

Port/NATO #63

**MEETING WITH AMBASSADOR HOLMES**

**Friday, 3 June 1983**

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ISSUES / TALKING POINTS

1. Defense Cooperation Negotiations.

☞ The agreement providing for US use of facilities in the Azores is now under renegotiation with Portugal. At the first plenary session on December 6, the Portuguese expressed flexibility on the structural form of a new agreement, but stipulated that it include a) a statement about continued security assistance funding for the life of the agreement, and b) a safeguard for Portugal in the event the US could not provide funding. The Portuguese also want to complete the renegotiation of the Labor and Technical Annexes left over from the 1979 Agreement, prior to the completion of any renewal of the Lajes Agreement. The Portuguese working group has agreed to the Labor text provided by the US side.

☞ Our main objective in these negotiations is to obtain agreement to our continued use of Lajes, and to our contingency use of as yet unspecified mainland facilities, for both NATO and non-NATO purposes. We are seeking access to these facilities for RDJTF and the Beja Airfield for tanker deployments, because Lajes itself is not large enough to meet all contingency needs. We also want to place a Ground Based Electro-Optical Deep Space Surveillance System (GEODSS) site on the mainland. However, if it becomes necessary in order to secure continued unimpeded use of Lajes, we are willing to drop some of these other requests.

☞ On 15 April 1983, the Portuguese advised us that they wanted to hold another plenary negotiating session on 4 May--to review the current state of play. It was obvious that the current government, which previously said that they could not consummate the agreement, was being forced to make a show of trying to press ahead on an immediate Lajes renewal, yielding to pressure from the Azoreans. Our position all along has been to negotiate for all the facilities, Azores and the mainland at the same time for one quid.

☞ In the May plenary session, the Portuguese Team seemed to just be fulfilling their instructions without much enthusiasm. So perfunctory was the Portuguese performance that they did not pursue their suggestion of concluding separate agreements on Lajes and mainland facilities.

☞ While the formal negotiations have been interrupted, awaiting a new coalition government, we have continued to meet at the working level. The first such session in early January reviewed the technical agreement text as well as each side's proposed revisions--identifying areas of mutual agreement and of difference. The most recent session (8-11 March) studied the structure and form of a new agreement. With the most important Portuguese parties in favor of

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NATO and the US-Portuguese defense relationship, we expect that any government formed will quickly move to conclude the new agreement.

-- Ask the Ambassador for his assessment of the talks and their prospects.

-- Do you believe the current Portuguese negotiator will remain under the new government?

**2. Security Assistance**

(c) During the May 4 base negotiating session the Portuguese pressed for higher levels of non-military grants and stated the government was unwilling to accept credits as "assistance" unless linked to a system for Portuguese exports. They are also seeking higher levels of US non-military assistance to balance military assistance. Ambassador Holmes discouraged them on counting on higher levels of grant assistance particularly in 1984. The Ambassador underscored that the special FY83 assistance and the FY84 proposals were made in the expectation that a satisfactory global agreement would be concluded. The Portuguese also suggested that the United States should consider an alternative program in the fields of road construction or energy. Specifically he mentioned helping Portugal to finance projects to link it into the Spanish natural gas pipeline and to construct truck feeder roads. Portuguese officials say they have projects ready in these areas, but that they lack financing.

(c) The Portuguese are concerned about our "best efforts" commitment on security assistance. The FY82 level of \$87.4M was considered totally inadequate. However the FY83 CR provided \$112M and we are seeking \$148M in FY84. It is intended that these two years will establish a "rising trend" up to an average level of about \$200M over the life of a new agreement.

Recent Security Assistance for Portugal (\$M)

	<u>FY82</u>	<u>FY83</u>	<u>FY84 (Request)</u>
MAP/Grant	20	37.5	60
FMS Credit	45	52.5	45
IMET	2.4	2.0	3
ESF	20	20	40
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TOTAL	87.4	112	148

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-- Ask the Ambassador if he agrees that the level for FY84 will be sufficient to support a new base agreement? And what if we get a continuing resolution?

### 3. General Reciprocal Procurement MOU

(u) On 28 March 1979 the Governments of the United States and Portugal signed a Memorandum of Understanding (MOU) relating to the principles governing mutual cooperation in research and development, production, procurement and logistic support of defense equipment.

(u) In June 1980, the Portuguese National Armaments director and representatives of Portuguese industry participated in a five-nation seminar in Washington with US industrial representatives to visit some US factories and Defense industrial complexes.

(u) Progress on implementation stalled for several months until the Portuguese identified a national representative who would come to Washington to follow up on Portuguese industrial initiatives.

(u) In late September 1982, Mr Villas Boas arrived in Washington, to represent Portuguese industry and is working with the Portuguese Commercial Attache. He is establishing contacts with US industry and plans to arrange a visit for the Portuguese National Armaments Director and his staff to Washington for a major MOU review meeting this year.

-- I understand that the repair facility is very well equipped and may soon have the capability to work on C-130's. We will encourage the Services to look at how they might be able to utilize these facilities.

### 4. Portuguese Economic Trends

(u) Portugal's chronic international financial problems have become a major preoccupation of the country's policy makers. Whatever the make-up of the new government will be, the severity of the imbalance will probably force it to implement further austerity measures and to renew negotiations with the IMF for a standby loan.

(u) Portugal's economic situation deteriorated in 1982, exacerbated by the international recession, and it faces even greater problems in 1983. Inflation is likely to again exceed 22 percent, while investment will fall in real terms. The current account deficit soared to an estimated \$3.3 billion, putting strain on the country's foreign borrowing capacity toward year's end. Government budget deficits have climbed as well. Although the government has

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already passed a strict 1983 provisional budget, this still falls short of the "urgent economic measures" called for by President Eanes. If even tougher steps are taken by a new government then some of these problems will be moderated, while unemployment will rise significantly.

Portugal has struggled with international financial problems since 1977, when a current account deficit of \$1.5 billion compelled the Socialists to obtain a \$70 million standby loan from the IMF and a \$750 million credit from a consortium of 14 governments. The adoption of an IMF-mandated stabilization program and a 0.75-percent monthly rate of depreciation for the escudo stimulated exports and invisibles and swung the current account close to balance by 1979. However, the turnaround in Portugal's external position was short lived. Lisbon loosened its monetary policy in 1980; this had the desired effect of promoting investment and employment, but the added stimulus put pressure on prices.

While Portugal's recurrent balance-of-payments deficits since the 1978 stabilization program are attributable in large part either to mistaken government policies or to worldwide conditions beyond the government's control, a variety of structural deficiencies have also come into play. Given its low agricultural productivity and lack of natural resources, Portugal must import 60 percent of its food and 80 percent of its fuel. Since these items--together with intermediate products for industry--comprise 80 percent of Lisbon's foreign purchases, it has been difficult to curtail imports.

A significant portion of Portugal's current account deficits over the last three years has been financed by foreign borrowing. From 1979 to 1982, Portugal's external debt nearly doubled to approximately \$13 billion, over half the country's GOP. Meanwhile, with interest rates and debt mounting, interest payments more than doubled, reaching approximately \$1.3 billion in 1982.

The strategy currently in place for remedying the current account deficit is that of the caretaker government. It is trying to raise import prices and reduce real personal income. The provisional 1983 budget raises the import surcharge from 10 to 30 percent and provides for stiff tax increases and price hikes for fuel, electricity and transportation.

In recent weeks, Lisbon has adjusted foreign exchange and monetary policies in response to recommendations from the IMF.

IMF assistance should be forthcoming after the new government takes over. Lisbon is working to arrange a \$140 million compensatory financing facility to make up for the shortfall in exports experienced in 1981. Negotiations for a \$1.5 billion

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standby loan have not started because the caretaker government lacks the authority to sign an agreement. However, the Socialists have expressed their determination to approach the IMF, despite the possibility that the degree of austerity this implies could ultimately cut into their popularity.

-- Ask the Ambassador if he believes Mario Soares (designate Prime Minister) will take the stringent economic measures obviously needed to lead Portugal out of this situation.

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