

**THE DIRECTOR OF
CENTRAL INTELLIGENCE**

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SUBJECT: Deputy Secretary Dam's Speech
before the Dallas World Affairs
Council

REFERENCE: Memorandum from Charles Hill,
same subject, dated 28 November 1984

We have checked with DDI/ALA and
DDI/OGI. No errors and no problems.

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**EXECUTIVE SECRETARIAT
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Remarks to 19: Please provide your agreement and or comments to ES - I will pass on to Skol. Check for facts and classification/Sources and Methods problems!

29 Nov 84
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United States Department of State

Washington, D.C. 20520

November 28, 1984

To: OVP - Mr. Donald P. Gregg
NSC - Mr. Robert Kimmitt
CEA - Mr. William Niskanen
CIA -
Commerce - Mrs. Helen Robbins
DOD - COL R. J. Affourtit
OMB - Mr. Alton Keel
Treasury - Mr. Christopher Hicks
USTR - Mr. Dennis Whitfield

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Subject: Deputy Secretary Dam's Speech before the
Dallas World Affairs Council

The Deputy Secretary is scheduled to deliver an on-the-record speech before the Dallas World Affairs Council on December 5. Please telephone your comments/clearance on the attached draft to Mike Skol, 632-9193, by noon Thursday, November 29.

Boonckinley
Charles Hill
Executive Secretary

Attachment:

Draft speech



L-290

Revised 11/27/84 7450P

"LATIN AMERICA: THE STRUGGLE TO RESTORE ECONOMIC GROWTH"

REMARKS BY
THE HONORABLE KENNETH W. DAM
DEPUTY SECRETARY OF STATE
BEFORE THE
DALLAS WORLD AFFAIRS COUNCIL
DALLAS, TEXAS
December 5, 1984

I. INTRODUCTION

I recently returned from ten days in Latin America. I was not in Central America, where the headlines are. I went to South America, and I should like to share with you what I saw there because it applies in most ways throughout the hemisphere, including Central America and the Caribbean.

I visited three countries -- Peru, Bolivia, and Argentina. Each has searing social and political problems. Argentina still feels the wounds of a "dirty war" between extremes of left and right. Bolivia is bedeviled by poverty, political instability, and organized narcotics trafficking. Peru, like Bolivia, is beset by drug trafficking; in addition, it is combatting a nihilist guerrilla movement.

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What struck me most, however, was that in all three countries I found civilian governments working hard to consolidate democracy in the face of their most severe economic crisis since the Great Depression. In all three, I found individual leaders struggling, often with great courage, against enormous odds. It is their struggle -- which is basically a struggle to restore economic growth while maintaining social and political stability -- that I should like to discuss with you today.

[NEAR-TERM SUCCESSES ...]

In the last few years, the international economic agenda has been dominated by the \$700 billion Third World external debt. When the debt crisis erupted in 1982, it threatened the viability of the international economic system. In a first response, the United States and other industrial democracies undertook emergency financing measures designed to overcome the immediate lack of liquidity in particular countries. This was followed rapidly by a second phase, in which the IMF and the World Bank also played key roles. In that second phase, we sought to support short-term stabilization and economic reform.

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It is now apparent that some important near-term successes have been scored. The total current account deficit of the seven largest Latin American debtors [Argentina, Brazil, Mexico, Colombia, Chile, Peru and Venezuela] -- who together hold about half of the Third World debt -- was reduced from \$34 billion in 1981 to just \$3 billion in 1983. In the same period, the combined trade accounts of these countries jumped from a surplus of less than \$1 billion to a surplus of \$31 billion.

Over \$70 billion in Latin American external debt has been rescheduled to permit orderly servicing. Mexico's impressive improvement enabled it to sign a multi-year agreement in September with its commercial bank Advisory Committee to reschedule payment on almost \$50 billion of public sector debt. Brazil will enter similar negotiations shortly. Both Mexico and Brazil should record positive growth this year.

[... LEAD TO A NEW PHASE: GROWTH]

We are thus entering a new phase. The emphasis is shifting from ensuring immediate liquidity to promoting long-term growth. Without renewed real growth, debtor nations will lurch from one short-term crisis to another.

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For a generation, from the late 1950's to the late 1970's, Latin America as a whole grew by 6 percent a year in real terms. But since the debt crisis erupted in 1982, and despite near-term successes in some countries, aggregate growth has been negative. Per capita income has fallen to roughly 1976 levels. Industrial sector unemployment, seldom a problem in the past, has become serious. Population continues to grow at about 2 percent a year, and entrants to the job market are increasing at about 3 percent a year.

As a creditor country, we often think in terms of the repayment of debts, hence the label "debt crisis". Behind this crisis, however, is the failure of most Latin American economies to generate the resources for the growth their societies require. How to meet popular expectations for jobs, for services, for education, for improved standards of living -- that is the underlying problem throughout Latin America. And that is why in this new phase we should be thinking growth, not debt.

[INTERNAL TRADE-OFFS]

Achieving sustained economic growth presents different challenges from those posed by balance of payments problems. Austerity programs and belt-tightening measures can be sold

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politically as short-term necessities. Sustainable growth, in contrast, requires far more fundamental economic and political changes.

The changes required to renew and sustain growth are often referred to under the heading of "structural adjustment." These changes involve permanent shifts in income distribution, resource allocation and political power -- often between city and countryside, labor and management, consumers and exporters. Adjustment involves decisions on subsidies, on exchange rates, on state enterprise, on private enterprise -- in short, on the way economic activity is organized in a particular country. These decisions are almost always painful. And they cannot be taken by outsiders.

The choice is not between adjustment today or adjustment tomorrow. It is between orderly adjustment -- cushioned by external support -- and disorderly adjustment forced by economic decline and attempts to sustain ineffective policies.

The Latin American experience is currently marked by the social and political strains associated with the adjustment measures needed to renew growth.

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The Peruvian Government, for example, has reached successive agreements with the IMF to take steps that would enable it to stabilize its economy and resume orderly servicing of its \$13 billion debt. But these steps have aroused intense opposition from political parties, labor, business and interest groups. A nationwide general strike was widely effective in March. And without effective adjustment, the economic situation has continued to deteriorate, eroding further the ability of the government to take decisive action. Meanwhile, particularly brutal guerrilla agitation and violence are corroding national confidence. These developments challenge Peru's government, which was restored to civilian democratic control only in 1980.

Peru's problems are not unique:

-- In the Dominican Republic last April, efforts to reduce food subsidies that the government could no longer afford to pay led to riots that left 60 dead. Only careful, patient leadership in the wake of those riots has restored the government's ability to conduct economic policy.

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- In Bolivia this spring, labor groups frustrated attempts at economic reform by striking and closing the Central Bank. Since then, the economy has greatly deteriorated, with inflation reaching almost 1500 per cent. The Bolivian Catholic Church recently warned that democracy was endangered. Civilian President Siles responded with a significant gesture, cutting his mandate short by one year and promising elections in June of 1985.

- In Ecuador, the democratically elected, reform-minded administration of President Febres Cordero faces a tough political challenge in putting his economic program through a skeptical Congress.

- In Honduras and El Salvador, newly developing democratic institutions must cope not only with economic difficulties, but with immediate security problems as well.

[EXTERNAL SUPPORT]

Each country must make the tough decisions on how to stabilize and restructure its economy. The international community can help in this effort and can cushion the impact of reforms. But domestic adjustment must come first, because international help will fail without it.

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Three factors in particular can help ease the adjustment process: IMF/World Bank efforts to promote growth, increased investment in the debtor countries, and more open trade. I should like to touch briefly on each of these factors in turn.

IMF/World Bank Efforts

In the short term, the United States can often provide bilateral assistance to cushion the shock of adjustment while ensuring that adjustment takes place. We are, for example, giving economic aid to each of the countries I have just named. In the short and medium term, multilateral institutions, such as the International Monetary Fund, the World Bank, and the Inter-American Development Bank, assist debtor countries by providing resources and policy advice.

The purpose of IMF programs, according to the Fund's Managing Director, is "to achieve a better balance of payments equilibrium and thus open the way for more vigorous and lasting growth [in debtor countries]." Consequently, IMF programs seek both "a better balance-of-payments equilibrium in the medium term and a more efficient use of scarce resources by introducing . . . incentives . . . to generate more domestic savings, more investment, and more exports." The United States supports this emphasis on growth.

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IMF efforts are complemented by those of the World Bank. The Bank's Structural Adjustment Loan program, for example, is designed to facilitate the sort of long-term economic changes I described earlier: changes to make exports more competitive; to mobilize domestic and foreign capital; to promote a more efficient use of domestic resources; and to bring about institutional reforms. These loans, together with the Bank's sectoral and project lending, can help developing countries carry out reforms at a time when slow growth and tight credit make such reforms as difficult as they are necessary.

Investment

Restoring vigorous and sustainable growth to the hemisphere will require continued infusions of capital for years to come. Official assistance levels, whether from bilateral or multilateral sources, are unlikely to rise much in the years ahead. It is also clear that private lending at the levels that prevailed in the 1970's is not in the interest of the banks or the borrowers. The capital required to sustain new growth will have to come from somewhere else.

Domestic savings must be a primary source of new investment. Adequate incentives -- such as positive real interest rates -- must be provided to encourage such savings. Priority should also be given to creating the right conditions

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for repatriation of the flight capital of the past decade. From 1979 to 1983, some \$100 billion -- I repeat, roughly \$100 billion -- was transferred out of Latin American countries. That money could have been used to generate income to service debt. Its absence means that local savings must be tapped to service debt rather than to stimulate economic growth. The volume of capital flight has fallen slightly in the past year, but remains a major problem.

Foreign direct investment is another important potential source of capital. As an alternative to acquiring new debt, foreign direct investment has many advantages. In hard times, the costs of investment, serviced by profits, are lower than the costs of debt capital, serviced by interest payments. Moreover, foreign direct investment develops human resources through training and education, provides access to new technology, and often generates its own international export markets.

The problem is that Latin America and the Caribbean have not been successful recently in competing for foreign direct investment. External and internal factors have combined to cause a pronounced dropoff in investment flows. For five major Latin American countries [Brazil, Mexico, Chile, Peru and Colombia], net inflows during 1983 were \$2.6 billion less than the 1979-82 average. And despite Mexico's recent financial successes, foreign investment flows to Mexico remain at a

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fraction of pre-crisis levels. Meanwhile, the Far East has seen foreign investment rise. And the United States, which offers excellent security and good yields, is proving extremely attractive to investors, including many from Latin America.

It will take political courage and determination for Latin American countries to compete more effectively for foreign investment. Both internal adjustments and international cooperation will be essential. Owners of capital need to earn a fair, risk-adjusted rate of return. They will not be attracted by restrictive rules enforced by government bureaucracies with little understanding of production or marketing requirements. Remedies in these areas would also curb capital flight and stimulate local savings.

Open Trade

Trade is as vital to growth as it has been to the easing of immediate liquidity problems. The United States has contributed decisively to improved Latin American trade accounts. We have kept our markets open -- even when those countries were forced to cut their imports from the United States and elsewhere. Accordingly, Latin American exports to the United States grew by over \$4 billion from 1982 to 1983, while they decreased to the rest of the world. In 1984, we expect to take almost half of all Latin American exports (\$50 billion out of \$111 billion).

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These figures belie the notion that the United States is "protectionist." Our projected \$130 billion merchandise trade deficit is evidence that we have kept our markets open, thus helping our Latin American trading partners to grow with our own economic expansion. However, if trade is to foster sustained growth, it must be a two-way street. We anticipate that renewed Latin American economic growth will lead to increased purchases by them of our goods. And we hope that individual Latin American countries will reduce their trade barriers and diversify their trade with others, and among themselves as well.

[WHAT'S AT STAKE]

The "trade-offs" between maintaining political and social stability today and building for growth tomorrow create awesome dilemmas for any government.

The difficulties can be eased somewhat if there is an alliance between the decision-makers and the people whose fate is being decided. As President Monge of Costa Rica, speaking from experience, told a European audience five months ago: QUOTE: Democracy works as a means of settling the problems of production and [winning] battles in the struggle against under-development and poverty. UNQUOTE.

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My talks in South America made me optimistic that President Monge is right. Men like Argentina's President Raul Alfonsin -- a profoundly decent man trying to do what is right in a country still wracked by the misdeeds of the recent past -- are now also working in democratic systems. And this kind of thing is happening throughout the hemisphere.

Counting just the past four years, our southern neighbors have cast some 150 million votes in 33 elections in 24 countries. That is more people voting in more elections in more countries than ever before in the history of Latin America and the Caribbean.

Over the past five years, elected civilian presidents have replaced military rulers in Argentina, Bolivia, Ecuador, El Salvador, Honduras, Panama, Peru and Uruguay. Additional countries as different as Brazil and Guatemala are now also moving toward greater democracy. The day before yesterday (December 3), the people of Grenada chose their leaders in a free and open election, restoring democracy on that island. More than 90 percent of the people of this region to our south now have governments that are either democratic or heading there.

But good political statistics cannot offset bad economics. The dictatorships were swept aside because they could not solve their nations' severe economic and social

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problems. Democratic governments, if they are to survive, must now prove that they can deal successfully with these challenges. They must implement adjustment measures and they must do so now, not later. If governments delay -- if adjustment measures are then forced upon them by circumstances -- there is a risk of triggering internal violence and a return to the military dictatorships of the past.

But that is not the only -- or even the most probable -- result. If the democratic governments fail, a whole range of alternatives is possible, and not just Marxist-Leninist regimes mimicking Cuba and Nicaragua. We have already seen in the Garcia Meza regime that ruled Bolivia from 1980 to 1982 a government dominated by narcotics traffickers. And beyond that, consider the dangerous chaos that could ensue if nihilistic radicals like Peru's Sendero Luminoso ["Shining Path"] guerrillas multiplied their strength.

The stakes are enormous. Hanging in the balance is the well-being of the 90 percent of Latin Americans now enjoying or moving toward democracy, as well as the security of the Western Hemisphere itself.

It is vital, then, that the Latin American governments directly at risk take today the actions necessary to build for sustained growth tomorrow. Foremost among such actions are policy changes to open up their markets and create conditions to attract and retain capital.

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The United States has supported -- and will continue to support -- such actions. Other industrial countries -- particularly Japan and the European Community -- must also work to cushion the adverse impact of economic adjustment. This can be done by supporting the international financial system, keeping markets open and exercising sensitivity along with fiscal responsibility.

When all is said and done, I came back from South America both concerned by the odds and convinced that a new era of hemispheric cooperation, growth and security is within our reach.