor coordination with our industrial allies during the last Administration:

The oil price increase in January 1974 caused serious disruption in the world's balance of payments. But no collective ap-

proaches to OPEC were made by the industrial nations in respect to suggestions to alleviate the hardships caused by that oil price. Instead, this was a tendency for various developed countries to attempt to gain a trade or investment advantage with individual OPEC nations; there was also a pattern of our industrial allies giving conflicting advice in respect to the investments of OPEC's accumulating reserves. (See below for more on that point.)

A second example is that insufficient assistance has been mutually extended to the LDC's in their recent balance of payments difficulties. Turning this problem over to the Development Committee of IMF-World Bank, instead of dealing with it with our industrial allies at the highest level, was a way of avoiding both a practical and moral dilemma. In the future, we must clearly define the spheres of collective action with our industrial partners, and we must strive to bring collective actions and pressures to bear on the problems of mutual interest.

LDC's

The industrial nucleus of the West must also develop a community of interests with the developing nations, while at the same time making clear the acceptable limits of economic action. There are five areas of priority in respect to our economic relations with the LDC's:

- (1) The problem of balance of payments deficits and external indebtedness;
- (2) the plight of the poorest countries;

- (3) food shortages;
- (4) commodity arrangements; and
- (5) structural reorganization of certain international institutions dealing with the development effort.

(1) The Less Developed Countries Payment Deficits - -

A Plan to Help

Perhaps the most dramatic illustration of the international economic transformations of the last few years has been the drastic worsening of the current account deficits of the non-oil less developed countries (LDC's). ("Current account deficits" refers to an excess of goods and services imports over goods and services exports, which must be financed by borrowing from external sources.) The next administration, whether Democratic or Republican, will have to deal with this disturbing problem.

The importance of this subject was emphasized at the IMF-World Bank Meeting in Manila, and by Secretary Simon in particular. Mr. Simon told the assembled finance ministers that the oil importers faced a massive balance of payments deficit of about \$50 billion next year, and the world could expect a similar disruptive situation to the events of 1974 after the 4-fold increase in oil prices.

Mr. Simon went on to say that unlike the first few years of the heavy oil surplus, the oil importing countries - - and the non-oil LDC's in particular - - will find it much harder in 1977 to finance their payment deficits by borrowing. This is so because many countries are approaching the limits of their ability to take on more debt, and because the IMF resources are being stretched - - although such resources were increased only recently by the Jamaica agreements in January.

Simon said:

"As debt grows, to finance the continuing deficits, an increasing number of countries which have delayed adjustments will approach limits beyond which they cannot afford to borrow and beyond which prudent creditors will not lend to them. This is a serious matter and it cannot be ignored by lenders or borrowers."

As a solution Simon urged:

"a combination of adjustment by individual countries, (i.e. cuts in imports, control of inflation, etc.), some slowing in the rate of private international lending, and moderate provision of official financing on a multilateral and conditional basis."

Mr. Witteveen, head of the IMF, and others at the Manila meeting, also stressed the dangers of increased borrowings abroad, and in particular of borrowing increases from private sources. In the case of the non-oil LDC's, gross new commercial bank lending to non-oil LDC's increased from \$9 billion in 1973 to \$22 billion at year-end 1975, rising from 38% of all borrowings to 50%. A well known international commercial banker has expressed his fears about private financing of the LDC's as follows:

"Absent the massive financing provided by the banking industry in the past 3 years to the non-oil LDC's, much of it a purely balance of payments nature, there would have been much more turmoil on the world economic scene than has been experienced. It is unwise to assume, however, that the international private banking community can continue to assume the major burden of financing the LDC's balance of payments deficits."

Early this year an atmosphere of crisis prevailed discussion of the non-OPEC LDC's deficits, with the pessimists seeing widespread

instability of the international banking system. This sense of panic was followed in the spring by feelings of optimism as some LDC's seemed to be improving their economic posture in concert with the worldwide recovery.

But with the prospect of a 10% or more increase in the price of oil imports at year-end, we are now returning to a more realistic appraisal of the situation. In short, we are faced again with the decision as to whether or not there is a need for setting up additional standby facilities for the non-oil LDC's, over and above the IMF facilities, in case the situation should become untenable.

But first, what is the extent of the needs and what are the existing official (mainly IMF) standby facilities available at this time?

The current account deficits of the non-oil LDC's increased from \$7 billion in 1973 to \$26 billion in 1974. Of this \$19 billion deterioration, about one-half was due directly to the oil price rise. Unlike the developed nations experience, the LDC's current account deficit continued to deteriorate in 1975 by a further \$10 billion, to \$35-37 billion. The deficit this year may decline somewhat, to \$29 billion - - still a disturbing figure - - and will remain in that neighborhood in 1977, according to the Morgan Guaranty Bank. Amortization of debt, or debt repayments, will add another \$12 billion on top of the LDC's \$29 billion current account deficit this year, and another \$14 billion on top of their deficit in 1977.

Expressed another way, the estimated external debt of the non-OPEC LDC's was about \$150 billion at the end of 1975 - - three times what it was at the end of 1973 - - and it will rise another \$21-22 billion this year. Loans from commercial banks probably will account for about two-thirds of the increase of this debt, and official sources - - international institutional, bilateral aid programs, etc. - - the bulk of the remainder. Therefore, total non-OPEC LDC's debt is likely to exceed \$170 billion by year-end 1976, with approximately \$70 billion of that owed to commercial banks.

The LDC's need to borrow would be lessened, and the recycling process would be working more smoothly, if more OPEC funds were going into the LDC's to make up for the more than \$10 billion increase in the price the LDC's are now paying for OPEC oil over 1973 levels. Unfortunately, the LDC's are not getting their fair share of either OPEC imports or investments, because the great bulk of that money is flowing to the developed world; this is a major cause of the LDC's problem. Also, the official mechanisms created to help recycle OPEC surplus funds to all oil importing countries are aimed largely at the developed nations, leaving the LDC's at a real disadvantage.

In respect to this last point the nine members of the EEC created a \$3 billion mutual assistance arrangement in 1974; the OECD as a whole took steps soon after the oil price increase to establish a \$25 billion "Financial Support Fund" - - although it has now been cancelled because the U. S. Congress refused to

go along; and finally, an \$8 billion Oil Facility was established in the IMF, but the IMF lent only \$3.6 billion of that amount to the non-oil developing nations. In short, the financial requirements of the industrial world were largely met by these actions.

The LDC's, however, were largely left out of the picture, and at a time when their deficits were mounting to unwieldy figures. True, they received \$3.6 billion from the IMF Oil Facility in 1974 and 1975, as mentioned above. And in January of this year, as shown in the following table, the resources available to them through the IMF were increased by a further \$5 billion - - although of that amount they are unlikely to be able to draw more than \$3-4 billion in any one year because of increased stringent conditions, the time to process applications, etc. The new IMF Trust Fund, established at Jamaica in January, is to be aimed at the poorest nations and will be made available on concessional terms; financed by the sale of the Fund's gold, the Trust Fund will mean only \$500 million in 1976, however, and perhaps \$1 billion in 1977.

In the aggregate, official flows of funds have financed only about one-third of the increase in the non-oil LDC financial requirements between 1973 and 1975 in spite of their greatly increased needs. The commercial banks and other private sources have financed about two-thirds, a somewhat dangerous development for the future.

IMF resources for non-OPEC developing
countries - -
availability and use
billions of dollars

	<u>1974</u>	<u>1975</u>	<u>1976</u>	
			<u>Old Rules</u>	<u>New Rules</u>
<u>Potentially available:</u>				
Credit tranches plus extended fund facilities	7.9	7.5	7.7	11.3
Compensatory financing facility	nil	nil	.6	1.4
Oil facility	3.7	4.3	1.2	1.2
Trust fund4
<u>Total available</u>	11.6	11.8	9.5	14.3
<u>Actual and projected use (gross):</u>				
Credit tranches	.75	.53)	2.4
Compensatory financing facility	.13	.23)	
Oil facility	.91	1.58		.7
Trust Fund	.	.		.4
<u>Total Use</u>	1.80	2.34		3.5

Certainly the preceding figures and facts are disturbing.

On the one hand, it is clearly necessary for the non-oil LDC's to restrict their external borrowings in order to slow the buildup in their indebtedness; on the other hand, this implies a slower rate of economic growth. There is also a danger that commercial banks have, or will, over extend themselves with specific LDC credits, and that they may be unable or unwilling to continue the high rate of lending to these countries experienced since 1973.

Thus, the IMF, the U. S. Government, and now the commercial banks attached increasing importance to the imposition of conditions to both official and private loans designed to bring about

further reduction in various countries current deficits - - whether LDC's or industrial countries. The increasing tendency to look for the imposition of IMF-designed standby conditions is to be welcomed. It is no secret that many countries, for internal political reasons, do not want to utilize the last three 'normal credit tranches' on the 'extended fund facilities' of the IMF because of the relatively stringent adjustment conditions attached.

What to do?

On balance, it is suggested that additional multinational standby facilities for the LDC's should be created, which would take some of the pressure off of the private banking system, but which would continue to impose conditionality on the recipients. Because of the different relative economic position of LDC's, however, different facilities should be established for the various groups.

The poorest countries, as Mr. Mc Namara has suggested, must be assisted by an expanded flow of funds from the richer countries - - including the remaining OPEC surplus nations, via bilateral as well as multinational official facilities on concessionary terms. The middle income, semi-industrialized LDC's, that have achieved adequate current account adjustment - - such as Taiwan and Korea - - must look primarily to the private capital markets. For the other LDC's, however, additional facilities are required on an emergency basis.

Proposals for Stand-by Emergency Facilities For Non-Oil LDC's

I For the Poorest Countries:

- It is proposed that in addition to its funding by the sale of gold, a \$2 billion enlargement of the IMF Trust Fund might be considered, to be effected as follows:

- (1) A \$1 billion contribution by OPEC nations, the individual country contributions to be decided among themselves.
- (2) A \$1 billion contribution by the industrialized OECD nations.

The aforementioned approach has the following advantages:

- Although this suggestion envisages a cash contribution to the Trust Fund by the individual nations involved, it would be a relatively small one by each, including the United States' portion.
- The Trust Fund has the advantage of being multinationally administered by the IMF, and therefore the granting of loans is not subject to political ramifications.
- OPEC's contribution, as well as the OECD nations' loans to the Trust Fund, would not be guaranteed by the IMF, but the monies would be repaid only if the Trust Fund's loans to individual LDC's are repaid.
- OECD's contributions could be made dependent on OPEC participation, and vice-versa, which would put very heavy pressure on both groups to contribute to this worthwhile cause.

II For Certain Middle Income Countries

The second proposal is that a \$3 billion Latin American Safety Net to provide last resort, emergency loans for balance of payment purposes, modeled on the \$3 billion EEC facility, might also be considered. The Safety Net would be structured as follows:

- (1) One half of the securities issued in the international private markets under the Net to be guaranteed by the United States and Canada, presumably up to a \$1 billion limit by the US and \$500 million by Canada.

- (2) One half of the securities issued under the Net to be guaranteed by Venezuela, Mexico and Brazil (say, up to \$350 million each), and Argentina, Colombia and Chile (\$150 million each). It is believed other guarantees are not necessary and it might be time-consuming to obtain them--although any other Latin American nation might afford its guarantee to an agreed upon portion of the securities issued under the Net, if they wished.

It is believed this approach to the subject, as compared with other ideas advanced along these lines to date, is distinctive in the following ways:

- This is a guarantee obligation only on the part of the participants; it involves no cash contributions.
- It is a hemispheric emergency facility, the northern and southern, the richer and poorer nations acting together, equally, to alleviate a temporary problem.
- Congress should react favorably to this concept as it relates politically with our Southern neighbors, and the Latin American nations should also appreciate the joint and equal aspects.
- Latin American countries participating in the guarantee would not be limited to a multiple of their guaranteed quotas in the amounts they could draw down from the Net.
- All nations in Latin America would be eligible for loans, whether or not they participate in the guarantee.
- The recent 4-tranche EEC \$1.3 billion financing in the Eurodollar and US markets provides a model for the possible Latin American Safety Net. It is believed that borrowings under the Safety Net, as described herein, could be effected on more or less comparable terms. The EEC financing, guaranteed by the 9 member nations of the EEC under the arrangements of their \$3 billion pool, consisted of a \$300 million 6-year public issue, a \$300 million 5-year syndicated bank loan, a \$500 million 3.7-year loan offered privately at 7 1/2%, and a 7-year DM 500 million Euro-Deutschemark bond issue carrying a coupon of 7 1/4%.

Under the above two proposals, the enlarged IMF Trust Fund would service most of the poorer countries of Asia and Africa on concessionary terms, while the Latin American Safety Net would take care of middle income, possible problem nations of the southern hemisphere on commercial terms, i.e. Argentina, Peru, Chile, etc. The Trust Fund and the Safety Net would be 'last resort' facilities, and drawings

should not substitute for regular IMF drawings conditioned on adoption of appropriate domestic policies. It is envisaged that the Safety Net would also be administered by the IMF, perhaps along the lines of the mechanism of the G-10 'Agreement to Borrow':

The enlargement of the Trust Fund for the benefit of the poorest countries, in the manner suggested, has political as well as practical ramifications. We must be sensitive to the increased organization and strength of the LDC's over the last 3 years within the UN and other international bodies, as well as among themselves, and the resultant more stringent tone of their demands. It is surely preferable to meet some of their more reasonable requests in a multinational manner of our own choosing, than to be the recipient of increasing bilateral demands and censure for not doing enough. It is not practical, at this time, to increase the resources of the IMF, because the recent changes in its facilities have not even been ratified by the necessary member nations.

There is the further consideration of deriving means to bring OPEC into more cooperative and widespread aid programs for the poorest countries with the OECD nations. To date most OPEC aid (about 80%) has been disbursed bilaterally to Moslem countries bordering the oil producing nations of the mid-east. The proposed Trust Fund increase, funded equally by both OPEC and OECD, is a method of broadening the number of countries receiving OPEC's aid, and thereby putting some of OPEC's surplus into the most needy nations, which in turn will help their balance of payments.

In respect to the Latin American Safety Net, realistically,

it is unlikely that either OPEC or Europe would contribute to an emergency facility for Latin America alone. Therefore, a regional concept modeled after the EEC regional facility would appear the most logical, and perhaps the only approach.

We have a special political affinity and responsibility for this hemisphere, i.e. the Monroe Doctrine, etc., and we have the Inter-American Development Bank, which includes Canada, as a model for North-South cooperation in matters of this sort. If Germany and the stronger members of the EEC can take care of the European community through the EEC Safety Net facility, is it not logical that the U. S. and Canada, and several of the stronger Latin American countries, should take care of the weaker nations in this hemisphere? The Latin American Safety Net mechanism also has strong political undertones as well; that is to say, it is a hemispheric cooperative effort for our neighbors to the South, and this should make a favorable impression in the U. S. Congress and in the various parliaments concerned.

(2) Special attention must be accorded the poorest countries among the L D C's, or those 60-odd nations having a per-capita GNP of \$350 or less. The US Congress has recognized this need in the International Development and Food Assistance Act. It requires the President to concentrate the bulk of US aid in those poor countries that make the greatest effort in four fields: land reform, increased agricultural self-sufficiency, reduced infant mortality and the control of population growth.. Recently a special Trust Fund has been created by the IMF for the poorest countries, to be funded by the sale of IMF gold over a period of four years. The funds so generated will be lent on concessionary terms to the most needy countries to assist them in their balance of payments problems, caused in large measure by the oil price increase. A prompt replenishment of the funds of the International Development Association (IDA), the "soft loan" affiliate of the World Bank, should be favorably considered by the US Congress. Worldwide tariff concessions for essential products of the poorest members of the world's fraternity must also be sympathetically considered.

In the years ahead further steps should be multinationally undertaken on behalf of the so-called "forgotten 40%" of humanity. Their priority on the global agenda must be recognized and dealt with.

(3) The first report of the International Food Policy Research Institute, a multinational entity formed under the aegis of the 1974

World Food Conference in Rome, states that the production of cereals, the major staple food in most developing countries, "will fall short of meeting food demand in food-deficit countries by 95-108 million tons in 1985-86." The report further states that in the event that production reflects the more recent unfavorable trends, "then cereal production could fall short an additional 100 million tons...Such a large transfer of food could well be unmanageable physically and financially."

For purposes of comparison, during the 1974-75 crisis period, food-deficit countries experienced shortfalls of 45 million tons, and an average of 28 million tons in the years 1969-71, which were considered relatively favorable. Based upon the conservatively projected deficit of about 100 million tons by 1985, it is expected that Asia will account for some 50% of the food deficit, North Africa and the Middle East for 20%, and Sub-Saharan Africa and Latin America for about 15% each.

As a result of the above, at least six major tasks await serious attention in 1976-77: a global system of food reserves to be discussed by the World Food Conference; a world-wide system of food aid and the prompt activation of the \$1 billion Investment Fund for Agricultural Development; a major effort by the Consultative Group on Food Production and Investment in Developing Countries to accelerate food production and improve nutrition within the Third World, particularly among small farmers; a major allocation of funds to the International Food Policy Research Institute; and

finally, proposals for dealing with the problem of such major sources of instability in the food system as the Soviet Union's unpredictable and sporadic forays into international market.

(4) The most pressing question that has come up at the North-South meetings, both in Paris and Nairobi, is the LDC's demand for buffer stock arrangement in regard to the principal commodities.

The U. S. is already signatory to the International agreements on coffee, wheat and tin. We have agreed to study the formation of, and our participation in, other agreements, and international meetings are scheduled over the coming months. The coffee and tin agreements are aimed at short term price stabilization, rather than long term pricing above market levels; the current wheat agreement serves largely as a forum for the exchange of information and coordination of food aid, rather than a mechanism to intervene in the market.

Of the three, the tin agreement, signed this year, is the only one that has meaningful provisions, as wanted by the LDC's in their current requests for the developed countries to play a part in protecting commodity prices from excessive swings. Therefore, perhaps a look at the tin agreement will provide useful background in respect to coming decisions on other commodities.

With U. S. participation, the ITA membership now comprises virtually all of the world's major consumers and approximately 90 per cent of free world production.

The primary objectives of the ITA are to provide for an efficient adjustment between world production and world consumption of tin, and to prevent excessive fluctuations in tin prices.

To reduce excessive fluctuations in tin prices the ITA utilizes a tin buffer stock which buys and sells tin on world markets. As opposed to the Coffee Agreement, the Tin Agreement relies primarily on the buffer stock, and secondarily on export quotas.

The buffer stock manager operates with a three-tiered price range. When tin prices are in the lower tier of the range he buys tin to support tin prices; when prices are in the middle tier, he stays out of the tin market; and when prices are in the upper tier he sells tin to put downward pressure on prices. The price range is set by the international Tin Council, the operating body of the ITA. Producers and consumers each have 1,000 of the 2,000 votes in the ITC and the U. S. has 259 votes.

The tin in the buffer stock is contributed by producers whose contributions are mandatory and by consumers whose contributions are voluntary. The U. S. has informed the ITC that we do not intend to make a voluntary contribution to the buffer stock. However, the fifth ITA does provide that at the end of 30 months the Tin Council can review the amount of voluntary contributions and after such a review can decide by a simple distributed majority - i.e. more than half of the producer votes and more than half of the consumer votes - to renegotiate the Agreement. Should such a re-

negotiation result in required consumer contributions, and should our policy remain opposed to such contributions, we would have the option of not ratifying the renegotiated Agreement and would simply leave the ITA.

There has been some fear that our joining the ITA will restrict our freedom of action in sales of surplus tin from our own strategic stockpiles. But the only constraint placed on our tin disposals by the ITA is to consult with the Tin Council before making sales. We have done this even before the Fifth Agreement and would expect to do so in the future even if we are not members of the Agreements.

Finally, there is the question whether U. S. participation would have a negative or a positive economic impact. In considering this matter it is important to realize that there can be no doubt that the ITA will continue, with or without U. S. participation. Participation, however, will give the U. S. an important role in the operation of the economic provisions of the Agreement including the determination of the price range to be defended by the buffer stock, the operation of the buffer stock, contributions to the buffer stock account, and decisions on export controls. With more than 25 per cent of the consumer country votes, we are assured of a prominent voice in these decisions.

(5) In the postwar era the Western World has organized many multinational, regional, and national development institutions, structured for the long haul, which are working well in assisting the developing world. We are therefore fortunate to now have in place a worldwide institutional framework to supplement the bilateral aid programs instigated since the war. It is time, however, that means be found to both strengthen the weaker multinational development bank, as well as to bring about the proper cooperation and interplay between existing institutions working in the field.

It is probable the World Bank should, and will, because of its relative size and objective management, continue as the bulwark of that international framework, but we should question what the Bank might look like 10, 25 years from now -- that is, will it continue to be centered in Washington, will it form strong regional offices with certain autonomous authorities, will it form new or participate more in existing institutions, or what?

It is probable that the Bank should put more emphasis in the next few years on regional offices, programs and, in particular, strengthening and cooperating with existing regional institutions. The IDB, ADB, Common Market and other regional groupings and programs have illustrated that, if properly conceived and organized, the regional approach can be of greater benefit to the individual countries involved. It has also been shown that the less strong

African Development Bank, The Central American Bank for Economic Integration, the Andean Development Corporation and the Caribbean Development Bank, among others, need assistance. That assistance can come from the developed nations, the World Bank, or both. For realistic and political reasons, however it is probable the World Bank is the logical entity to help, and the Bank should eventually have a formal relationship with many regional development banks, certainly in the form of holding some of their debt securities, and down the road perhaps owning some of the shares of certain institutions as well (possibly non-voting), and providing some form of guarantees for selected banks' securities in the international markets. In short, a type of AT&T organization 10, 20 years from now with the WB as the parent company, but with strong, independent subsidiaries, each able to borrow on its own and operate on its own. WB assistance would be provided only when needed and only when asked for.

An AT&T set-up is suggested - - but with an important distinction: The WB would obviously not control these institutions; the ownership and control would remain in the areas where they were situated. Any stock participation by the WB, for example, would be in strictly minority percentages, perhaps in non-voting shares, and might be made only in order to strengthen the borrowing base of the smaller banks - - the central weakness in the weaker institutions. The political facts of life would allow for no other type of association, and indeed each region might well be different - - Latin America, for instance, perhaps choosing to go its own separate

way.

Therefore, it is recommended that an early amendment to the WB's Articles of Agreement be affected to allow the Bank to make loans to, guarantee securities of, and make investments in certain of the regional development banks. This would allow the WB the option to negotiate with any regional bank that chose, on its own volition, to approach the Bank in these respects.

In order to assure present and prospective holders of WB securities that the Bank will not irresponsibly deplete its assets and borrowing base (callable capital), an acceptable overall limitation on the amount of funds committed under loans, guarantees and subscriptions to regional development banks might be imposed. A quantitative limitation of, say, 10% of the Bank's callable capital might be considered.

Energy

In 1973 the United States imported approximately 37% of its petroleum requirements at a cost of \$8 billion; in 1974, after the oil price increase, the dollar volume of these imports rose to \$24 billion. Our 1976 imports are estimated to increase 20% over the last year to a cost of about \$35 billion, and we will be importing over 40% of our total petroleum needs. Domestic production of oil and gas is declining at an annual rate of about 6%.

By 1980, four years from now, the U. S. will import a minimum of 50-55%, or 12 million barrels a day, of our petroleum re-

quirements; and the cost, depending on OPEC pricing policies, could be in the \$80-\$90 billion range - - a figure that could cause serious disruption in our balance of payments.

Worldwide, western imports from OPEC are now expected to increase from the present 27,000,000 barrels daily to 37,000,000 barrels a day by 1985.

Clearly, the U. S. and the world continue to face an energy crises, for which long-term solutions must be found.

Policies must be devised to encourage substitute sources of energy on a worldwide basis, in addition to national programs and incentives. The efforts of the International Energy Agency, formed as an arm of the OECD, should be encouraged and their powers strengthened and enlarged. Creation of the proposed International Energy Institute, also under the aegis of the OECD, to promote research and alternative energy sources, should be promptly activated. We must also consult on a regular basis, more than we have in the past, with the other major oil importers to devise collective plans and programs in case of emergencies.

Careful consideration should be given to invoking a World Energy Conference, based on the format of the World Food Conference in Rome in 1974. Extensive and detailed prior work for such a conference would be essential, which could take over a year to prepare. The principal oil importers, including representatives of the LDC's, should be invited to such a conference, and it is hoped that meaningful programs, and perhaps the creation of

permanent institutions, would follow from such a gathering.

Special attention must be accorded the oil producers, not only because their exports fuel the industrial and transportation machinery of the West, but because their massive accumulation of reserves affects the entire international monetary system. We must join other major oil importers and reason collectively with the exporters, pointing out the dangers of increasing oil prices and soliciting OPEC's support of participating in efforts to establish a more stable international monetary system.

Since the oil price increase at the end of 1973, OPEC nations accumulated some \$65 billion in additional reserves in 1974, \$30 billion more in 1975 and an estimated \$30 billion in 1976. This massive accumulation of surplus funds is after annually increasing their imports from \$25 billion in 1973 to an estimated \$90 billion by the end of 1976.

The first two years following the oil price increase witnessed an alarming disruption in the stability of the world's balance of payments, and was a principal cause of the worldwide recession from which we are now emerging. Although satisfactory adjustments have been made within the OECD nations, with the possible exceptions of Italy and Great Britain, the LDC's continue to be hurt by the ramifications of the oil price increase - - as discussed above. The magnitude of these deficits is causing disruption in the growth rate, and in many cases the living standards,

of many of the most affected members of the Third World; more collective action by the more prosperous nations must be taken in the near future.

Eastern Bloc Trade

Within the last 5 years, Western trade with the Eastern Bloc has increased more than three times. Russian and communist satellite nations have begun to borrow heavily in the Eurodollar and other foreign markets to finance this trade, as well as to finance their own internal development. As Eastern Bloc trade and financial relations open further with the West, we must devise collective policies to assure that no disruptions occur in our own and Western balance of payments, financial markets and trading patterns, while at the same time we should encourage the expansion of Eastern economic transactions with the West.

The Soviet economy has been unable to meet certain rapidly rising consumer expectations, and its increased productivity will depend to a great extent on capital and technology from abroad. Eastern Europe is also seeking know-how, capital and increased trade with the West.

In the coming decade we may expect to see the following trends - - assuming stable political conditions - - for which policies must be devised: (1) The Eastern Bloc will escalate strategies to gain assistance from the West in loans and access to technology; (2) they will favor vastly increased trade; (4) the Soviet Union will continue to be dependent, from time to time,

on massive grain purchases from the West; and (5) economic relations among the nations of the Eastern Bloc may become increasingly fragmented.

We must be prepared to meet these developments with imaginative proposals, while maintaining at the same time a cautious attitude.

World Trade

In the years 1960 through 1974 world exports nearly tripled, and the volume of world commodity production doubled. World trade will hit new records in both value and volume this year. According to GATT estimates, the value of world trade could top \$1 trillion in 1976, compared with \$880 billion last year. This increase will mainly represent a rise in trade volume projected to be in the neighborhood of 10%. The change in prices of goods in world trade will be very modest in dollar terms, only about 3%, although this is partly due to the relative strength of the dollar. Since 1970 more than three fourths of the annual dollar growth of world trade has stemmed from inflation; prices rose an average 15% per year, while the increase in the volume of world trade averaged only 5%.

Looking to 1977, the prospects for world trade are reasonably encouraging, both in terms of volume growth and inflation. Prices in world trade will be higher, of course. Producers of traded manufactured goods will be trying to recoup traditional profit margins. In addition, there will be significant price

rises for some raw materials in 1977, in particular, petroleum. Nevertheless, the relatively moderate growth of aggregate demand and the likely continuation of the present climate of monetary caution suggest that there will not be marked acceleration in the rate of increase in prices of goods in world trade.

Worldwide tariff concessions for essential products of the poorest members of the world's fraternity must be sympathetically considered. The proposals before the present "Tokyo Round" of the GATT negotiations that would provide the developing nations with greater access to the markets of the developed countries should be favorably considered. These proposals include: special treatment for products of the least developed countries; the implementation of generalized tariff preferences for all developing countries; and early agreement on tariff cuts for tropical products.

International Monetary System

The International monetary system is not a question of high political salience so long as things seem to be running smoothly. Its main function is to facilitate international trade and other transactions as harmoniously and unobtrusively as possible. It has clearly failed this test during the last half decade or longer, but there is reason to believe that the road ahead, while not completely smooth, will be a lot smoother than the recent past. The problems ahead are on the whole ones of skillful management rather than ones of major alterations in the

structure of an entire system. The basis, incomplete in some respects, now exists for evolutionary improvement.

The first requirement is better management of total demand by the major countries of the world. Without this, no monetary system can function smoothly. The United States should keep its economy on an even keel not only for the sake of its own residents, but also for the sake of other countries, hence for the sake of U. S. foreign policy objectives, given the still predominate place of the United States in the world economy. But other major countries, and especially Germany and Japan, as the second and third largest trading economies, must increasingly share this role. In the past they have too often let others take the lead and have relied on "export-led" recovery from recession. That is possible for a small country, but large ones must take the lead in generating recoveries. At the present time Japan seems to be headed for its largest trade surplus ever. One objective of U. S. policy should be to coordinate management of world aggregate demand with these leading economies. To this end, high level meetings of economic officials of the leading five or six countries should take place on a regular basis, with a view to joint planning and coordination of demand management.

Secondly, we must learn how to manage the present system of flexible exchange rates. For most countries, the exchange rate is too important a variable to be left entirely to the determination of "market forces." Large and erratic movements in exchange

rates can needlessly disrupt foreign trade. Government actions will influence the exchange rate in any case, and there will be instances in which direct intervention in the exchange market is an appropriate and efficacious action. But an exchange rate is intrinsically two-sided, so again coordination of intervention actions will be necessary. With experience we can discover guidelines for intervention that are appropriate and acceptable to all interested governments. The United States should work strongly to this end, while still protecting the fundamental flexibility of rates that will be necessary to accommodate diverse national economic developments. The United States should participate in the development of informal guidelines to govern intervention, preferably guidelines that smooth the movement of exchange rates in the short run but also that avoid large accumulations or run-downs of international reserves over time.

Third, the United States should participate with other countries in the development of a system for close surveillance of developments in the international financial markets, with the objective of discovering weak points early and preventing them from cascading into major financial crises. This will involve a greater explicit commitment by the leading central banks to support international financial markets, though not necessarily individual banks, then hitherto they have been willing to give.

A part of this surveillance would involve a close watch on the liquidity that is generated both within these markets and

elsewhere. Most generation of liquidity takes place within national markets. But the international financial markets now have the capacity to generate liquidity as well, at present outside the control mechanism of any national monetary authority. The creation of international liquidity may also take place when countries add national currencies, such as the dollar and the mark, to their international reserves; and when they effectively revalue the gold in international reserves toward market prices for gold. Such changes need not automatically add to world inflationary pressures. But the possibility is there, and should be closely monitored.

Finally, insofar as possible the responsibility for global surveillance should be lodged in the International Monetary Fund, which now has about 130 member countries. Some important decisions can only be effectively taken by the leading half dozen or so countries; but those decisions can be informed by discussions in the IMF.

These are all evolutionary developments, and need not be thrust into the political limelight.

Telegram to J. Carter

I welcome your election. Your decisive, unambiguous statements in defense of the rights of man throughout the world have a deep (lit. "principled") significance and raise new hopes. I am convinced that the USA, conducting itself with courage and decisiveness, made strong by its democratic and moral traditions, powerful in its economic and military relationships as the leading (lit. "first") nation of the West, - the USA will bear with honor the burden which history has placed on its citizens and its leaders.

.3 November 1976

Andrei Sakharov

*Just - Jfu
prepare answer
for me*

*LV NTC
12/2/76*

To Stuart Eizenstat
From Jimmy Carter
12/2/76

ELECTROSTATIC REPRODUCTION MADE FOR
PRESERVATION PURPOSES

ТЕЛЕГРАММА г-ну Картеру

Приветствую Ваше избрание. Ваши решительные подвусмысленные
заявления в защиту прав человека во всем мире имеют принципи-
альное значение и вселяют новые надежды. Я уверен, что исполненная
чувства и ответственности, сильная своей демократическими и правствен-
ными традициями, сильная в экономическом и военном отношении
первая страна Запада - США с честью несет бремя, возложенное
на ее гражданами и руководителями историей.

3 ноября 1976 года.

Андрей Сахаров

MEMORANDUM

November 10, 1976

TO: The President-elect
FROM: *jm* Jack Watson, David Aaron, Tony Lake
SUBJECT: Foreign Policy Conference

*Early Jan
J*

We should begin planning immediately for the foreign policy conference you mentioned at Moline and again at your post-election press conference. We can do so most efficiently if we have your guidance on a number of points. We would take no action, of course, until we had presented full plans to you.

Timing

Your phrasing - that such a meeting would be "scheduled" soon after the election - requires us within the next week or two to announce the conference and when it will be held. We recommend, however, that it not actually be convened until mid-January. (Henry Owen and Zbig agree.) Our reasons are that:

--The Congressional leadership will then have been chosen, so we can be sure they are included. Now, all candidates for leadership posts, including key committees and subcommittees, would probably have to be included.

--Your own senior appointees could play a central role in the conference, including the detailed planning of it. This would help establish their relations with the Congressional and public attendees.

--It would avoid turning the Conference into a forum at which the candidates for senior positions competed to make a favorable impression. The emphasis, we believe, should be on getting the views of Congressional figures and of a broad spectrum of public figures who are not necessarily candidates for foreign policy positions in your administration.

--It would follow the substantive discussions you would presumably have had during December, which would provide you with useful background for the Conference.

These are not insurmountable problems, but we do believe they argue for holding the meeting later.

Plan meeting for January _____ Plan for late November or December _____

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Size

We recommend including about thirty to forty people. Less would not allow the inclusion of both Senate and House leaders, your senior appointees, and ten or fifteen public figures from labor, business, agriculture, consumer groups, etc. More would be unwieldy.

Plan for thirty to forty _____

Plan for less _____

More _____

Issues and Format

We would suggest keeping to foreign policy and general arms control issues, staying away from the Defense budget. You and your Secretary of Defense-designate will presumably be consulting Congressional leaders on this separately. To include Defense spending would require involving key figures on both the Armed Services Committees at the conference; draw attention in unpredictable ways to the difficult B-1 bomber decision you must make; and take up too much time on a discussion of systems and numbers when you want a broader focus.

While it should be broad in content, we also think the conference should be focused on a number of specific issue areas.

Foreign policy issues to be discussed might most usefully be those involving negotiations or programs which will require Congressional support. These might include a) East-West relations (including trade, arms control issues and human rights); b) Southern Africa; c) the Middle East and Greece/Turkey; d) energy and OPEC; e) international economic issues including the effect of an oil price increase and the multilateral trade negotiations; f) economic relations with the Third World, including aid and commodities arrangements; and g) cultural and other exchanges between Americans and other peoples. These substantive discussions could be preceded by a session on openness and Executive-Congressional relations in foreign policy making.

This would, of course, easily fill a two-day conference. A manageable format might be to kick off each substantive section with a fifteen minute briefing on the current situation and policy by a middle level official of this Administration. You could then call on one or two members of the conference to begin the discussion by presenting their views. These should, on most issues, include a Member of Congress.

MEMORANDUM - Page 3

1.. Agree on issues _____

Delete these issues _____

Add these issues _____

2. Agree on format _____

Change as follows _____

MEMORANDUM

November 10, 1976

TO: The President-elect
FROM: Jack Watson, David Aaron, Tony Lake
SUBJECT: National Security Briefings

In addition to the CIA briefings, we recommend that you take time during the transition for a few in-depth discussions of other major subjects which will be central to your responsibilities as President and that will shape the course of international events during your Administration. They would concentrate on areas of knowledge you may feel were not adequately covered during the campaign. In the field of foreign policy, these subjects would be:

- The Soviet Union, including the triangular relations with China and the nature of Soviet society;
- The Middle East, with particular attention to intra-arab rivalries;
- Southern Africa, going beyond the current negotiations to the future of South Africa;
- The International economy, especially OPEC.

In the defense field, the subjects would be:

- Command and control arrangements over nuclear forces;
- Strategic nuclear targeting plans.

There also will be other defense-related briefings, particularly relating to the budget, which will be recommended in the course of the transition.

Foreign Policy Briefings

The idea would be to have no more than three of the very best people on each subject discuss the larger historic, cultural and even philosophical background to the day-to-day issues which you will face as President. (The discussions you heard at Plains dealt more with immediate policy concerns.) The participants would be drawn from within the Government and possibly the academic world. They would represent different points of view and would not necessarily be candidates for Presidential appointment. We would try to keep the group as

small as possible so as to maximize the interchange. The goal is to help you develop your own intellectual background for dealing with specific policy choices which will confront you during your Administration.

For example, the discussion of the USSR would focus on the possibilities for conflict and cooperation over the next eight years. It would address such questions as how the history of Russia, the nature of Soviet society, the geo-political position of the Soviet Union and the philosophical tradition of Soviet leaders combine to shape the ambitions of the Soviet Union and the willingness of its leaders to cooperate constructively with the rest of the world.

Despite their wide thrust we believe these discussions can be non-academic and focused on policy. They can help provide a firmer base for decisions you may confront early in your Presidency. It will be increasingly difficult for you to have this discussion of fundamentals after inauguration day.

We would hope to schedule four two-hour sessions with you on the above issues before the end of the year and prior to your larger Congressional conference on foreign policy issues. If the timing works out, you may make this part of an effort to involve potential Cabinet choices in the transition. In this event, we would suggest inviting a different leading candidate for Secretary of State or National Security Advisor to each meeting, to the extent they are held before the appointments are made.

Your Decision

_____ Approve: Schedule the meetings

_____ Disapprove

_____ Make the following changes in format or subjects to be considered.

Defense Briefings

You will be receiving a memorandum from the leader of the Defense Department liaison team, Richard Steadman, spelling out in detail the briefings you might wish on Defense questions. (He will begin work next week). At this point, however, we would like your authority to begin to develop two briefings that relate to your responsibilities as President and Commander-In-Chief.

They are:

--A briefing on the command and control procedures for use by the President in the event of nuclear war. This would include consultation commitments with allies; existing arrangements, if any, for pre-delegation of authority; and a candid briefing by the military concerning what happens after such orders are issued.

--A briefing on the SIOP (Single Integrated Operational Plan) which is the master plan for the use of United States Strategic nuclear forces.

_____ Approve

_____ Disapprove

MEMORANDUM

To: P/Eket
for information
November 11, 1976
JW
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/

TO: Jack Watson
FROM: David Aaron
SUBJECT: Mission for NSC Liaison

There would be five functions for the NSC liaison group:

1. Prepare options for the organization of the NSC system.
This would include:

--The NSC Committee system;

--The NSC staff;

--The process for day-to-day handling of national security matters of interest to the President.

2. Develop information on specific Presidential commitments, responsibilities, and actions, which the President and the NSC advisor must know either before inauguration day or immediately upon assuming office. This would include such things as the renewal of commitments on crisis consultation with our allies, nuclear command and control procedures, special agreements with foreign governments unknown to the rest of the Government (a practice we may wish to change).

3. Summarize existing presidential level decisions, including current National Security Decision Memorandums (NSDM's), National Security Intelligence Directives (NSCID's), etc. This summary would include current activities within the National Security Council system such as National Security study memos (NSSMs), proposed intelligence activities, etc. It would identify those directives and activities that might be continued, renewed, or terminated.

4. Serve as a point of coordination and support for Governor Carter on National Security issues requiring his attention during the transition period, working with Lake, Steadman, etc.

5. Prepare a briefing book on the above matters for the President and for the National Security advisor.

Work in support of these objectives is already underway within the NSC staff.

MEMORANDUM

November 11, 1976

TO: The President-elect
FROM: *JW* Jack Watson, David Aaron, Tony Lake
SUBJECT: Foreign Policy/Defense Advisory Committees

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Attached is a memorandum from Henry Owen suggesting the formation of certain foreign policy and defense advisory groups to help achieve openness in a Carter Administration. We agree with his idea (although would argue for political reasons against making the Middle East one of the first issues to be studied).

We suggest that:

--The idea be first examined and planned by your senior appointees. (This might be a good idea for you to raise with candidates, to see how open they are to ideas on "openness".)

--If you then wish to proceed, you could launch the idea at the Foreign Policy Conference which we suggest be held in mid-January.

Agree _____ Disagree _____

MEMORANDUM

November 10, 1976

TO: President-Elect

FROM: Henry Owen *HO*

SUBJECT: Openness in Foreign Policy and Creation of Advisory Committees

During the campaign you said that yours would be an open administration--that it would draw the attentive public into foreign policy-making.

One way to do this would be to build on the precedent of the General Advisory Committee, which counsels the President on arms control. In the late 1960s and early 1970s, membership on this Committee was of high quality: John McCloy chaired it; members included businessmen (John McCone), labor leaders (I. W. Abel), political figures (William Scranton), academics (Kermit Gordon), arms control specialists (Jack Ruina), and ex-officials (Dean Rusk). Its existence was mandated by statute, and its members had to be confirmed by the Senate. It convened every few months, and was fully briefed by the Government on highly classified matters. It met about once a year with the President, and more often with the Secretary of State and the Director of the Arms Control and Disarmament Agency to give them advice. It is a measure of the important role it played in policy-making that Gerard Smith, who used to head the SALT Delegation and the Arms Control and Disarmament Agency, would rather be chairman of this Committee in the future than hold a full-time job in Government. I remember that Kermit Gordon (then President of Brookings) also prized his membership on it greatly. (Lately the Committee has run down in membership and function, along with the Agency that it advises.)

My proposal is that you should appoint similar committees in other areas, where difficult and important policy decisions will have to be made and where public and Congressional support will be needed.

Each committee might cover a broad area--one committee on foreign policy, one on economic policy toward developing countries, one on arms control, and one on defense policy. Each committee would fix its own agenda. For example, the foreign policy committee might begin by focusing on the Middle East; the committee on economic policy might start off by looking at proposals for reorganizing our foreign aid (shifting from bilateral to multilateral aid); the arms control committee might examine the Backfire and cruise missile issues; and the defense committee might analyze the question of manpower savings. As these issues were resolved, the committees could move on to other questions.

There is, of course, a risk that one of these committees will end up by acting in a way that is irresponsible, rather than helpful. Experience with the General Advisory Committee suggests that this risk

can be minimized by careful selection of members. The committees should consist of first-rate people drawn from all over the country and from both political parties. Some committee members would be experts in their field; others would be persons of experience and judgment who, like members of a jury, would hear the evidence and give their view. A small full-time staff would assist each committee.

The committees would be fully briefed about what was going on in their fields; the President and senior officials would meet them periodically to hear their counsel. These committees would be serious ventures--in contrast to the advisory panels that the State Department once had (and perhaps still has), which meet seldom and are little heeded by even the middle grade officials whom they advise. Most governmental advisory committees are a waste of time; only if the President takes them seriously and outstanding people are members is there a chance that they will be useful.

An early announcement that you intended to create such committees and to ask the intended chairmen to call on you would be evidence that you proposed to do something about openness. Later the committees' full membership could be announced, enabling you to draw on and reward able people who are not able to serve full-time in Government.

November 13, 1976

An Analysis of Threats to the International
Financial System

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Introduction and Summary

The international financial system is faced in 1977 with the prospect of a continuation and possible escalation of the substantial current account imbalances associated with the large OPEC current account surpluses that have totalled almost \$150 billion over the last three years. Even if OPEC decides not to increase the price of oil on January 1, the possibility arises that the weaker countries, which have had a cumulative three-year current account deficit of about \$190 billion, will decide that they cannot accumulate another \$50-60 billion in foreign debt in 1977. Alternatively, private and official financial institutions may well decide that they cannot prudently finance such an increase in international debt in 1977.

If either situation should arise, and neither can be dismissed on a priori grounds, the strains on the international financial system and the international economy would become acute. For example, a \$30 billion reduction in the combined 1977 current account deficit of the weaker countries could, as a first step, lead to a 6 per cent reduction in the real GNP of the weaker countries and to more than a 1-1/2 per cent reduction in the real GNP of the stronger oil-importing countries. Policy makers in most countries could not afford to impose on their economies losses of real output on this scale. Instead they may resort to import-restrictions and massive exchange-rate depreciations. International financial markets would be plunged into turmoil. The secondary effects

ELECTROSTATIC REPRODUCTION MADE FOR
PRESERVATION PURPOSES

of such initial, drastic adjustments would lead to a precipitous loss of confidence. The world economy could well be plunged into a deep recession, and the functioning of the international financial system could be damaged for decades.

Against this background, a decision by OPEC to increase further the already high price of oil would be an invitation to global financial disaster. A 15 per cent increase in the price of imported oil would add about \$20 billion to OPEC revenues and \$15 billion to the OPEC surplus in 1977. It would add another \$8 billion to the already swollen deficits of the weaker oil-importing countries. Instinctive, defensive reactions to the prospect of the added burden of this further increase in foreign debt would threaten to wipe out the difficult progress that has recently been made toward the restoration of worldwide prosperity with reasonable price stability within a liberal international trade and financial environment. The damage would be inflicted not only on the international financial system but also on domestic economies and on banks and other financial institutions in the United States and around the world.

I. The International Financial System Today

A. Table 1 shows the distribution of past and prospective global current account positions for the period 1973-1977. The table shows how the OPEC surplus has been divided between the "strong" oil-importing countries (United States, Germany, Japan, Switzerland, The Netherlands) and the "weaker" oil-importing countries (the non-oil developing countries and the other OECD countries).

1. The projections for 1977 are based on two assumptions.

a. OPEC will decide not to raise the price of oil on January 1, 1977.

b. The aggregate current account deficits shown in the table can and will be financed.

2. Table 1 shows that OPEC accumulated \$145 billion in net current account surpluses in 1974-1976 and will add another \$40 billion in 1977.

3. Table 1 also shows that the aggregate current account deficit of the weaker countries rose from about \$10 billion in 1973 to over \$60 billion in each of the past three years.

a. Under optimistic assumptions, the collective deficit of these countries can be expected to decline only to about \$55 billion next year.

b. The aggregate current account deficit of the non-oil developing countries was \$95 billion over the past three years. The rate of deficit in 1977 under the best of circumstances will decline by less than 20 per cent from the average rate for 1974-1976.

Table 1--Summary of Current Account Balances
(goods, services and private transfers; billions of U.S. dollars)

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976^{1/}</u>	<u>1977^{2/}</u>
<u>"Strong" Countries</u>	<u>11.4</u>	<u>12.2</u>	<u>26.3</u>	<u>18</u>	<u>21-3/4</u>
United States	2.0	1.9	14.5	1-1/4	5
Germany	6.7	12.4	7.5	6-1/2	8-1/2
Japan	0.1	-4.5	-0.4	4	2-1/2
Switzerland	0.4	0.3	2.7	3-3/4	3-1/2
The Netherlands	2.2	2.1	2.0	2-1/2	2-1/4
<u>"Weaker" Countries</u>	<u>-10.5</u>	<u>-65.3</u>	<u>-60.5</u>	<u>-62-1/2</u>	<u>-54-1/4</u>
France	-0.1	-4.9	1.3	-3	-3
Italy	-2.1	-7.4	-0.2	-2-1/2	-1-1/2
United Kingdom	-1.2	-7.1	-3.0	-2-1/2	-2
Canada	-0.1	-1.8	-5.0	-4-1/2	-5
Other Developed Countries ^{3/}	3.0	-15.5	-16.6	-20	-16-3/4
Non-Oil LDCs	-10.0	-28.6	-37.0	-30	-26
<u>OPEC</u>	<u>5.7</u>	<u>66.2</u>	<u>35.0</u>	<u>44</u>	<u>40</u>
High Absorbers ^{4/}	-3.5	7.3	-2.8	-2	--
Intermediate ^{5/}	2.1	22.4	7.0	11	11
Low Absorbers ^{6/}	7.1	36.5	30.8	35	29
Residual ^{7/}	-6.6	-13.1	-0.8	1/2	-7-1/2

^{1/} Estimated.

^{2/} Projected assuming no increase in the price of oil.

^{3/} Includes other Western Europe, Australia, New Zealand and South Africa.

^{4/} Algeria, Ecuador, Gabon, Indonesia, and Venezuela.

^{5/} Nigeria, Iran, Iraq, and Libya.

^{6/} Saudi Arabia, United Arab Emirates, Kuwait, and Qatar.

^{7/} Eastern Europe, other countries not included elsewhere and statistical discrepancy.

B. The figures presented in Table 1 mask the financing problems of, and accumulation of debt by, the weaker countries.

1. Consider the situation of the non-oil developing countries. (Table 2 presents, for selected non-oil developing countries, data on cumulative 1974-1976 current account deficits and debts to banks along with available figures on population and GNP per capita.)

a. At the end of March, 1976, external claims on non-oil developing countries of banks in the Group-of-Ten countries and Switzerland including all foreign branches of U.S. banks amounted to almost \$90 billion.^{1/} As of the same date, U.S. bank claims on non-oil developing countries were \$42.2 billion. (Consolidated U.S. bank claims on non-oil developing countries rose from \$36.5 billion on September 30, 1975 -- the first date for which such data are available -- to \$44.6 billion on June 30, 1976 -- the most recent date for which such data are available.)

b. The non-oil developing countries have received gross credit from commercial banks estimated at over \$61 billion during 1974-1976 (\$20 billion per year) compared with \$9 billion in 1973. Net credit from commercial banks was an estimated \$45 billion over the three-year period (\$15 billion per year) compared with \$6 billion in 1973.^{2/}

2. The weaker developed countries present a similar picture. (Table 3 presents data on cumulative deficits and debts of selected developed countries that face potentially serious external financing problems in 1977.)

^{1/} Source: Bank for International Settlements.

^{2/} Source: Morgan Guaranty Trust Company of New York, World Financial Markets, September 1976.

Table 2 -- Data on Selected Non-Oil Developing Countries

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	1973 GNP per capita (U.S. dollars)	1973 Population (millions)	Cumulative Current Account ^{1/} Deficits (1974-1976)	Cumulative Deficit per capita ^{2/}	Cumulative Deficit as per cent of 1973 GNP ^{3/}	G-10 Bank Claims Mar. 31, 1976 ^{4/}	U.S. Bank Claims June 30, 1976 ^{5/}
Argentina	1,640	24.3	1,317	54	3.3	3,187	2,204
Brazil	760	101.1	20,219	200	26.3	15,837	11,036
Chile	720	10.2	1,435	141	19.5	786	638
Colombia	440	22.5	889	40	9.0	1,448	1,251
Mexico	890	56.0	10,657	190	21.4	14,599	11,537
Peru	620	14.5	3,365	232	37.4	2,477	1,670
Korea	400	32.9	4,599	140	34.9	3,440	3,010
Pakistan	120	66.2	3,402	51	42.5	139	n.a.
Philippines	280	40.2	2,243	56	19.9	2,294	2,059
Thailand	270	39.4	1,535	39	14.4	1,278	821
Ghana	300	9.3	373	40	13.4	16	n.a.
Kenya	170	12.5	754	60	35.5	102	n.a.
Sudan	130	17.1	1,183	69	53.2	256	n.a.
Tanzania	130	14.0	842	60	46.3	11	n.a.
Zaire	140	23.4	1,112	48	33.9	759	269
Zambia	430	4.6	856	184	42.9	362	121
Other Non-oil LDCs	n.a.	n.a.	40,819	n.a.	n.a.	42,273	10,032
TOTAL	n.a.	n.a.	95,600	n.a.	n.a.	89,284	44,585

^{1/} Goods, services and private transfers; millions of U.S. dollars.

^{2/} Column (3) divided by column (2).

^{3/} Column (4) divided by column (1).

^{4/} External claims by G-10 countries and Switzerland plus claims by U.S. bank branches in off-shore financial centers; millions of U.S. dollars.

^{5/} Claims by domestic offices of U.S. banks (and U.S. agencies and branches of foreign banks) plus claims by U.S. foreign bank branches; millions of U.S. dollars.

Table 3 -- Data for Selected Developed Countries
Facing Serious External Financing Problems

	Cumulative Current Account Deficits (1974-76) ^{1/}	Projected 1977 Deficit	Cumulative Private Financial Credit ^{2/}	U.S. Bank Claims June 30, 1976 ^{3/}
Denmark	3.6	1.2	1,901	760
Finland	4.4	0.8	1,701	942
France	6.6	3.0	9,303	8,359
Greece	3.4	1.0	677	1,552
Iceland	0.3	0.1	161	n.a.
Ireland	0.8	0.2	1,030	n.a.
Italy	10.1	1.5	2,701	5,646
Portugal	2.8	1.3	216	300
Spain	10.2	2.6	3,772	2,356
Turkey	3.6	1.2	214	n.a.
United Kingdom	12.6	2.0	9,745	39,886

^{1/} Goods, services and private transfers; billions of U.S. dollars.

^{2/} Gross new borrowings of medium-term Euro-credits, Euro-bonds, and foreign bonds; millions of U.S. dollars (1974-1976:III).

^{3/} Claims by domestic offices of U.S. banks (and U.S. agencies and branches of foreign banks) plus claims by U.S. foreign bank branches; millions of U.S. dollars. (NOTE: Includes substantial inter-bank claims.)

a. The weaker developed countries raised \$15.1 billion from medium-term Euro-market credits, Euro-bonds, and foreign bonds in 1973. In 1974 they raised \$21.3 billion; in 1975 they raised \$17.1 billion, and in the first three quarters of 1976 they raised \$19.4 billion.^{1/}

b. The collective annual current account deficit of the 11 weaker developed countries listed in Table 3 more than quadrupled between 1973 and 1974-1976, from \$4.4 billion to \$19.5 billion. In 1977, without an increase in the oil price, these countries will still have an aggregate deficit of almost \$15 billion.

c. Table 4 presents for illustrative purposes the expected distribution of current account positions among strong, weaker and OPEC countries in 1977 with and without a 15 per cent increase in the price of oil.

1. A 15 per cent increase in the price of oil would add \$15 billion to the projected OPEC surplus in 1977.

2. This price increase would add \$8 billion to the projected 1977 deficit of the weaker countries. Consequently, their aggregate needs for new external financing in 1977 would show no reduction from estimated levels in 1976.

^{1/} Source: World Bank.

Table 4 -- Summary of 1977 Current Account Balances
(goods, services and private transfers; billions of U.S. dollars)

	(A) Without an Oil-Price Increase ^{1/}	(B) With a 15 percent Oil-Price Increase	(C) Change with an Oil-Price Increase ^{2/}
<u>"Strong" Countries</u>	<u>21-3/4</u>	<u>14-3/4</u>	<u>-7</u>
United States	5	1-3/4	-3-1/4
Germany	8-1/2	7-1/4	-1-1/4
Japan	2-1/2	1/2	-2
Switzerland and The Netherlands	5-3/4	5-1/4	-1/2
<u>"Weaker" Countries</u>	<u>-54-1/4</u>	<u>-62-1/4</u>	<u>-8</u>
France	-3	-4	-1
Italy	-1-1/2	-2-1/2	-1
United Kingdom	-2	-2-1/4	-1/4
Other Developed Countries ^{3/}	-21-3/4	-25-3/4	-4
Non-Oil LDCs	-26	-27-3/4	-1-3/4
<u>OPEC</u>	<u>40</u>	<u>55</u>	<u>15</u>
High Absorbers ^{4/}	--	1/4	1/4
Intermediate ^{5/}	11	17-3/4	6-3/4
Low Absorbers ^{6/}	29	37	8
Residual ^{7/}	-7-1/2	-7-1/2	0

^{1/} From Table 1.

^{2/} Difference between column (B) and column (A).

^{3/} Includes other Western Europe, Canada, Australia, New Zealand and South Africa.

^{4/} Algeria, Ecuador, Gabon, Indonesia, and Venezuela.

^{5/} Nigeria, Iran, Iraq, and Libya.

^{6/} Saudi Arabia, United Arab Emirates, Kuwait, and Qatar.

^{7/} Eastern Europe, other countries not included elsewhere and statistical discrepancy.

II. The Problem of Adjustment

A. It is now clear that, even without an increase in the price of oil, OPEC will run a substantial current account surplus in 1977.

1. Authorities in many countries and officials in many financial institutions may be severely disappointed that the OPEC surplus is not declining as rapidly as they thought it would.

2. Adjustment actions have been taken by some countries, and many more will be required in 1977. The question is to what degree these or additional actions will disrupt the international financial system.

B. In the face of projected large current account deficits in 1977, authorities in the weaker countries may be forced to take further adjustment actions by a combination of the following circumstances.

1. The countries themselves might realize that they cannot accept the large deficits and further accumulations of foreign debts projected in 1977. Consequently, they might adopt corrective measures additional to any that they have already taken or planned. This tendency might be reinforced by the emphasis at the recent IMF meetings in Manila on the need to direct domestic policy toward external adjustment.

2. Private financial institutions might well decide that it would be imprudent to lend to the weaker countries in 1977 on the scale that would be needed to finance the deficits shown in Table 1. Some banks may be reaching their legal limits on lending to particular foreign borrowers, many are reaching their self-imposed lending limits, and most banks are increasingly concerned about the quality of their loan portfolios. Consequently, private financial institutions may severely

cut back their new lending to the weaker countries in 1977. In this case, the weaker countries would have no other choice but to take drastic adjustment actions.

3. The International Monetary Fund has financed drawings by its members of over \$4.5 billion in 1974, about \$4.5 billion in 1975, and over \$7 billion in the first nine months of 1976. (Substantial further drawings are in prospect for the last quarter of this year.) The IMF will not have the resources in 1977 to continue to lend on this scale. Consequently countries that might have expected to be able to look to the IMF for further temporary financial assistance may be required to take more severe adjustment actions than they had planned.

C. Thus, even without an increase in the price of oil, the international financial system is faced with the prospect that for one reason or another the weaker countries will adopt adjustment measures to reduce drastically their projected, aggregate current account deficit in 1977.

1. Table 5 illustrates how a hypothetical \$30 billion reduction in the projected 1977 current account deficit of the weaker countries might be distributed among the strong countries and OPEC.

2. What adjustment measures might be adopted by the weaker countries in order to produce a \$30 billion improvement in their projected aggregate 1977 current account deficit? Three types of policies are possible.

a. The weaker countries might adopt tighter domestic, macro-economic policies, i.e., use monetary and fiscal policy to reduce domestic demand, while leaving their exchange rates unchanged.

Table 5 -- Distribution of a \$30 billion Reduction
in the 1977 Current Account Deficit of the
Weaker Countries
(billions of U.S. dollars)

	(A) <u>1977 Without Adjustment^{1/}</u>	(B) <u>1977 With Adjustment</u>	(C) <u>Change^{2/}</u>
<u>"Strong" Countries</u>	<u>21-3/4</u>	<u>-3-1/4</u>	<u>-25</u>
United States	5	-5	-10
Germany	8-1/2	-1/2	-9
Japan	2-1/2	-1/2	-3
Switzerland and The Netherlands	5-3/4	2-3/4	-3
<u>"Weaker" Countries</u>	<u>-54-1/4</u>	<u>-24-1/4</u>	<u>+30</u>
Other Developed Countries	-28-1/4	-8-1/4	+20
Non-Oil LDCs	-26	-16	+10
<u>OPEC</u>	<u>40</u>	<u>35</u>	<u>-5</u>
Residual	-7-1/2	-7-1/2	0

^{1/} From Table 1.

^{2/} Column (B) minus Column (A).

b. The weaker countries might allow their exchange rates to depreciate relative to the strong countries' currencies.

c. The weaker countries might impose or intensify import restrictions.

3. In practice, the weaker countries would probably adopt a combination of all three types of policies. To the extent that adjustment action was forced upon them, they might be more likely to choose in the first instance to allow their exchange rates to depreciate or to impose import restrictions. (The process of international adjustment is discussed in more detail in Section IV below.)

III. Implications of Substantial, Global Current-Account Adjustment in 1977

A. Implications for the Weaker Countries

1. If the weaker countries acted to generate a \$30 billion improvement in their projected current account deficit in 1977 by adopting tighter domestic, macro-economic policies, this current account adjustment would require a 6 per cent average reduction in their real GNP in 1977 compared with what it otherwise would have been.

a. Such a policy would help to slow down the rate of inflation, which is dangerously high in many of these countries.

b. The loss in real GNP in 1977 would be much more than 6 per cent for many of the weaker countries. Moreover, many of them now are looking forward to a modest (2-4 per cent) or no increase in real GNP in 1977. In other words, many of these countries would experience substantial recessions.

2. If the weaker countries acted to generate a \$30 billion improvement in their projected current account deficit in 1977 by allowing their exchange rates to depreciate relative to the strong countries' currencies, this action might in the first instance tend to increase the growth of real GNP in the weaker countries.

a. In the face of already high inflation rates in many of these countries, this policy would, however, lead to even higher inflation rates.

b. The added inflation and the exchange-rate depreciation could well lead to a loss of confidence by domestic producers and

consumers. Savings rates would rise; domestic investment would decline. The ultimate consequences for the domestic economies in the weaker countries could be a substantial reduction in the rate of real economic activity.

c. To the extent that the inflationary effects of the exchange-rate depreciation did not reduce domestic demand, a compensating reduction in domestic demand would be necessary in most of the weaker countries to satisfy successfully the additional demand for exports and import substitutes without adding further to domestic inflation.

3. If the weaker countries acted to generate a \$30 billion improvement in their projected current account deficit in 1977 by imposing or intensifying import restrictions (or by subsidizing their exports), the direct impact on their domestic economies could be expansionary, since demand for import substitutes would be increased.

a. To the extent, however, that the trade restrictions affected essential imports that could not easily or quickly be produced domestically, a reduction in real growth would result.

b. As in the case of a policy of exchange-rate depreciation, supporting macro-economic policies would probably be required to prevent an increase in domestic demand.

c. Moreover, the domestic inflationary consequences of import restrictions could lead eventually to higher savings rates, lower domestic investment, and lower levels of domestic demand.

d. The imposition of across-the-board import restrictions by the weaker countries would, of course, be highly disruptive to the world trading system and could lead to retaliatory steps that nullified the effects of the initial actions.

B. Implications for the Strong Countries

1. United States. The achievement of a \$30 billion reduction in the projected 1977 current account deficit of the weaker countries would require roughly a \$10 billion increase in the 1977 U.S. current account deficit in 1977, on the assumption that the other strong countries accept the changes in their projected 1977 current account positions that are assigned to them in Table 5.

a. Under the assumption of unchanged U.S. macro-economic policies, a \$10 billion current-account reduction would, as a first step, lead to a 1-1/2 to 2 per cent reduction in the rate of growth of U.S. real GNP in 1977. Feedback effects from disruptions of the international financial system could well raise this figure to 3-4 per cent.

b. The impact of this deflationary shock should tend to reduce the U.S. inflation rate. But any increase in the price of oil would tend to wipe out this effect.

c. Under the assumption of an unchanged U.S. fiscal policy, the reduction in U.S. GNP, compared with what it otherwise would be, would increase the government deficit.

d. Under the assumption of unchanged monetary policy expressed in terms of growth rates for the monetary aggregates, U.S. interest rates would tend to be lower.

e. A \$5 billion U.S. current account deficit accompanied by sluggish domestic demand would be likely to induce

protectionist forces in the United States to demand new import restrictions. If they received a favorable response to their demands, this would not only nullify part of the improvement sought by the weaker countries and lead to retaliation; it would also increase the U.S. inflation rate and damage the international trading system.

2. Other Strong Countries. The direction of the effects on the economies of the other strong countries of achieving a \$30 billion improvement in the projected 1977 current account position of the weaker countries would be the same as for the United States.

a. However, because these economies are somewhat more open than the U.S. economy, the initial depressing effect on their real GNP would be somewhat smaller than for the United States. For example, for Germany the direct loss in real GNP in 1977 might be on the order of 1 to 1-1/2 per cent.

b. If the other strong countries did not accept the current account deficits, or reduced surpluses, assigned to them in Table 5, and took actions to offset them, the associated change in the U.S. current account position would be larger and the effects on the U.S. economy, assuming unchanged U.S. policies, would be greater.

C. Implications for OPEC

1. Based on the above rough calculations, a reduction of \$30 billion in the projected 1977 current account deficit of the weaker countries is likely to lead to a 3-1/2 to 4 per cent reduction in the demand for OPEC oil. Assuming that 1977 OPEC oil revenues would be \$126 billion without an oil-price increase, this would lead to roughly a \$5 billion reduction in the OPEC surplus in 1977.

a. This calculation assumes that OPEC imports would be unaffected by the reduced demand for OPEC oil. In fact, OPEC imports might be marginally lower.

b. This calculation ignores the effects on OPEC investment income of lower interest rates in the United States and in the other strong countries.

2. If the adjustment actions by the weaker countries took the form of exchange-rate depreciation or import restrictions that were not directed at oil imports, the reduction in the OPEC surplus would be smaller, since the reduction in non-OPEC real GNP ceteris paribus would be smaller.

3. However, there is a substantial probability that the process of current account adjustment by the weaker countries could lead to a spiralling world-wide recession. (See below.) In this case, OPEC revenues would be dramatically reduced.

IV. Implications for the International Financial System

A. The previous section outlined in isolation the effects on countries' domestic economies of the achievement of a hypothetical \$30 billion improvement in the projected 1977 current account deficit of the weaker countries.

B. However, it is likely that the ultimate effects on the world economy would be much larger than those that have been outlined above.

1. The analysis in the previous section assumed that the process of adjustment would be smooth. In fact, this assumption is likely to be unjustified.

a. The required adjustments within the economies of the weaker countries are likely to be larger by an unknown factor than those implied by the mechanical analysis that was applied. That analysis necessarily ignored the unquantifiable effects on national economies and the world economy of the damage to confidence that would occur.

b. Moreover, each of the weaker countries could not be expected to share proportionately in the aggregate current account improvement of the group. For those weaker countries that delayed in taking action, international feedback effects would lead to larger current account deficits in 1977 than are now projected for them. Their ultimate adjustment actions would have to be that much more severe. In other words, the hypothesized \$30 billion improvement in the 1977 current account deficit of the weaker countries as a group would be only a net improvement; the process of adjustment and dislocation would necessarily continue for many years.

2. The shocks to the economies of the weaker countries analyzed in the previous section would be severe.

a. The prospective loss in real GNP under a policy based on domestic contraction is so large that it is unlikely that many countries would be strong enough politically to go far with this method of adjustment.

b. The size and scale of the required increases in tariffs and tighter import quotas would be of historic proportions. Retaliation in kind would be inevitable.

c. To achieve alone, or even to contribute substantially to, the hypothesized improvement in the current account position of the weaker countries in one year, the required size of exchange-rate adjustments is likely either to be politically intolerable or to lead to rationing of foreign exchange through capital controls or to result in severe domestic economic disruptions and distortions.

d. Finally, the effects of these adjustments on inflation rates and domestic confidence would be substantial and incalculable.

3. In the face of these severe disruptions, the ultimate impacts on national economies or the responses of their policy makers are unknown. But the risks are clear.

a. Secondary macro-economic adjustments for some countries would be substantial.

b. Retaliation or protection through import restrictions would be probable.

c. Disturbances in financial markets would probably lead to the widespread adoption or intensification of capital controls.

C. Therefore, the most likely overall result of an international adjustment on the scale outlined in this paper would be a severe world-wide recession or depression and a drying up of international financial flows for generations. Once the process of severe international adjustment got under way, many of the weaker countries would have no choice other than to default on their loans or at least to seek deferral of their interest payments. Such actions could, in turn, endanger the stability of banks and other private financial institutions in the United States, Germany, Japan and other major industrial countries. For example, it has been estimated on the basis of 1975 data that a deferral of interest payments to the six largest U.S. banks by the six largest LDC borrowers would have reduced their after tax earnings by 17 to 57 per cent. At a minimum, the result of this type of action would be a severe retrenchment in the lending programs of all banks, which could precipitate an international financial crisis. The probability of such a crisis would be substantially increased if OPEC decides to raise the price of oil on January 1, 1977.

Jack -
This sounds
good -
J

Memorandum

November 24, 1976

To: President-elect Carter

From: Charlie Schultze

Attached is a short memorandum by Ed Fried of the Brookings Institution about possible organizational structures for making foreign economic policy.

enclosure

November 30, 1976

MEMORANDUM FOR GOVERNOR CARTER

SUBJECT: Organizing Foreign Economic Policy

1. The Problem. Foreign economic policy raises problems because it affects a number of agencies. Trade negotiations, for example, engage the interests--frequently divergent--of Agriculture, Commerce, Labor, and Interior, as well as State. Much the same is true for international commodities or energy policies or for negotiations on the use of seabed resources. As U.S. involvement in the world economy has grown in size and complexity, foreign economic policy has come to have a greater impact on domestic economic policy--and hence on the interests of domestic agencies. By the same token, in formulating domestic economic policy today there is greater need to take foreign policy consequences into account.

2. What Needs To Be Done? Effective machinery to coordinate foreign economic policy should:

- deal both with domestic and foreign economic policy: focusing on one alone is not likely to produce the necessary interaction between the interests involved;
- produce technically expert statements of issues and options;
- resolve differences among agencies where possible, without paralyzing action or reducing matters to the lowest common denominator;
- set out for the President important issues that cannot be resolved;
- anticipate for the President important issues that are likely to come up in the future.

← Defense

Coordination is a staff operation; the coordinator should not compete with the agencies, or be the arbiter of disputes among them, or negotiate with other governments. The purpose is to resolve disputes among agencies having comparatively narrow interests with the objective of developing a presidential policy, and to see that issues are brought to the President when reconciliation is not possible.

3. Possible Models. In the Kennedy-Johnson years and during the early part of the Nixon administration, special counsels in the White House had responsibility for coordinating specific foreign economic policy issues (notably textiles, international aviation, and oil), which they carried out informally. The NSC was also used, sometimes through the formal structuring of Council meetings but more typically through the informal mediation of the Special Assistant and the principal staff economist. The system required only a few people and worked reasonably well. There could be no assurance, however, that all the relevant agencies would have their say and the procedure was geared more to managing problems as they came up than to anticipating them.

In 1971 President Nixon, following the recommendation of the Ash Committee on reorganizing the government, established the Council on International Economic Policy as a formal coordinating structure. Legislative authority was subsequently obtained. The underlying rationale seemed attractive; since foreign economic policy involves a number of agencies, having a White House structure to oversee their disputes would make it possible to lay down a clear administration policy. As a matter of fact, the system never worked well and is now atrophied. The purely

international focus of the Council proved to be too narrow for examining foreign economic policy and the system lost credibility as a result. In its heyday, moreover, the Executive Director became an independent participant in the decision making process rather than a coordinator. Creating still another staff--and a comparatively large one--in the White House has also been a disadvantage.

President Ford's innovation is the Economic Policy Board, which is designed to coordinate all economic policy--domestic and foreign. Its agenda at one time or another seems to have covered most of the problems in foreign economic policy except for international financial matters, which Treasury has managed to keep under its own aegis. The Executive Director is a counsellor to the President and procedures are informal. Since in-depth discussions are not practical at meetings of the Executive Committee or the Board itself, special inter-agency groups are set up to analyze such issues as energy, grain reserves, and commodity policy. They report to the Board on their findings and recommendations. The Executive Director, who is responsible for preparing the issues for the Board and briefing the President, has not himself taken independent positions, at least not in public, and works with a very small staff. The fact that President Ford met fairly frequently with the Board obviously added to its status.

4. Recommendations. The Economic Policy Board strikes me as the most promising model to follow, principally because it deals with economic issues across the board, is flexible, and avoids the bureaucratic dangers

inherent in a large coordinating staff.

I recommend two important modifications:

- Make the Chairman of the Council of Economic Advisers the Executive Director. This would ensure technical competence in the preparation of issues, the discussion of those issues in the Board, and the briefing of the President. Furthermore, CEA expertise should be useful in reconciling domestic and foreign policy claims in the broader national interest.

- Add the Special Assistant for National Security Affairs to the Board and its Executive Committee. This would give needed additional weight to foreign policy in a structure that is necessarily heavy on the domestic side.

The Council for International Economic Policy should be abolished.



Edward R. Fried

PRIORITY
PRECEDENCE

UNCLAS
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FOR COMMCENTER USE ONLY

FROM: Maxie Wells, Plains

TO: Mr. Jack Watson
Transition Office
HEW Building
Washington, D. C.

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SPECIAL INSTRUCTIONS:

One copy each page to Watson.

MEMORANDUM

NATIONAL SECURITY COUNCIL

C

November 18, 1976

MEMORANDUM FOR THE PRESIDENT ELECT

FROM: JACK WATSON
 STU EISENSTADT
 DAVE AARON

SUBJECT: Discussion of "Sources and Methods"
 with George Bush

In his private ^{MEETING-}reading with you and the Vice President Elect, George Bush plans to raise certain highly sensitive intelligence collection activities and possibly certain key covert actions. Everything we have learned since the Bay of Pigs and in particular in the course of the Senate investigation of the CIA makes clear that it is extremely important that the authorization and review of clandestine activities be systematic and formal. The most serious abuses and mistakes have occurred when the CIA was acting under the impression that it had direct Presidential authority to conduct some operation or another. Transitions have been particularly risky times when authority for the conduct of clandestine activities has become blurred to the detriment of our national security.

Accordingly, we recommend that in your conversation of these sensitive issues with George Bush, you make the following points:

-- You will want the NSC/CIA liaison representative (David Aaron) to take a close look at these programs in the same systematic way that the NSC system now considers them. (You should be aware that the NSC is doing a full scale review of all clandestine activities which will be available in December and made part of your transition planning process.)

-- You are not in a position to authorize any clandestine activities until such time as you become President and have had an opportunity to conduct the systematic review indicated above.

SANITIZED

Per: Rac Project

ESDN; NLC-126-1-3-1-2

BY: [Signature] NARA, DATE 12/6/82

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State Dept. review completed

NLC Review Completed.

Test ban
Nuclear prolif
November 11, 1976
China testing nuclear
USSR " JC

9/

MEMORANDUM

TO: The President-elect
FROM: *fw* Jack Watson, David Aaron, Tony Lake
SUBJECT: Foreign Policy Issues For Your Action

This memorandum covers foreign policy subjects on which your guidance would be useful. It covers:

- Further follow-up on foreign policy issues, growing out of the campaign;
- The question of contacts with foreign press.

1. Foreign Policy Issues Remaining from the Campaign

In a previous memo it was suggested that you may wish to contact key countries through their embassies in Washington to assuage certain concerns which may have arisen from the campaign. Since that time:

- Averell Harriman has talked to Ambassador Dobrynin (USSR). In a separate memo, we propose a cautious but positive response.
- Senator Mondale had a positive talk with Ambassador Dinitz (Israel).
- You have addressed the OPEC question in your first press conference.

OPEC.

Deputy Secretary Robinson has indicated privately that it would be desirable for you to make a further statement on an OPEC price rise (See attached memo of conversation with Henry Owen). Robinson claims that your remarks at the last press conference are being misinterpreted and that a further comment would be helpful.

Since an OPEC price rise could hurt your plans for our domestic economic recovery, we believe you should say something more at the first opportunity.

We recommend you say:

- An OPEC price rise at this time would seriously undermine efforts for economic recovery throughout the industrialized world as well as damage the developing countries. It would damage our relations with the OPEC countries and be a poor way to start with a new U.S. Administration.

SANTIZED

Per, Rac Project
ESDN: NLC-126-1-3-1-7 _____ Agree

BY: *Q* WARA DATE 12/1/76 _____ Disagree

ELECTROSTATIC REPRODUCTION MADE FOR PRESERVATION PURPOSES

Panama

Deputy Secretary Robinson also suggested that a comment on Panama would help defuse the tense situation there. We suggest that Sol Linowitz be asked to call the Panamanian Ambassador and say that you asked him to reiterate your intention to pursue the negotiations and your hope that progress can be made before the inauguration. (This would not commit you to particular details in your negotiating strategy as President.)

_____ Approve

_____ Disapprove

✓ Angola

One other issue is that Holden Roberto _____

25X1

_____ has written to you through Tony Lake. The letter takes issue with your comment that the U.S. backed the wrong or losing side in Angola and asks for your support. _____

25X1

we recommend that you not respond personally but authorize Tony Lake to provide a non-committal acknowledgement on your behalf.

_____ Approve

_____ Disapprove

2. Contacts with Foreign Press

We have had several requests for you to meet with members of the foreign press.

We generally recommend that you avoid any specific interviews or even group discussions with foreign press representatives during the next few weeks. (Jody Powell agrees). This is consistent with our general suggestion that you keep a low profile on foreign policy issues during the transition.

The Japanese

A prominent Japanese professor with close ties to leaders of the ruling Liberal Democratic Party (LDP) has asked for an extensive interview on all outstanding issues between the U.S. and Japan. He previously requested such an interview during the campaign, but was told that there would not be time. The interview would be published in a widely-read Japanese journal. Part of his purpose in requesting the interview was to help the LDP in the forthcoming

MEMORANDUM - Page 3

Japanese elections. The calculation was that your making warm statements about your desire to work closely with Japan would help our traditional friends there -- i.e., the LDP.

Since it is probably too late to achieve that effect now, we recommend that we respond by saying that your current schedule is full but that he should check again in mid or late December to see whether it might be possible then. Jody Powell agrees.

_____ Approve

_____ Disapprove

You have also been asked by the Dean of the Foreign Press Corps in Washington, Arnaud deSegonzac, if you would meet with a group of foreign press on a basis similar to the meeting you held in Plains with the American press corps shortly after the election. Again, our recommendation would be that you avoid such a meeting for the next few weeks. Jody Powell agrees. We will explain it on scheduling grounds.

_____ Approve

_____ Disapprove

MEMORANDUM OF CONVERSATION

November 10, 1976

SUBJECT: Transition

Last night at a Brookings dinner, Charles Robinson, Deputy Secretary of State, made the following remarks to me -- largely in response to questions -- about transition problems. He made clear that he was speaking personally, and his confidence should be respected.

1. OPEC He indicated that the administration was trying to develop an agreed European-Japanese-American posture to discourage Iran from pressing for higher oil prices at the forthcoming OPEC meeting. A unilateral U.S. move would not be effective. There was some chance, he thought, that the OPEC countries would defer any major decision until the new administration took office. In answer to a question, he indicated that although the administration did not propose to ask Governor Carter to make a statement, his personal view was that a further statement by the President-elect stressing his concern over any OPEC price increase would be useful because: (i) last week's statement by Governor Carter in Plains was being misinterpreted -- the reference to the administration's having full responsibility until January 20 was being taken by some OPEC observers to indicate a lack of concern, despite the accompanying indication of Governor Carter's substantive views; (ii) a remark attributed to Dick Cooper in a U.S. periodical that the United States could withstand a 10%, or even a 20%, price increase was also being misinterpreted.

2. Panama. The Panamanian government needed to have some indication of progress in negotiations with the United States if domestic turbulence was to be avoided, and the administration was trying to move ahead in negotiations. The Panamanians, however, were hanging back because of uncertainty as to whether to deal with an outgoing administration. In answer to a question, he said that a statement by Governor Carter stressing his hope that the negotiations could achieve progress during the transition might be useful in persuading the Panamanians to negotiate with the outgoing administration.

3. Greece and Turkey. He reported that the Greeks were disinclined to negotiate further with the outgoing administration about the pending base treaty and doubted there was anything either Governor Carter or the outgoing administration could do about it.

4. Brazil-Germany Nuclear Deal. He said that the administration had some hope of concluding an agreement with France that would roll back the France-Pakistan nuclear deal; if so, this would pave the way for also rolling back the Germany-Brazil nuclear deal. Governor Carter's past statements on the nuclear issue had been most helpful and had been used by the administration in trying to persuade the French to take a more flexible view on this question. No further statement was needed.

130
Henry Owen

IMMEDIATE

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PRECEDENCE

CLASSIFICATION

FROM: DAVID AARON
TO: PRESIDENT-ELECT CARTER

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MEMORANDUM

NATIONAL SECURITY COUNCIL

TO GOV 16

November 30, 1976

MEMORANDUM FOR THE PRESIDENT ELECT

FROM: DAVID AARON

SUBJECT: Vance-Owen Memos of Conversation

Attached are memoranda of conversation between Cy Vance and the Turkish Ambassador to the UN and between Henry Owen and Ambassador Dobrynin and others. Note particularly that:

-- The Turkish Ambassador opens the door to mediation (points 4 and 5, Vance memcon).

-- Dobrynin's warning against reductions in SALT does not entirely square with Kissinger's version of the Soviet position. You will recall Kissinger said they were prepared to accept a cut several hundred below the Vladivostock ceilings (see paragraph 2, Owen memcon, November 24, 1976).

MEMORANDUM OF CONVERSATION
WITH AMBASSADOR TURKMEN

Ambassador Turkmen asked to come and see me at the behest of his Foreign Minister, whom I got to know well during the 1967 Cyprus crisis. Ambassador Turkmen made the following points on behalf of Foreign Minister Caglayangil:

1. It is urgent that the Defense Cooperation Agreement be approved by the US Senate promptly after the first of the year. If approval is withheld, Turkey will not take drastic action such as pulling out of NATO, but our failure to act affirmatively will have a very strong, adverse impact in Turkey. Turkish public opinion is already inflamed. On the other hand, if favorable action is taken by the Congress on the Turkish agreement (and presumably on the Greek agreement at a later date), US political leverage on other matters affecting Turkey, including Cyprus, will be greatly increased.
2. The Turkish army is not putting pressure on the Turkish government to remain in Cyprus--as he understands has been suggested in the US. The Turkish army has said, however, that if the civilian political judgment is to keep military forces in Cyprus, the army needs a minimum size

force, which is approximately that which they have there now.

3. Some progress is being made on the Aegean problems. Parallel discussions on the Aegean and Cyprus can go forward together. With respect to the former, negotiations between Greece and Turkey on the issue of continental shelf oil and mineral rights start tomorrow. Also starting tomorrow are similar negotiations on air rights issues.
4. With respect to third-party mediation, Turkey would favor no mediation. Turkey recognizes, however, that this is not the Greek position and, accordingly, will take that into account.
5. If the Defense Cooperation Agreement issue is settled, he believes that the US could and should facilitate discussions on the Aegean and Cyprus problems by quiet diplomacy among the parties.

CRVance

11-1-76

TURKISH PERMANENT MISSION
TO THE UNITED NATIONS

No = 1101-213

October 25, 1976

The Honorable
Cyrus Vance
Simpson, Thackers
& Bartlett
1 Battery Park Plaza
New York, N.Y. 10004

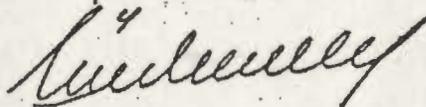
Dear Mr. Vance,

Please find attached the text of a letter which I received through telex this morning, addressed to you by my Foreign Minister, H.E. Mr. I.S. Caglayangil.

As you will see from the letter, my Foreign Minister has instructed me to call on you. I would appreciate it very much if we could meet at your earliest convenience.

With warmest regards,

Sincerely,



Iltis Turkmen
Ambassador
Permanent Representative of
Turkey to the United Nations

October 23, 1976

Dear Mr. Vance,

Knowing your interest in the preservation and development of the relations of friendship established between our two countries, which after three decades of harmonious cooperation had become indeed traditional, but which have been rather seriously disturbed in the recent years. I thought I should write to you to convey some of our preoccupations and apprehensions as to the future of our bilateral ties. I am of the opinion that in the present circumstances no effort should be spared, on the part of those who realize the importance of these ties, to try to eliminate the rather artificial obstacles which are being created to prevent a better understanding between our nations.

I have taken advantage during my annual trip to New York to attend the session of the United Nations Assembly to travel in the United States, and on their invitations, to give lectures on the present orientations of Turkish foreign policy and

Turco-American relations at the Mid-America Club in Chicago and the World Affairs Councils of Los Angeles and San Francisco, where I met the press and prominent Americans in these cities.

The contacts and conversations which I have had gave me the impression that certain lobbies in the United States are influential enough to distort Turkey's image in the eyes of the American public opinion and to create serious misunderstandings on Turkey's position on certain important foreign policy issues. And what worries me most is the fact that statements which are being made during the present election campaign, and which may further disturb our relations, are clearly reflecting the views of these lobbies. The purpose of such activities is no doubt to divert the Turkish-American relations from its traditional course and disrupt relations of cooperation for the development of which both nations have deployed so much effort over the years.

As you are aware, Turkish public opinion is already deeply hurt by the Congress's decision to impose an arms embargo on Turkey, and consequently, Turkish-American bilateral security relations have lately undergone a serious trial. However, the Turkish Government acted with restraint and spared no effort to avoid any further deterioration of the relations between the two countries. The United States Government shared the same

view on the value of the continuation of the Turkish-American friendship and security cooperation. This common understanding have led the two Governments to sign a new defense cooperation agreement in Washington on 26 March 1976, with the aim of restoring confidence between the two nations. I think this is a considerable achievement on both sides under the circumstances. And I believe both countries have a common interest in putting into effect the agreement as soon as possible.

I do not doubt that with your deep knowledge of foreign relations and of the particular conditions in this region of the world, you are on your part considering the problem in its proper historical and political perspective, and that you may perhaps wish to use your influence as an authority on foreign affairs to try to prevent a further weakening of ties which have proved valuable in the past, and which, I think, still are for both countries and the free world. I have asked Ambassador Iltter Turkmen, our Permanent Representative to the United Nations, to call on you at your convenience so as to inform you more in detail of existing difficulties. I hope Ambassador Turkmen may have a broad and frank conversation with you on this problem.

With kind regards,

Sincerely,

IHSAN SABRI CAGLAYANGIL
Foreign Minister of Turkey

November 24, 1976

MEMORANDUM OF CONVERSATION

SUBJECT: U.S.-Soviet Relations

On the shuttle flight from Washington to New York, Ambassador Dobrynin sat next to me and discussed U.S.-Soviet relations. For the most part, his remarks were the standard Soviet line, but a few points are worth reporting:

1. Governor Carter. He asked about Governor Carter's foreign policy intentions; I referred him, as is my practice, to the Governor's speeches. His answer suggested that he had read them with some care. He was still uncertain on some points, but had concluded that there would be only nuances of differences between Governor Carter's foreign policy and that of the present administration.

2. SALT. He hoped that this could be buttoned up quickly: the agreement was virtually completed; the Backfire and cruise missile issues were easy to settle (there should be a 600 kilometer limitation on the latter); only an act of will was needed to sign the agreement in a few months. If, on the other hand, the Carter administration tried to add new features -- e.g., a qualitative freeze or deeper quantitative cuts in force levels -- to the agreement, this would add years to the negotiation. Better to take these issues up in negotiating SALT III, immediately after concluding SALT II.

3. MBFR. The first step toward limiting conventional forces was to conclude the Mutual Balanced Force Reduction negotiation in Vienna. He asked what Governor Carter's view of this important matter was. I drew his attention to the favorable reference to this negotiation in

Governor Carter's speech to the Foreign Policy Association. He said that the U.S. proposal to withdraw some nuclear weapons from Europe in return for a Soviet tank army was unacceptable; how could the withdrawal of nuclear weapons be verified? And why did we object to a national ceiling on German forces? I drew his attention to the political problems vis a vis the Federal Republic; he said they had problems with East Germany, too.

4. Soviet Build-Up. In answer to a question as to what worried him most in U.S.-Soviet relations, he mentioned exaggerated U.S. fears of the Soviet military build-up; he singled out misleading U.S. estimates of the Soviet civil defense program, as one example. I said that what concerned me most was the build-up of Soviet forces in Europe and the high proportion of Soviet gross national product going to military purposes; neither of these phenomena was equalled in the West. He said that the Soviet European build-up was only "modernization" and that we overestimated the proportion of Soviet GNP going to defense. He kept coming back to this issue; everything, he said, flowed from this U.S. misunderstanding. I tried to tell him that the problem was not one of perception, but underlying reality. He said that the Soviet military program was fixed and would not change, except as a result of arms agreements. He attributed difficulties in arms control and exaggerated estimates of the Soviet build-up largely to the U.S. military who, he said, played a much larger role in the U.S. than they did in the USSR.

5. Middle East. The USSR favored a general settlement based on UN Resolution 242, including full normalization of Arab relations with Israel, so did the Arab countries. Now it was up to the U.S. to persuade Israel to accept a general settlement and to make the necessary territorial concessions. The USSR would be quite prepared to see the Palestinians come to a Geneva Conference as part of other Arab delegations, if that was acceptable to the Palestinians. But, he asked, would a Democratic administration be able to

pursue a Middle East general settlement, given what he described as its greater dependence on pro-Israeli votes in the U.S. I pointed out that Governor Carter's New Jersey speech, proposing such a settlement, had won wide approval in the U.S.

6. Korea. What happened there (notably, whether we withdrew ground forces) was not the Soviets' affair, since the U.S. had excluded them from its proposal for a four power negotiation. When I asked if he thought North Korea might "do something foolish", he said "yes". This was the only time in the conversation he said a communist nation might act aggressively.

7. Angola. The Angolan intervention had been the result of special circumstances, which would not recur.

8. China. The improvement in inter-state relations between China and the USSR was modest and would go slowly.

9. Comment: Throughout the talk he was friendly, cheerful, and voluble. When I said that it was remarkable how he always seemed to conclude that the USSR was on the right side of the argument, he said cheerfully no they were wrong in some things. I held my breath waiting for an example; he said they were not effective in propaganda.

Henry Owen

MEMORANDUM
OF
CONVERSATION

Subject: Yugoslavia

Tad Szulc (New Republic) told me last night that the Yugoslav Deputy Chief of Mission in Washington had said to him of Governor Carter's recent statement in Plains about Yugoslavia: "If I'd written it myself I couldn't have done better." The DCM added that debate about Yugoslavia in the campaign had publicly surfaced the Soviet threat to Yugoslavia in a way that the Yugoslavs had long wanted but could not themselves accomplish. The result of that surfacing and of Governor Carter's Plains statement was to compel Brezhnev to make the statement that he delivered recently in Yugoslavia about Soviet respect for Yugoslavia's independence. All in all, the Yugoslavs were very pleased with the outcome of the debate.

^{bo}
Henry Owen

MEMORANDUM
OF
CONVERSATION

Subject: Korea

At the regular Brookings luncheon with Japanese reporters in Washington earlier this week I tried to answer questions about the foreign policy of a Carter Administration, and was struck by the large concentration of these questions on the prospective withdrawal of U.S. ground forces from Korea. Although most of these reporters are well to the left of the current Japanese government, they were clearly afraid that such a withdrawal would trigger North Korean attack and unhinge Japanese confidence in the U.S. They reported that these concerns were widely shared in Japan and that the Japanese ambassador in the U.S. had recently made a speech stressing the importance of U.S. forces in Korea.

I repeated Governor Carter's assurance that timing and manner of any withdrawal would be decided in consultation with the Japanese government, and that if Japan felt the withdrawal had to be phased over a considerable period to allow for a South Korean military build-up, this would be taken into account in Governor Carter's decisions. The consultation would, in short, be genuine--not sham. This seemed to mollify them somewhat, but they were still worried.

Comment: If an opportunity arises in a press conference, it would be useful if Governor Carter could underline his intention to consult with Japan after January 20 about U.S. forces in Korea before reaching any decision.

^{WJO}
Henry Owen

Vance
forwarded
12/2/76

November 23, 1976

TO: The President-Elect
FROM: Zbigniew Brzezinski *ZB*
SUBJECT: Saudi Arabian Position Regarding a Middle Eastern Settlement

The enclosed statement - though informal - originates from Crown Prince Fahd of Saudi Arabia and was transmitted to me by Mr. Harry Kern, an international consultant with strong Saudi connections. The Crown Prince asked that it be brought "to the attention of Mr. Carter's appropriate advisers". I believe that items 3 and 5 on the attached are noteworthy, since they indicate some Saudi flexibility on two critical points.

Enclosure

P.S.

A newspaperman called, saying that you have been concerned over an interview with me in a left-wing French paper. Perhaps this is gossip, but the fact is that the "interview" is a fabrication; I have given no interviews for the last 6 months or so!

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1. The policy of the Saudi Government is to reach a peaceful settlement with Israel and to accomplish this as soon as possible. Not until then, can the Arabs really deal with the pressing Arab problems in the region.

2. The terms of settlement should include provision for a Palestinian state of some kind. Such a Palestinian entity should include the Gaza Strip and the West Bank. But the basic reason for the creation of some kind of state is to give the Palestinians some focus for their national life, something they can call their own. This is the only way to stop the violent Palestinian activities that threaten stability in every Arab country where the Palestinians form a measurable minority. The Saudi authority puts it this way: With a state of their own, the Palestinians will go to bed at home at night instead of hanging around coffee houses and street corners exchanging grievances.

3. The borders of Israel should be based on UN Resolution 242 and on the 1967 frontiers. But "practical" modifications of the 1967 borders would be acceptable. The imperative consideration, from the Arab standpoint, is to establish borders that also set, once and for all, guaranteed limits to Israeli territorial expansion.

4. Guarantees of Israel's borders by the U.S. would be acceptable and desirable. So would similar guarantees by the Soviet Union. The USSR in March or April of 1975 indicated it might guarantee future Israel borders and this was welcomed by Saudi Arabia.

5. An Arab flag must fly, in some form, in Jerusalem but access to the Holy Places must be guaranteed to the "pilgrims" of the Jewish, Moslem and Christian faiths. (This is the least defined of any point and I believe would be open to many kinds of modification. The Saudis have been in touch with the Vatican, through very private channels, on this question and are amenable to Vatican suggestions. Allon stresses "a religious and not a political solution" to Jerusalem and this also is Saudi thinking. So instead of an Arab presence there might be an Islamic presence).

TO: GREG SCHNEIDER'S

L'Ambasciatore d'Italia

10041

1/3
Maxie
Fide

Here is ambassador's ~~copy~~ letter.
He may publish Andreotti's reply.
You may want this for your records.

~~Handwritten signature~~
November 22, 1976

Dear Mr. Aaron:

I have the honour to transmit to you the text of a letter (with an unofficial translation) addressed to the President-elect, Governor Carter, by the Italian President of the Council of Ministers, Mr. Giulio Andreotti. The original of the letter will be forwarded to you as soon as we will receive it.

Please accept, my dear Mr. Aaron, the assurances of my highest consideration.

Handwritten signature

Mr. David Aaron
Room 393
Old Executive Office Building
Washington, D.C. 20506

ELECTROSTATIC REPRODUCTION MADE FOR PRESERVATION PURPOSES

Caro Signor Carter,

La ringrazio del suo cortese messaggio del 18 corrente. Comprendo le ragioni che non Le consentono, prima della Sua investitura ufficiale, di avere incontri con uomini di governo stranieri e Le sono molto grato di avermi manifestato il Suo desiderio di incontrarmi dopo la data del 20 gennaio del 1977 e di stabilire con me un rapporto personale di collaborazione.

Concordo pienamente con Lei nel giudicare che un nostro incontro ci consentira' di procedere a un proficuo esame degli importanti problemi di comune interesse in un momento di gravi difficolta' e contribuirà a rafforzare ulteriormente gli stretti e fiduciosi rapporti che esistono tra i nostri due Paesi.

In tale gradita attesa, mi crada,

Suo Giulio Andreotti

L'Onorevole James Earl Carter
Presidente-eletto
Plains, Georgia 31780

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Unofficial translation

Dear Mr. Carter:

I thank you for your courteous message of November 18. I understand the reasons why it is not possible for you to meet with foreign leaders before your inauguration, and I am most grateful to you for having expressed to me your wish to meet with me after January 20 of next year and to establish with me a personal relationship of collaboration.

I fully agree with you that a meeting between us will allow us a fruitful examination of the important problems of common interest in this moment of grave difficulties and will contribute to strengthen further the close and confident ties which exist between our two Countries.

In this hopeful expectation, I remain

Yours

Giulio Andreotti

The Honorable
James Earl Carter, Jr.
President-elect
Plains, Georgia 31780