

~~SECRET~~
CONTROLLED DISSEM

SNIE 97-69

6 March 1969

SPECIAL NATIONAL INTELLIGENCE ESTIMATE

Number 97-69

PERU AND THE US THE IMPLICATIONS OF THE IPC CONTROVERSY

ADVANCE DISSEMINATION

NOTE: This estimate was approved by the United States Intelligence Board on 6 March 1969. The printed copies will be disseminated in a few days.

CONTROLLED DISSEM
~~SECRET~~

APPROVED FOR RELEASE
DATE: FEB 2001

~~S-E-C-R-E-T~~

CONTENTS

	<u>Page</u>
THE PROBLEM	
CONCLUSIONS	
DISCUSSION	4
I. THE MILITARY COUP AND THE IPC	4
Background	4
Elements of Friction With the US	6
II. THE MILITARY REGIME: GOALS, INFLUENCES, AND POLITICAL CONFLICTS	11
III. THE ECONOMIC REALITIES	17
IV. US SANCTIONS AND PERUVIAN REACTIONS	19
V. OUTLOOK	23
VI. LATIN AMERICAN REACTIONS	26

~~S-E-C-R-E-T~~

~~GROUP 1
Excluded from automatic
downgrading and
declassification~~

~~S-E-C-R-E-T~~

CENTRAL INTELLIGENCE AGENCY

6 March 1969

SUBJECT: SNIE 97-69: PERU AND THE US: THE IMPLICATIONS OF THE
IPC CONTROVERSY

THE PROBLEM

To assess the consequences of the controversy over the property of the International Petroleum Company (IPC) with respect to the prospects for Peru under the military regime, its relations with the US, and the implications of developments in Peru for US relations in Latin America generally.

CONCLUSIONS

A. Because the issue is now caught up in highly emotional nationalism, the military regime in Peru will almost certainly not meet the requirements of US law for compensation of the IPC for its expropriated assets. Thus, if all the forces now in train

GROUP 1
Excluded from automatic
downgrading and
declassification

~~S-E-C-R-E-T~~

~~S-E-C R-E-T~~

continue, the crisis with Peru over the IPC will be a major one -- perhaps disastrous for Peru and for US-Peruvian relations.

B. Although the initial economic impact of the Hickenlooper and Sugar Act amendments by themselves would not be severe, a sharp reduction of international lending and private investment -- either directly or indirectly because of US action -- would have profound consequences for Peru. Over the long run Peru would at best face severe economic strains. At worst, the hardships occasioned by US sanctions could lead the military government into drastic improvisations.

C. The application of US legislation even in the minimum way required would provoke sharply anti-US sentiments throughout the Peruvian Government and society. This would be especially true if President Velasco remains in office (as we believe likely). If sanctions went beyond what the amendments require, US-Peruvian relations would deteriorate drastically. Under Velasco, Peruvian reactions might come to include expropriation of other US businesses and even a break in diplomatic relations.

D. President Velasco's personal entourage, apart from those in the cabinet who support him, is composed of men whose political

- 2 -

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

continue, the crisis with Peru over the IPC will be a major one -- perhaps disastrous for Peru and for US-Peruvian relations.

B. Although the initial economic impact of the Hickenlooper and Sugar Act amendments by themselves would not be severe, a sharp reduction of international lending and private investment -- either directly or indirectly because of US action -- would have profound consequences for Peru. Over the long run Peru would at best face severe economic strains. At worst, the hardships occasioned by US sanctions could lead the military government into drastic improvisations.

C. The application of US legislation even in the minimum way required would provoke sharply anti-US sentiments throughout the Peruvian Government and society. This would be especially true if President Velasco remains in office (as we believe likely). If sanctions went beyond what the amendments require, US-Peruvian relations would deteriorate drastically. Under Velasco, Peruvian reactions might come to include expropriation of other US businesses and even a break in diplomatic relations.

D. President Velasco's personal entourage, apart from those in the cabinet who support him, is composed of men whose political

- 2 -

~~S-E-C R-E-T~~

~~S-E-C-R-E-T~~

views cover the spectrum from extreme right to extreme left. All appear to be ultranationalistic and anti-American. We have no evidence to indicate that the advisers on the political left have influence on Velasco which is different from or greater than that of the other ultranationalists.

E. If President Velasco should be removed from office by a group of relatively moderate generals, either before or after US sanctions were invoked, actions against the US would probably be less extreme; they might be confined to such comparatively short-term reprisals as preventing the remittance of profits by US companies. But no one could hold office in Peru's present and prospective climate who appeared to give way on the IPC issue or failed to assert strong independence of US influence.

F. Peru's recent moves to establish diplomatic and economic relations with the USSR and other European Communist countries, which were begun last year under President Belaúnde, probably are more a show of independence from the US (and an effort to expand markets) than a serious intention to develop a firm and close relationship. We doubt that either side will be anxious to move rapidly in that direction, though Peru may entertain hopes (in our view unrealistic) of important economic benefits.

- 3 -

~~S-E-C-R-E-T~~

~~S-E-C R-E-T~~

G. In Latin America the public reaction to US actions will be generally acrimonious, and will tend to harden Peru's conviction that its cause is just. The danger is not so much that other governments will officially join with Peru in condemning US policy, by such means as votes in the Organization of American States, as that they will be stimulated to a general sharpening of resentments they already feel, especially in the sphere of economic relationships. Over time, a number of countries will probably try harder to broaden their foreign economic and cultural relations as a protection against dependence upon the US -- and they may care much less about how the US views the propriety of these new relationships.

DISCUSSION

I. THE MILITARY COUP AND THE IPC

Background

1. In October 1968, the military establishment in Peru threw out the government of President Fernando Belaunde Terry, whose election it had supported in 1963. The military leaders deplored

- 4 -

~~S-E-C R-E-T~~

~~S-E-C-R-E-T~~

the chaotic state of civilian politics and were concerned about growing economic strains. Moreover, they feared that the political and economic malaise would favor the election to the presidency in 1969 of their archenemy, Víctor Raúl Haya de la Torre.

2. A military coup had been undertaken in 1962 to forestall Haya's election; the ruling junta at that time acted only as a short-term caretaker -- until a coalition of political parties strong enough to elect Belaúnde could be formed. By the time of the 1968 coup, however, the military leaders were convinced that constructive representative government was beyond Peru's ken. They have made it clear that they intend to retain direct control of the government for a long time, in order, they say, to right the centuries-old wrongs in Peru's political, economic, and social structure.

3. To create immediate popular support for their regime, they seized upon the most nationalistic issue available as a justification for the coup: condemnation of Belaúnde's terms of settlement of a longstanding dispute with the US-owned IPC, which were widely regarded in Peru as being too favorable to the company. They then proceeded to expropriate a major part of IPC's assets. The ramifications of this action now threaten not only to strain

- 5 -

~~S-E-C-R-E-T~~

~~S-E-C R-E-T~~

gravely Peru's relations with the US, but also to compound the difficulty of the tasks the regime has set for itself within Peru. These developments in turn could focus the attention of other Latin American governments upon their own growing objections to a variety of US policies.

Elements of Friction With the US

4. The expropriation took place against a background of long-smouldering general resentment toward the US on the IPC and other issues -- resentment stemming in large part from Peru's heavy economic dependence on the US. US firms dominate many of the country's export industries (especially mineral exports) and have been increasing their influence in the domestic economy as well. For several years the US has purchased more than 40 percent of Peru's exports and furnished nearly 40 percent of Peru's imports.

5. In addition to the direct effects of its official loans and aid, the overall impact of the US upon the Peruvian economy is significantly increased because Peru receives large amounts of capital from private and international lending agencies with

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

which the US has great influence.^{1/} Beneficial though this relationship has been, it has caused a Peruvian ambivalence between gratitude on the one hand and the resentment of debtors toward their creditors on the other. Thus, Peruvian nationalists have claimed not only that the US and US business exploit Peru's resources, but also that the US has not been sufficiently generous with its aid to Peru.

6. For most Peruvians -- especially the military -- apparent or real challenges to national sovereignty take on grave importance. Thus, in addition to their general feeling of subordination to a superpower, Peruvian military leaders have more specific grounds for their attitude. The members of the military junta in 1962 believed that their coup was in the best interests of both Peru and the US, since in their view the election of Haya would also have threatened the goals of the Alliance for Progress. They were shocked when the US suspended diplomatic relations and aid programs until they promised to hold elections. Then in 1967, after

^{1/} From 1961-1968 the US authorized for Peru some \$350 million in economic assistance and about \$85 million in military aid. Of this, some \$240 million was grant assistance, and about \$195 million was in the form of loans. Peru also benefits from its US sugar quota. In 1968, the value of its sugar exports to the US was some \$59 million, of which about \$44 million represented the premium price paid by the US. In addition, Peru has since 1961 received some \$250 million in credit authorizations from international lending agencies in which the US has influence.

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

the US had balked at selling F-5 fighter aircraft to Peru, the Peruvian military decided to purchase jet aircraft from France -- only to see the US try to prevent the transaction. Because the passage by the US Congress of the Conte-Long and Symington amendments to the US foreign aid bill coincided with Peru's purchase of the jets, Peruvians of all persuasions have felt that their country's action was the specific occasion for the US legislation.^{2/}

7. Although the US tempered its reaction to the coup of 1968, the members of the current junta evidently expected their accession to power to cause difficulties in Peruvian-US relations. Their belief was hardened by warnings that US legislation will require suspension of aid to Peru and a cancellation of Peru's sugar quota unless appropriate steps are taken within six months toward compensation for the expropriated IPC property. In the case of US aid the six months will expire on 4 April; in the case

^{2/} The amendments direct the President of the US to withhold economic aid from countries in an amount equivalent to the amount spent by them for "sophisticated weapons systems"; to terminate economic aid to countries if they divert US aid or an unnecessarily large portion of their own resources to military expenditures; and to use the US voting power in the Inter-American Development Bank to disapprove any loan from the Bank's Fund for Special Operations which might assist in the acquisition of "sophisticated or heavy" military equipment.

~~S-E-C R-E-T~~

~~S-E-C-R-E-T~~

of the sugar quota, on 9 April.^{3/} Nevertheless, some of the members of the regime apparently refuse to believe that the US President is required by law to proceed in this matter without the traditional flexibility of diplomacy.

8. Under the leadership of President Juan Velasco Alvarado, the now retired general who led the October coup, the military regime has responded to preliminary US pressure with an increasingly inflexible position on the matter of compensation to IPC for its expropriated property. Velasco has declared that the matter will be decided in Peru's courts -- where it is highly unlikely that the IPC could win a satisfactory decision. As if to foreclose negotiations, the regime has asserted the existence of a debt owed by IPC to Peru of some \$690 million (accumulated

^{3/} Under the Hickenlooper amendment to US foreign aid legislation, US economic aid is to be suspended when a recipient country nationalizes the property of a US-owned firm, or "has taken steps to repudiate or nullify existing contracts or agreements," and fails within six months to "take appropriate steps, which may include arbitration, to discharge its obligations under international law toward such . . . entity, including speedy compensation for such property in convertible foreign exchange, equivalent to the full value thereof" The date from which this grace period runs is 4 October 1968, when Peru nullified the August agreements between the Belaúnde government and the IPC. In addition, the US Sugar Act of 1948 (as amended) provides for the cancellation of a country's sugar quota in circumstances similar to those described in the Hickenlooper amendment. The date from which this grace period runs is 9 October, when Peru seized IPC's Talara refinery.

~~S-E-C-R-E-T~~

since 1924), which IPC denies in its entirety. What is more, a recent decree apparently requires IPC to deposit the \$690 million with the government before the courts will hear either its claims for title to subsurface mineral rights or its counterarguments to the allegation of debt. Finally, since the government has moved against IPC's remaining assets -- including its distribution system for refined products -- the chance that any way will be found to meet the requirements of US legislation is diminished still further.

9. Now still another Peruvian grievance against the US has intruded itself into the already troubled relationship. On 14 February 1969, a Peruvian gunboat fired on one US fishing vessel and forced another to land and pay a fine for unlicensed fishing within the 200-mile territorial waters which Peru has claimed since 1947.^{4/} Peruvians maintain that by not recognizing this claim the US encourages its fishing boats to infringe upon Peru's control of one of its major resources, even though the US boats fish for tuna while the Peruvian fishing and fishmeal industries are based so far on the anchovy. The US Congress has

^{4/} Six other countries claim as much, at least for fishing rights. They are Argentina, Chile, Ecuador, El Salvador, Nicaragua, and Panama. Costa Rica claims special competence over living resources to 200 miles. And three others are considering the assertion of some kind of 200-mile claim: Brazil, Colombia, and Uruguay.

~~S-E-C R-E-T~~

established penalties to be imposed against countries which interfere with US fishing vessels operating outside a 12-mile fishing limit; these include suspension of military sales and the recall of ships on loan. The existence of these penalties, and the fact that US boats have continued to fish within 200 miles, have added to the regime's hostility toward the US. The recent challenge by the Peruvian gunboat was the most vigorous to date. Although the regime has played down the incident, the issue of fishing rights is likely to flare again.

II. THE MILITARY REGIME: GOALS, INFLUENCES, AND POLITICAL CONFLICTS

10. The Peruvian Government is currently made up of the President, selected by a junta composed of the commanders of the armed forces, and a cabinet made up of generals and admirals. This group, and the entire officer corps, are united at minimum by strong feelings about morality in government and national independence, so important in the rationale for their coup. So far they have had strong public support -- based especially on their nationalistic posture toward IPC. A large portion of the population accepted the military takeover on the grounds that strong leadership was necessary to rectify the damage done to Peru by the corruption and chaos of the deposed civilian government. In fact, even

- 11 -

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

Haya de la Torre's APRA party has so far been relatively quiet, partly out of recognition that its interests would not be served by opposing a regime which has so completely wrapped itself in the Peruvian flag.

11. The main thrust of the regime's short-run domestic program is to achieve financial stabilization. For the long term, according to various published plans and statements, the regime will probably try to expand state controls over the economy and increase public investment. The new leaders talk of attempting to impose larger direct taxes on property, personal income, and business profits -- where few now exist. The regime is likely also to move to expand the Peruvian share, public and private, in the ownership and profits of foreign-owned businesses. Plans apparently call for proceeding gradually with these measures and with such costly social reforms as distribution of land to the peasants. These plans stress increased production and exports, as well as more equal distribution of income.

12. In foreign affairs, the regime has already undertaken to alter Peru's close alignment with the US. It accelerated Belaúnde's effort to establish diplomatic and trade relations with the Soviet Union and other Communist countries. But so far much

~~S-E-C R-E-T~~

of this has probably been for show -- part of the general nationalistic striving for independence.^{5/} Peruvian leaders probably also hope for increased investment and assistance from West Europe -- particularly France -- and from Japan. Even if a way were found to mend US-Peruvian relations soon, the regime would try to develop its ties with both Communist and non-Communist countries in the hope that these would reduce Peru's future economic dependence upon the US.

13. Although the members of the regime apparently are united on most fundamental goals, to a large extent the stridency of their current nationalism is the creation of President Velasco. He has made some efforts to offset his ultranationalism by reiterating the point that Peru's main difficulty is with IPC alone. At the same time it seems clear that his attitude toward the US has become more antagonistic since he took office.

14. Velasco's motives are far from clear. He seems to be a man caught up in the action-reaction cycle initiated by his

^{5/} For example, the recent trade agreement with the Soviet Union provides for most-favored nation treatment and an exchange of commercial representatives, but specifies that goods will be paid for in convertible currencies. Peru restricted the number of the Soviet representatives to seven, and limited their functions. So far there is no provision for Soviet aid. The agreement is apparently a first step and possibly lays the basis for more detailed negotiations later.

~~S-E-C-R-E-T~~

sponsorship of the IPC expropriation. He seeks advice where he can also find personal support, and he uses nationalism demagogically, to perpetuate his own position. His personal entourage is composed of men whose views cover the political spectrum from extreme right to extreme left, but all appear to be ultranationalistic and anti-American. They are civilians -- including the owners and the editor of the anti-IPC newspaper El Comercio on the right, and the dean of the Lima Bar Association on the left -- and they are military men whose political inexperience and ambition lead them to support Velasco's policy of confrontation with the US.

15. There is no evidence so far that the advice or support of the Peruvian Communist parties has been important to Velasco. They are weak in leadership and organization, and as a political force are probably unable to react quickly enough in the fast-breaking atmosphere of current Peruvian politics to gain influence with any faction of the regime. In fact, though many of the officers now in the regime may have a reformist bent, and all may have been caught up in a wave of nationalism, they also have uniformly anti-Communist backgrounds. A number are even concerned that the regime moved too quickly to establish diplomatic relations with the Soviet Union.

- 14 -

~~S-E-C-R-E-T~~

~~S-E-C-R-E-T~~

16. In Peruvian society as a whole, extreme leftist ideology -- whether specifically Communist or generally Marxist -- has never had effective appeal. APRA, the strongest party and the one with the widest popular base, has been anti-Communist for many years; it controls most of the labor unions and has vigorously opposed even the slightest inroads into labor by the Communists. Among intellectuals in Peru, as elsewhere in Latin America, there are Communists and other Marxists; this is especially the case among economists and historians, whose "anti-imperialist" bias has been evident for many years. Many leftists teach in the universities, and some even lecture in the Center for Higher Military Studies. But what appears to give leftists influence with Velasco is their ultranationalism rather than any loyalty to a foreign ideology or interest. We have no evidence that their influence on Velasco is different from or greater than that of other ultranationalist radicals all along the spectrum.

17. It is clear that Velasco does not have the loyalty of all his cabinet ministers, particularly insofar as his extreme views on the IPC issue threaten Peru's economic development as well as its general relationship with the US. Motivations of those who dissent from his leadership -- known to US observers as the "moderates" -- are also mixed. They include personal ambition,

- 15 -

~~S-E-C-R-E-T~~

~~S-E-C-R-E-T~~

general concern for the Peruvian economy, doubts about Velasco's ability and his tack, and conservative views on communism and extremism generally.

F(b)(1)
F(b)(3)

18.

F(b)(1)
F(b)(3)

- 16 -

~~S-E-C-R-E-T~~

~~S-E-C-R-E-T~~

III. THE ECONOMIC REALITIES

19. The military assumed control at a time of economic uncertainty which was, in good part, the result of the political malaise which characterized the last years of the Belaúnde regime. During the 1950's and early 1960's the Peruvian gross domestic product grew at an average annual rate of nearly six percent. This growth resulted mainly from the expansion of exports -- particularly of fishmeal, a new product which now accounts for one quarter of Peru's export earnings. Increased foreign investment was also an important factor in some sectors of manufacturing and export. Yet despite the growth of output and investment, poverty in Peru is still widespread, and about half the population lives only on the fringes of the money economy.

20. Starting in 1966, Peru began to have increased difficulty both with budget deficits and with the balance of payments. In 1967, a widening government deficit, reduction in export earnings, the growing burden of payments on foreign debt, and flight of capital brought on a financial crisis and a major devaluation. For political reasons, the President and the legislature could not agree on a stabilization program which would clear the way for renewed growth. Instead, matters worsened, and the failure

~~S-E-C-R-E-T~~

~~S-E-C R-E-T~~

of the government to adopt a coherent economic policy further eroded the confidence of Peruvian businessmen. Finally, several months before his removal, Belaunde was granted special decree powers, under which he began a promising stabilization program that has been continued and in some respects expanded by the military government.

21. Whatever its successes in trimming expenditures and otherwise reducing financial pressures in the short term, the ability of the military regime to carry out a long-term program of reform and development will depend both on its acquisition of increased domestic revenues and upon its ability to stimulate even greater foreign investment than in the past. Thus, even with continued US economic assistance a major question for the regime would be whether it can transform Peru's economic and social structure without driving foreign and domestic investors away. The military regime has yet to confront the traditional social and economic elite, and that group is unlikely to go along easily with stringent fiscal and tax measures.

22. Furthermore, the objectives of making existing industry and agriculture more efficient, and of expanding and diversifying the export sector, will take not only large financial resources,

- 18 -

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

but also time, technical skills not yet available from the educational system, and sophisticated planning. The process of getting underway on these projects has barely started, and it may be some time until the power structure of this government shakes down enough to make substantial progress.

IV. US SANCTIONS AND PERUVIAN REACTIONS

23. The US has not authorized any new development loans for Peru since July 1967, in effect because of Peru's purchase of Mirage jet aircraft from France and the subsequent passage of the Symington and Conte-Long amendments. About \$37 million in loans remains in the pipeline, and technical assistance -- the other component of AID's program for Peru -- has continued despite the strain in US-Peruvian relations. Peru's basic export quota of sugar for the US market in 1969 would involve a prospective subsidy of about \$25 million. By the date on which US sanctions may be imposed, Peru probably will have shipped about 35 percent of its annual quota; thus Peru stands to lose some \$17 million in 1969 as a result of its reduced sugar exports to the US.

24. The minimum sanctions required by the Hickenlooper and Sugar Act amendments would be the suspension of all loans and

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

grants from AID, of Peru's sugar quota, and of all military assistance. These suspensions by themselves would not initially have a severe economic impact on Peru. But US legislation also requires that the US use its veto power in the Inter-American Development Bank to prevent new loans to Peru from the Bank's special funds (though not from its regular resources). Any important decline in receipts of capital would probably also create conditions which would prevent Peru from meeting the financial requirements necessary to permit further drawings against its standby credit with the International Monetary Fund. The effect of all these actions would probably be a loss to Peru of at least \$80 million in 1969.

25. Also important is the prospect that the Export-Import Bank, which has loaned nearly \$120 million to Peru since 1961, would delay new loans for Peruvian development if US sanctions are imposed. Peru has counted upon future assistance from this agency to help finance the \$600 million copper expansion program of US-owned companies over the next several years. Similarly, US influence in the International Bank for Reconstruction and Development (IBRD) is such that its development assistance -- about \$140 million during 1961-1968 -- might also be affected.

- 20 -

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

In any case, the IBRD has a long-established policy of deferring action on loan applications from a member engaged in an important financial dispute with another member; thus, it probably would not authorize new loans to Peru unless the US stated it had no objection.

26. If the US and the international lending agencies held up their programs for Peru, the inflows of private foreign capital, which had been expected to average about \$150 million annually over the next five years, would probably also be sharply curtailed -- at least for the next year or so. Even if the only sanctions imposed were those required by the Hickenlooper and Sugar Act amendments, there would probably be a considerable reduction in foreign investment. Private investment by US enterprises has already been delayed as investors await the outcome of the US-Peruvian imbroglio.

27. Velasco has come only slowly to believe that the warning of US sanctions is more than a bluff. He is known to have doubted that the US law would be invoked if it directly damaged a US interest -- in this case W. R. Grace and Company, which accounts for about one-fifth of Peru's sugar production. Even if the US tried to limit the number and severity of its sanctions, Velasco's immediate reaction would probably be vehement. If on the other

~~S-E-C R-E-T~~

~~S-E-C-R-E-T~~

hand an institution like the IBERD suspended its assistance, he would probably view it as an additional direct and hostile US action.

28. One response by Peru to the minimum US sanctions might be to restrict the remittance of profits by US and other foreign businesses. This would be effective temporarily: Peru could probably stem that outflow (some \$70 to \$90 million annually) sufficiently to fully offset the prospective decline in receipts of capital from official sources. But the net effect of such a step would be to discourage new foreign investment and to compound Peru's economic troubles over the long term. If it lost a wider variety of sources of assistance, the Peruvian Government might respond emotionally and take the extreme step of expropriating much or all of the remaining US investments in Peru. These probably have a market value of about \$1.5 billion and are located in all sectors of the economy -- mining, agriculture, manufacturing, shipping, commerce, communications, and banking.^{6/}

^{6/} In addition to W. R. Grace and Company (sugar, textiles, chemicals, banking, and shipping), the more important investments are those of the Cerro Corporation (copper) and Southern Peru Copper Company, the Belco Petroleum Corporation, and the International Telephone and Telegraph Company. Peru and the US have signed a specific agreement under which the US Government guarantees US investors that their profits earned in Peru will be convertible into dollars, but it does not guarantee them against losses from expropriation.

~~S-E-C-R-E-T~~

~~S-E-C R-E-T~~

V. OUTLOOK

29. In short, if all the forces now in train continue, the crisis with Peru over the IPC case will be a major one -- perhaps disastrous for Peru and for US-Peruvian relations. For the foreseeable future we believe it is unlikely that any Peruvian regime, whatever its private disposition toward the US, will be able to yield sufficiently on the IPC case to satisfy fully the requirements of US law. A Peruvian leader who attempted this would be accused of selling out to the US, and would surely come under attack from a large coalition of popular and military forces united mainly in their nationalism. Although the economic consequences for Peru would almost certainly be harsh, especially insofar as anticipated foreign investment and lending are lost, such considerations would probably be subordinated to the more irrational and emotional matter of national pride.

30. We believe the chances are better than even that Velasco will retain power at least through early April. It is not likely that he will seek a way to avoid the application of US sanctions -- his personal position stands to be made stronger whether or not the US invokes the amendments. His response once sanctions were applied would probably be harsh-- the more so if the US invoked

- 23 -

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

sanctions in addition to the Hickenlooper and Sugar Act amendments. He would probably send home the US Ambassador, the USAID mission, and the military missions, but he might allow some lower level US diplomatic personnel to remain. His reaction toward US businesses would probably be punitive, including some further expropriations or confiscation of property, if only to prove that he had not been intimidated. Under extreme conditions he might break diplomatic relations with the US, and the damage would not be easily repaired.

31. It is not clear whether the moderate group in the cabinet could exert restraint upon a series of emotional countermeasures by Velasco. The danger is that Velasco so far has been more successful in rallying fellow nationalists than the moderates have been in restraining his impulses. And popular reaction throughout Latin America against US sanctions would tend to make Velasco feel even stronger.

32. Should Velasco be replaced before early April, and a more moderate regime agree to some form of negotiation, or if tension on the IPC issue should be reduced by some other means, the regime would still continue to seek ways to demonstrate its independence from US economic and political influence. If it were caught up in a general emotional reaction to widening US

- 24 -

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

sanctions, even a government of moderate officers might undertake some further moves against US business. Particularly vulnerable if expropriation were contemplated either by Velasco or others would be US interests in communications, banking, and petroleum.

33. Assuming the present collision course persists, it is difficult to foresee the domestic political situation in Peru once US sanctions were imposed. It seems likely that as economic strains mounted, the regime and the populace would become increasingly frustrated and emotional. With Velasco in power, the regime could become more radical and begin attacking entrenched Peruvian economic interests, with the result that a revolutionary situation could emerge. It is also possible that once anger against the IPC and the US had vented, the more moderate among the officers would decide that Velasco had come to the end of his usefulness. In such circumstances a new military administration might come to power and slowly try to pick up the pieces.

34. We believe that in any case Peru would not turn rapidly or wholeheartedly to the Communist countries as a replacement for lost US aid and investment. For their part, the Soviets would probably be extremely cautious about undertaking any expensive commitments to Peru, especially if the longevity of the

- 25 -

~~S-E-C R-E-T~~

~~S-E-C R-E-T~~

administration were in question. The Peruvians would be hard pressed to fill the economic void after their nationalistic blustering had subsided. They might have some success in obtaining investment capital from France, Japan, and some others, but we doubt that all sources taken together would make up more than a portion of Peru's loss of funds, directly and indirectly, from US sanctions.

VI. LATIN AMERICAN REACTIONS

35. We believe that the application of even a minimum of economic sanctions against Peru would precipitate widespread and vehement criticism of the US among numerous politically articulate groups in Latin America. They do not generally understand the facts of the case, or the way in which the US Government works. It is now conventional for most of them to describe as an intervention any action by a foreign power which affects the internal political, social, and economic development of a country. And in this context, the US is not just a foreign power, but rather the largest foreign investor, trading partner, and source of economic assistance for nearly all Latin American countries -- a position which inspires, along with some gratitude, strong suspicion and resentment.

- 26 -

~~S-E-C R-E-T~~

~~S-E-C-R-E-T~~

36. Many Latin American governments are already concerned about US aid and trade policies. Their principal complaints are that (a) US restrictions on imports rear formidable barriers to Latin America's exports; (b) US domestic policies have adversely affected economic developments because they have been a major cause of fluctuations in world market prices for the region's main exports and in the flow of private US capital to the region; and (c) US economic assistance programs to Latin America have generally been meager, paternalistic, and self-serving, and have failed to compensate the region adequately for the negative effects of other US policies. While many of these accusations are meant to gloss over some of the endemic causes for Latin America's economic failures, they have wide appeal.

37. Thus, while the official reactions of most Latin American countries to US sanctions against Peru might not be severe, most governments would become increasingly alarmed about the general concept of US sanctions, now invoked against a friendly Latin American country for the first time. Some would feel concerned about their own vulnerability some day to similar penalties, and thus they might be responsive to a request by Peru to discuss the

- 27 -

~~S-E-C-R-E-T~~

~~S-E-C-R-E-T~~

matter under Article 16 of the OAS Charter.^{7/} Most countries would not want to be in a position of having to take sides by voting, but if the full force of US sanctions were imposed the official governmental support for Peru in Latin America would probably be stronger and more immediate. Many would take the occasion to air their own bilateral grievances with US economic and assistance policies.

38. Of greater concern to the US than the likely immediate response among Latin American governments, however, is the way in which this application of US sanctions might come to be viewed as the most recent and threatening in a series of US interventions over the past century. Many would draw a parallel between US actions against Peru and its earlier economic actions against Cuba. All would worry that the sanctions indicated that the new US Administration intended to follow harsher and less forthcoming policies than did its predecessors. The Hickenlooper and Sugar Act amendments fit the Latin view that the US will go to great

^{7/} "No state may use or encourage the use of coercive measures of an economic or political character in order to force the sovereign will of another state and obtain from it advantages of any kind."

~~S-E-C-R-E-T~~

~~S-E-C-R-E-T~~

lengths to protect US business interests abroad, and that other aspects of official US interest in the hemisphere come second. Thus, we believe that a number of countries will press harder than in the past to broaden their foreign economic and cultural relations as a means of protecting themselves from heavy dependence upon the US -- and they may care much less about how the US views the propriety of these new relationships.

- 29 -

~~S-E-C-R-E-T~~