PDCBH280

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

APR 4 1990

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA, NEAR EAST AND EUROPE

FROM: ANE/PD, Bruce J. Odell

SUBJECT: Portugal FY 1990 Cash Transfer

Problem: Your authorization is required to obligate a cash grant of $39,402,248 with the Government of Portugal.

Background: In December 1983, the U.S. Secretary of State and the Portuguese Foreign Minister signed diplomatic notes which extended the U.S. right to use the Lajes Base in the Azores from February 1984 to February 1991. Concurrent with certain security understandings, the U.S. Government made a best efforts pledge to assist the economic development and well-being of Portugal, and to cooperate with Portugal in such other ways as may be mutually beneficial, subject to the availability of funds and other requirements of United States laws. To that end, the U.S. agreed to grant non-military assistance totaling $40 million during FY 1984 and $80 million during FY 1985 using ESF funds. Assistance after FY 1985 was to be provided on a best efforts basis.

In FY 1986, the U.S. provided a cash transfer to Portugal in the amount of $76.487 million. FY 1987 assistance was provided in the amount of $64.712 million. FY 1988 assistance dropped to $32,013,105, reflecting U.S. budget constraints. Disappointed by this decline in assistance, which they felt was inconsistent with the spirit of "best efforts" pledges the U.S. Government made during negotiations of the Lajes Base Agreement, the Portuguese Government requested consultations under a provision in the 1983 base agreement. In the consultations, we sought to address Portuguese concerns about the level of military assistance and ESF as flexibly and effectively as possible given U.S. budget constraints. A mutually satisfactory conclusion to the consultations was reached in January, 1989 with the commitment to provide certain military equipment to supplement our military aid and by extending an additional $55 million in housing investment guarantees (HIG) through 1991. The $55 million HIG was authorized in September, 1989, as was an associated $600,000

Technical Consultants and Training Project, subject to congressional notification and availability of funds in accordance the A.I.D. OYB/allotment process. It is intended that the Technical Consultants and Training Project will be financed from funds, allocated to Portugal under the FY 1990 OYB.

Also, key to conclusion of the consultations was a commitment to an increase in ESF assistance to $50 million in FY 1989. No commitment to specific ESF levels was made beyond FY 1989, except that best efforts would be made to obtain substantial ESF levels for Portugal in each of the subsequent years through the remaining life of the Lajes Base Agreement, which expires in February, 1991.

A.I.D.'s FY 1990 Congressional Presentation notified Congress that we planned to provide a $50 million cash transfer to Portugal. However, the FY 1990 A.I.D. OYB process only provides $40,175,000 for Portugal for the current fiscal year, of which 0.43% has been sequestered to meet the President's Drug Initiative Program required under the Transportation Appropriations Bill for FY 1990, leaving a balance of $40,002,248. As agreed with the Government of Portugal, $600,000 is reserved to fund the Technical Consultants and Training Project associated with the FY 1989 Housing investment Guaranty. Thus, $39,402,248 remains available for the FY 1990 ESF cash grant.

Portugal is a NATO country of strategic importance to the U.S., and is the site of a number of U.S. facilities. While Portugal's democratic system and institutions have become firmly established after a period in 1974-75 of some turmoil, the country is the poorest in Western Europe and faces substantial economic challenges. In the years immediately following the revolution, economic upneaval led to heavy investment in state-owned industries leading to foreign borrowing and balance of payments problems. These problems required Portugal to adopt an IMF adjustment program in 1983. Portugal then made rapid strides in structural adjustment through such measures as a sharp devaluation, increases in interest rates to positive levels in real terms, and significant reductions in subsidy and investment expenditures. These adjustments, together with very favorable external circumstances, led to a turnaround in the Portuguese economy and Portugal entered the European Community in 1986. More recently, several policy weaknesses are currently causing some setbacks to economic performance and the country has initiated a limited privatization program. These weaknesses comprise mainly a continuing large budget deficit and slippages in exchange rate and interest rate management. As a result, the inflation rate has crept back to about 13% and the balance of payments on current account has swung back into a modest deficit. Portuguese authorities need to persevere in tackling its privatization program and make further progress on policy measures to arrest the incipient decline in the economy and to prepare it for full integration with the European Community after 1992.

Discussion: The proposed assistance to the Government of Portugal consists of a cash grant of $39,402,248.

The purpose of the proposed assistance is to promote the social and economic development of Portugal in support of its continued political stability. The dollars provided under the grant are for balance of payments support.

The FY 1990 cash transfer to Portugal is covered by the "separate accounts" provisos contained in the FY 1990 Appropriations Bill. Accordingly, the draft agreement and draft Implementation Letter for countersignature, which were sent to Lisbon for pre-negotiation, follow established A.I.D. guidance on cash transfers concerning the use of grant funds and accountability for these.

The draft agreement provides that the funds may be used from the separate account in any of the following ways, in the following order of priority:

-- for goods (including raw materials, capital and consumer goods) and services from the United States;

-- for payment of non-military bilateral debt owed to the U. S. Government;

-- for payment of debt owed to multilateral development institutions or the IMF; and

-- other purposes or uses as agreed in writing between the United States and Portugal.

The Government of Portugal would make the determination to use the funds in the separate account for specific uses which would be agreed upon by the two Governments. One proposed use is for support of the Luso-American Development Foundation (LADF). We consider such use would be a desirable statement of GOP support for that institution, and your approval of this cash transfer will also constitute approval of this particular use.

As to other uses of the dollars, inasmuch as Portugal has a progressive, open foreign exchange system which we do not wish to affect by the reimposition of the controls required to track import transactions, it is appropriate, and may be necessary, for Portugal to use the cash transfer for other than the first priority item, which is imports from the United States. The use of cash transfer funds to pay debt owed to multilateral development institutions or the IMF, however, requires approval by the Regional Assistant Administrator. Given that Portugal's non-military bilateral debt owed to the U.S. Government is very low, it could be necessary to use some portion of the grant to make payments to multilateral development institutions or the IMF, and your approval to include such payments among eligible uses of the grant is therefore requested.

Consistent with last year's cash transfer, we are not requiring that the dollar transfer result in any setting aside of local currency by the Government of Portugal for mutually agreed-upon uses. A.I.D.'s "Supplemental Guidance on Programming Local Currency" requires that local currency be programmed in conjunction with cash transfers (and other specified forms of assistance), except as may be otherwise approved by the appropriate Regional Assistant Administrator. Amplified PD No. 5 encourages programming of local currency as a tool for moving toward the goal of an overall host country budget that represents a sound, development-oriented allocation of budget resources set within a market-oriented policy framework.

The Government of Portugal has heretofore annually allocated its own resources to the Regional Government of the Azores. Since FY 1984, our agreements and associated documents have encouraged or recognized this contribution in support of social and economic development in that poor and strategically located area, but have not contained specific requirements to this effect. There has thus been no setting aside of local currency in prior years for the purpose of mutual programming.

For FY 1990, as in FY 1989, Portugal has already transferred an amount of its own currency (escudos) to the Azores. This was done by the Government of Portugal in accordance with its own budgeting process.

Given that, as described above, Portugal on its own has already completed its transfer of funds to the Azores, and in an amount which we consider to be substantial and reasonable, there is no policy or other reason to require any setting aside of local currency for this (or any other) purpose. Any requirement to program local currency would in this context be meaningless. For these reasons, and in light of Portugal's status as a NATO ally, your approval that, consistent with last year's approach, the FY 1990 cash grant to Portugal not require the setting aside of local currency is requested.

The FY 1990 Appropriations Act requires that Congress be notified 15 days in advance of the obligation of any cash transfer. That notification was submitted on March 8, 1990 and expired March 23, 1990.

Funds have been apportioned and the Mission will be advised of the budget allowance. Disbursement of the grant will be made via electronic funds transfer immediately after the conditions precedent have been met.

Recommendations:

1. That you authorize an ESF cash grant to Portugal in the amount of $39,402,248 by signing this Action Memorandum and the PAAD attached as Tab A;

2. That you delegate authority to the U.S. Ambassador to Portugal, or his designee, under Delegation of Authority No. 402, to execute a grant agreement for the above amount, in which delegation the State Department concurs;

3. That you approve GOP use of dollar proceeds from the separate account for support of LADF and also use all or a portion of the dollar proceeds for payment of debt to multilateral development banks and the IMF;

4. That you hereby approve that A.I.D. not require that the Government of Portugal set aside an amount of local currency equivalent to the grant, or a portion thereof, for programming for mutually agreed upon purposes.

Approved: Carol Adelman

Disapproved: ____________

Date: 4/4/90

Attachment:
Tab A - Portugal FY 1990 ESF Cash Transfer PAAD

CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number
150-K-616

2. Country
Portugal

3. Category
Economic Support Funds (ESF)

4. Date

5. To
AA/ANE, Carol C. Adelman

6. OYB Change Number
N/A

7. From
ANE/PD, Bruce J. Odell 4/3/90

8. OYB Increase
N/A
To be taken from:
N/A

9. Approval Requested for Commitment of
$ 39,402,248

10. Appropriation Budget Plan Code
QES0-90-37150-KG-31 72-110/11037

11. Type Funding
☐ Loan ☒ Grant

12. Local Currency Arrangement
☐ Informal ☐ Formal ☐ None

13. Estimated Delivery Period
6 months

14. Transaction Eligibility Date

15. Commodities Financed
N/A Cash Transfer

16. Permitted Source	17. Estimated Source
U.S. only	U.S. $39,402,248
Limited F.W.	Industrialized Countries
Free World	Local
Cash	Other

18. Summary Description

This authorization approves a $39,402,248 grant to the Government of Portugal (GOP) for balance-of-payments purposes, subject to the conditions contained in the PAAD and the accompanying Action Memorandum. The grant will be provided as a cash transfer, disbursed in a single tranche. The dollars provided under the grant will be placed in a separate account. Eligible uses will include a contribution to the Luso-American Development Foundation (LADF); payment for imports of goods and services from the U.S.; payment of bilateral non-military debt owed to the U.S.; and subject to AA/ANE approval in the context of this authorization, payment of debt owed to multilateral development banks and the IMF. Other uses could be agreed to if requested by the GOP and approved by A.I.D. according to the requirements of the Agency's "Amplified Policy Guidance" on ESF Cash Transfer Assistance.

This authorization also approves the fact that A.I.D. will not require that the GOP set aside an amount of local currency at least equivalent to the grant for programming for mutually agreed purposes. This authorization also delegates to the U.S. Ambassador to Portugal, or his designee, the authority to execute the Grant Agreement.

Additional Clearances:
ANE/DP:PDavis(draft)Date 3/14/90
ANE/EE:RBrown(draft)Date 3/15/90
ANE/PD:RNachtrieb RN Date 3/31/90

19. Clearances	Date
DAA/ANE:JBlackton	
ANE/PD/ME:JSilver (draft)	3/15/90
PPC/EA:RSiegel (draft)	3/13/90
ANE/GC:JSilverstone (draft)	3/15/90
EUR/WE:KHillas (draft)	3/15/90
F/FM:MUsnick MU	3/27/9
ANE/DP:DCarr (draft)	3/14/90

20. Action
☒ APPROVED ☐ DISAPPROVED

Authorized Signature: Carol Adelman Date: 4/4/90

Title: Assistant Administrator, Bureau for Asia, Near East & Europe

AID 1120-1 (5-82) CLASSIFICATION:

UNITED STATES

INTERNATIONAL DEVELOPMENT COOPERATION AGENCY

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT NUMBER 150-K-61

PROGRAM ASSISTANCE
APPROVAL DOCUMENT
(PAAD)
PORTUGAL: FY 1990 CASH TRANSFER PROGRAM

MARCH, 1990

TABLE OF CONTENTS

I. Summary and Recommendations

This PAAD proposes a cash grant of $39,402,248.

Portugal is a relatively recent democracy, open elections having been instituted following the 1974 revolution. After an initial period of uncertainty, its democratic system and institutions have become firmly established. However, economic upheaval in the aftermath of the revolution led to balance of payments difficulties which required adoption of an IMF adjustment program in 1983. Since that time, the Portugese economy has strengthened markedly, and in 1986 Portugal entered the European Economic Community. Nevertheless, the country faces the need for continued adjustments, including further reductions in the budget deficit and privatization of state-owned industries, which will challenge the Government's ability to prevail over strong vested interests.

Portugal must also contend with a heavy accumulation of debt contracted in earlier years; this burden has declined, but remained at 40% of GDP by the summer of 1989. Finally, Portugal is the poorest country in Western Europe, with a per capita GNP of just over $4,000.

Portugal is a charter member of NATO and the site of strategically important Lajes air base. Lajes helps ensure U.S. dominance of sealanes vital to reinforcement of Europe and provides an indispensable transit point to contingencies in the Middle East and Africa. The Portuguese have been particularly cooperative in allowing transit flights through Lajes to non-NATO destinations. The U.S. wishes to promote the social and economic development of Portugal in support of its continued political stability.

The FY 1990 Cash Transfer to Portugal is covered by the "separate accounts" provisos contained in the FY 1990 Appropriations Bill. The agreement will follow A.I.D.'s established guidance, "ESF Cash Transfers -- Amplified Policy Guidance," with respect to separate accounts and accountability for the dollars, and their use. One agreed-upon use would be a contribution by the GOP to the Luso-American Development Foundation (LADF). This use indicates GOP support, which the U.S. has agreed on in past years.

As to other uses by the GOP of cash transfer dollars, inasmuch as Portugal has a progressive, open foreign exchange system on which we do not wish to encourage reimposition of controls, it is appropriate and may be necessary that Portugal allow use of a portion of the balance of the cash transfer for other than imports from the U.S., which is the first order of priority. The aforementioned guidance permits payment of debt owed to multilateral development banks or the IMF, with the approval of the Regional Assistant Administrator. Given that Portugal's non-military bilateral debt to the U.S. Government is low, such approval is requested in the context of PAAD approval.

The grant will not result in the setting aside of local currency to be programmed for mutually agreed purposes. Portugal has annually allocated its own resources to the Azores in an amount equal to or greater than half the value of the cash transfer. Since 1984, our agreements and associated documents have encouraged or recognized this contribution, but have not contained specific requirements to this effect. Moreover, as in FY 1989, in anticipation of an FY 1990 cash transfer but without any notification of the FY 90 ESF assistance level or the timing for its obligation, Portugal, in accordance with its own internal budgeting process, went ahead and transferred an amount of its own currency (approximately $40 million) to the Regional Government of the Azores. We consider that this contribution, together with other assistance provided, represents a substantial and reasonable level of support for the Azores, on the part of the GOP. Any requirement to set aside and program local currency for the Azores (or otherwise) from the FY 1990 grant would, therefore, be meaningless. A.I.D.'s "Supplemental Guidance on Programming Local Currency" requires that the Regional Assistant Administrator provide approval in cases where local currency is not set aside for programming. Such approval is requested in the context of this PAAD. The same approach was utilized with respect to this aspect of the cash transfer to Portugal in FY 1989.

This PAAD recommends that AA/ANE:

-- authorize the grant in the amount of $39,402,248, subject to the conditions contained in the PAAD;

-- delegate authority to the U.S. Ambassador to Portugal, or his designee, to execute a grant agreement for the above amount;

-- approve support to LADF and payment of debt to multilateral development banks and the IMF as eligible uses of the grant;

-- approve that A.I.D. not require that the Government of Portugal to set aside an amount of local currency equivalent to the grant, or a portion thereof, to be programmed for mutually agreed-upon purposes.

II. Political Situation

Portugal is a charter member of NATO and the site of the strategically important Azores Islands air base. Azores helps to ensure U.S. dominance of sealanes vital to reinforcement of Europe and provides an indispensable transit point to contingencies in the Middle East and Africa. The Portuguese have been particularly cooperative in allowing transit flights through the Azores to non-Nato destinations.

Portugal is a relatively recent democracy, with open elections having been instituted following the 1974 revolution. After an initial period of uncertainty, its democratic system and institutions have become firmly established. Minority governments have ruled until 1987, when one party won an absolute majority in Parliament.

Highly expansionary and statist policies followed by the Portuguese government in the aftermath of the revolution caused increasing balance of payments difficulties. These difficulties led to the adoption of an IMF adjustment program in 1983. Since that time, with the marked liberalization of government policies, the Portuguese economy has strengthened markedly, and, in 1986, Portugal entered the European Community.

The United States provides cash transfers to Portugal to further cooperative political relationships. In so doing, the cash transfers promote the social and economic development of the country.

III. Program History

In December 1983, the United States and Portugal reached agreement on U.S. use of the military base on Azores Islands. In conjunction therewith, the U.S. has granted non-military assistance to Portugal as follows (in $ million): 1984- 40, 1985- 80, 1986- 76.5, 1987- 64.7, 1988- 32.0, and 1989- 50.

Portugal has also received assistance from the IMF, amounting to SDR 42.4 million in 1977 and SDR 757.6 million during the 1983 to 1985 period.

IV. Early Economic Background and Policy Setting

In the three years following the revolution of April 1974, Portugal's political and economic systems were radically transformed. A representative political system was introduced and trade unions were legalized. In the economic sphere, three transformations took place.

1. Under a comprehensive land reform, large farms in the central wheat growing regions of the country were taken over by landless farmers and worker cooperatives.

2. Labor legislation was enacted making it extremely difficult to dismiss employees.

3. Banks, insurance and transportation companies, and large industrial companies were nationalized.

The public sector budgetary deficit expanded enormously through this third transformation and through large wage increases; rigid price controls and generous subsidies for food and fuel; large increases in staffing; and rapid expansions in public investments. These developments, along with a widespread lack of discipline and continuing political unrest, led to declines in productivity and serious balance of payments difficulties. The BOP situation was also aggravated by the two oil price shocks and recession in the rest of Europe which dampened the demand for Portuguese exports and the earnings from tourism and overseas workers.

Under the first IMF stabilization program of 1978-80, Portugal succeeded initially in reducing the BOP deficit substantially, but did not make much progress on reducing the budget deficit. The program was abandoned in 1980 with the second oil price shock as Portuguese officials preferred expansionary demand policies and extensive new overseas borrowings to renewed adjustment efforts.

These lax financial policies and continued adverse external developments pushed Portugal into a second crisis by 1983, with the annual inflation rate rising above 22% and the budgetary and balance-of-payments deficits going out of control. As a percentage of GDP, the budgetary deficit was 13% during 1982 and the BOP deficit on current account 14%. These adverse circumstances convinced Portuguese officials to enter a second IMF supported stabilization program in 1983-5.

The turnaround in the Portuguese economy since 1985 has been based both on very favorable external circumstances and on the adjustment measures undertaken in connection with the IMF stabilization program and during the last few years. The persistant character of the budget-deficit and inflation problems demonstrate the need for renewed vigor in pushing adjustment.

V. Favorable External Environment

The two components of the remarkably favorable external environment since 1985 have been a radical shift in Portugal's terms of trade and entry into the European Community.

A. Improvement In Terms Of Trade

Much of the deterioration in Portugal's balance of payments situation during the early 1980s resulted from sharp rises in the price of imports, particularly oil. Conversely, a large part of the economic turn-around since 1984/85 has resulted from an improvement of Portugal's terms of trade (export prices relative to import prices). The most important contribution came from the 50% decline in the price of oil in 1986. (In 1983-5, oil accounted for about 20-23% of Portugal's merchandise imports). On the export side, Portugal's export prices grew by 17% per year in dollar terms during 1986 and 1987. All in all, Portugal's terms of trade have improved by almost 20% since 1984, thus restoring the index to levels experienced a decade earlier (see below). An additional positive feature of the international pricing structure was the sharp reduction in international interest rates which made it easier for Portugal to service its foreign debts.

	1975-82	1983	1984	1985	1986	1987	1988
Terms of Trade (1977 = 100)	95.0	84.0	83.0	86.4	96.6	97.5	98.9

B. Massive Structural Adjustment Assistance From the European Community

Portugal joined the European Community on January 1, 1986. Under the Articles of Accession, a transition period of seven years was allowed (ten years for agriculture) during which Portugal must drop all trade and capital barriers against other members and adopt the Common Agricultural Policy. To assist the process of making Portugal a competitive member of the Community, massive structural adjustment funds were delivered. Entry into the Community is thus a dynamic force for Portugal's economy both through massive financial assistance and the required accompanying measures for increased competitiveness within the agricultural and industrial sectors. At the same time, large increases in foreign investment have been stimulated by the general high level of business confidence. Part of this rise in business confidence can be ascribed to Portugal's increased integration into the Community.

The financial flows into Portugal from the Community have been leaping year after year. On a net basis, these flows can be tabulated as follows:

	1986	1987	1988	1989
Net Financial Flows ($ million)	207	374	718	850

These financial flows are largely non-reimbursable grants from EC agricultural, industrial and other funds. The EC generally finances between 27.5 and 50% of the cost of the project, the Portuguese government 11 to 16%, and the private or state beneficiary the balance. The future net annual flows from the Community are estimated at $900 -1,200 million through 1992. Structural adjustment assistance in agriculture is scheduled through 1995; the estimate for 1988 gross disbursements in agriculture from the Community was about $361 million.

Production in agriculture has been largely stagnant for two decades, with yields for most crops about 40% below the EC average. This low productivity has been due both to excessive protection and to the diversion of investment funds in favor of heavy industry and other structural problems such as the general land fragmentation associated with the 1974-6 land reform, low rural educational levels, and the deficient marketing channels. With Portuguese agricultural output prices being aligned downward with EC prices, productivity gains in many agricultural activities are necessary to keep most grower activities remunerative. (Some abandonment of marginal lands or shifts into more profitable crops would, of course, be rewarding for the economy as a whole).

Over half of the EC funds so far received have been devoted to agricultural development projects or have offered indirect assistance in agriculture through improving rural roads or raising educational standards. One estimate suggests that public investment levels in agriculture may have quintupled over previous annual average levels. In addition, as part of the overall agricultural program, efficiency is being increased through the government's gradual elimination of its marketing monopoly and through the permitted entry of European suppliers of farm inputs.

Modernization in Portuguese industry is taking place both through the reduction in trade barriers and the increasing grants for investment programs. Portugal has been an associate member of the Community since 1972 so that tariffs against EC nations were already low by 1986, in the region of 5%. Import surcharges and licenses, however, were significant barriers and these have been phased out over the last three years, except for a limited list of restricted items.

Serious overmanning exists in much of Portuguese industry as a legacy of the post revolution years and the highly restrictive legislation governing dismissals. This legislation has recently been liberalized slightly. The growing competitive pressures attendant upon Portugal's increasing integration into the Community have not yet caused any significant restructuring in Portuguese industry, such as an increase in bankruptcies among small companies or a release of redundant labor. These structural dislocations are expected to arise soon, which would be a temporary necessary cost for increasing overall efficiency in Portuguese industry.

The EC program of assistance to Portuguese industry only began in 1988. This five-year program is expected to involve expenditures totalling ECU 1 billion. This assistance comprises advice on simplifying investment incentives and making them more generous, including the adoption of an investment tax credit; training and support to scientific and market research as well as various infrastructure such as roads, telecommunications, and water, sewage and energy facilities; and direct support for the modernization projects of a few large enterprises. The EC inspired improvement of investment incentives and fostering of a high level of business confidence have already sparked a foreign investment boom, with the annual flows of net direct investment jumping from $239 million in 1986 to $821 million in 1988 and to $700 million during the first half of 1989. The net portfolio investment flows had meanwhile jumped from $404 million to $1.8 billion. The major recent agreements on foreign investment have comprised one with Ford for a $120 million auto stereo systems plant and another with GM for a $60 million plant to produce electronic ignition systems for cars.

VI. Stabilization and Structural Reform

Portugal has been able to take advantage of the dynamic stimuli afforded by a very favorable external environment through its success in stabilization during 1983-5. More recently, the country's leaders have begun to tackle seriously several of the economy's structural weaknesses. However, the priority given by the country's leaders to pursuit of a competitive growth strategy has conflicted with the need for greater vigor in containing inflation and the budgetary deficit.

A. The Stabilization Program and Early Results

The fundamental basis for the dramatic turnaround in the Portuguese economy after 1985 has been the draconian stabilization measures adopted by the Portuguese authorities during the mid-1980's. The IMF-supported stabilization program of 1983-5 centered on deep cuts in aggregate demand through restrictive tax, expenditure and credit policies; sharp price increases; and by a sharp devaluation. Prices on fertilizers, feedstuffs and milk were increased by 47 to 75% and on cereals by 30 to 50% in June 1983, while smaller additional price increases on these products and a large price increase for petroleum products took place in September 1983. As a result of these tax and price policies and of expenditure cuts, consumption fell annually by 0.3% between 1983-5, real wages by 6% and the investment volume by 14%. In real terms, investment in 1985 was 40% below the 1982 level. The escudo was devalued by a total of 32% during 1983 to $1= 146 escudos. Interest rates were raised significantly and became positive in real terms during 1985. Stabilization was accompanied by severe recessionary conditions, with real GDP falling by 0.3% during 1983 and another 1.6% during 1984.

B. Limited Privatization and Improvements to Investment Climate

A major obstacle to achieving fiscal balance is the large scope and inefficiency of the public enterprise sector. These problems had been entrenched by constitutional and legal provisions and by administrative practice. The 1974-5 nationalizations, covering utilities, banks, transport, and a broad range of industries, such as paper, steel, and cement, were enshrined in a constitutional provision. Excessive expansions in employment in these state enterprises were also made difficult to reverse through laws against labor dismissals.

The July 1987 election of the first single-party majority government since the 1974-5 revolution has led to the removal or liberalization of several of these provisions. The new social democratic party government then ratified by March 1988, a law permitting the sale of up to 49% of the equity in state enterprises to private interests. Other laws later that year opened additional sectors to private investment entry, including steel, petrochemicals, oil refining, transport, telecommunications, and energy. Separate laws were also passed to increase the amount of privately-owned land at the expense of cooperatives and to help consolidate many small parcels and to open new sectors to private enterprise such as newspapers and radio broadcasting. A constitutional revision was finally approved by Parliament during the summer of 1989, allowing the sale of more than 49% of the shares of public companies. Labor reforms had also been introduced to facilitate dismissals, but their scope had been greatly reduced by a 1988 decision of the Constitutional Court. Basically, dismissals can be done freely by companies with less than 21 workers; otherwise, changes in technology or market factors have to be used as the justifications. Even before the change in labor laws, public enterprises had met some success in streamlining their operations, with their total employment in 1987 some 10% below the 1982 level.

The first privatization occurred in February 1989 for a brewery, followed in April by a bank, and in June by two insurance companies. Also expected to be privatized soon are a cement company, another brewery and the second half of the brewery privatized in 1989. Another bank is to be privatized in early 1990. These privatizations were at the rate of 49%. The ultimate goal of the privatization program is 10 banks, 6 insurance companies and 40 non-financial companies in such fields as paper, chemicals and communications. The allocation of the privatization sales proceeds is 20% for reinforcing the structure of the companies which will remain in the public sector and most of the remaining 80% for prepayment of the public debt. Restructuring is already planned for the national steel company and a chemical company to include significant reductions in capacity and manpower. Also planned are the leasing or turnover of management of a major petrochemical company and the shipbuilding company to national or international concerns. Several of the stronger state banks have increased investments in the weaker banks to make them more attractive for privatization; to the same end, entry by new banks has been made more difficult by a recent 40% increase in the minimum required equity requirements. (In the previous four years, new private entries had been encouraged in an effort to force the state banks to become more efficient and competitive).

The privatization program has thus started slowly, but with determination. A more rapid pace would be desirable, both to facilitate fiscal balance and to promote efficiency improvements for the newly privatized firms as well as those remaining public sector firms which are being restructured.

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The Portuguese investment climate has been criticized for poor bureaucratic procedures and a restrictive labor code. There have also been investor complaints of a small market, underdeveloped infrastructure and a low level of technical sophistication. As we have seen, however, investment incentives have recently been improved in response to EC technical assistance and, combined with the confidence-generating process of EC entry and associated EC assistance to Portuguese infrastructure, this has stimulated a sharp rise in foreign investments. A possible new impediment to the foreign investment climate is the apparently discriminatory treatment of foreign investors in the new 1989 tax system with respect to capital gains and profit income. This situation may discourage investments from countries, such as the United States, with which Portugal does not have double taxation treaties.

C. Fiscal Restraint

Most of the progress in reducing the budget deficit has come about through reductions in subsidy payments, which have declined by about 5 percentage points of GDP since the end of 1983. The early reduction was the direct result of sharp increases in prices on food, feed, fertilizer and fuels, while the more recent reductions have been largely due to tax simplification and declines in international prices. During 1986, a new petroleum tax and the value added tax (VAT) were introduced, substituting for complex sets of earlier taxes. The petroleum tax served particularly to capture the windfall gains from the sharp decline that year in the international price of oil. During the spring of 1989, domestic prices on petroleum products were increased in line with the increases in international prices. Most public enterprises had been given freedom during 1983-5 to raise prices in line with market developments and the need to raise investment capital so that dependence on the administrative budget has been gradually reduced.

One of the advantages of the new VAT is collection simplicity. This is also a feature of the new system of direct taxes adopted in January 1989. This system replaces 7 taxes with two: individual and corporate. Marginal tax rates have been reduced on individuals in exchange for lower amounts of deductions. Higher rates have been set on profit income. It is hoped that collection simplicity is leading to less tax evasion and higher tax yields.

Otherwise, Portuguese fiscal policy has been insufficiently restrictive since about 1985. For example, some increases in administered prices have taken place at the beginning of 1988 and 1989 ranging mostly between 5 and 6% each year, but these have been below the rate of inflation. Wages and salaries in the public sector were raised sharply during 1986 and 1987 from previously depressed levels. During the late 1988-early 1989 period, the government took a tougher line. Despite a series of strikes, the wage increases granted for civil servants were 9.5% and for public enterprise employees about 8% or slightly below the inflation rate. According to an aggregate fiscal assessment by the World Bank, total revenues rose by an annual average of 22.0% per year during the 1985-7 period and total expenditures by 19.5%. Leaving aside autonomous funds and services, local governments and social security, Central government revenues rose by an average of 25.3% per year during the 1985 - 1988 period and expenditures by 18.7% (See Table 1). Recovering from earlier severely depressed levels, public fixed investment expanded by an annual average of 23.6% during the same period and current expenditures by 17.7%.

The upshot of these developments has been a decline in the overall budget deficit as a percentage of GDP from an average of 11.5% during 1980-4 to 8.1% in 1987 and to 7.2% in 1988. The deficit for public enterprises has gone down from 8% of GDP in 1984 to 1.5% in 1987. However, the World Bank contends that there was a shift in the overall Portuguese fiscal stance from strongly contractionary in the 1982-4 period to expansionary in 1985-7.

A major effect of insufficient progress in reducing the budget deficit has been tight credit controls on private sector activities, as the lion's share of credit has been absorbed by the administrative public sector. Inflationary pressures have persisted and recently strengthened.

D. Mixed Experience on Inflation, Exchange Rates, and Interest Rates

Portugal had some success in moderating the economy's inflation rate during the mid- 1980's, but more recently the rate has bounced upward again over the rate attained during 1986. The annual inflation rate averaged over 24% during 1981-4 and then came down sharply during 1985 and 1986 to 19% and 12% respectively. A further slight decline occurred during 1987, but there have since been increases in the rate during 1983 and 1989 to perhaps 13% in the latter year (see Table I).

Fighting inflation has been an important goal for the Portuguese government. Indeed, policy-makers have cited a concern with inflation to justify a less flexible exchange rate policy. The escudo-dollar rate was 146 to one during 1984 and, after a further depreciation during 1985, stabilized at about that same rate during 1986-8. The Portuguese currency has depreciated only modestly against a weighted basket of overseas currencies during the last five years. The rate of depreciation has been much less than the rate suggested by Portugal's high inflation rate compared with inflation experienced by its trading partners. Portuguese authorities had set the monthly depreciation rate at a high of 1.0% per month in June 1983; this rate was then successively lowered to 0.4% per month for 1988. The monthly depreciation rate was further lowered to 0.25% for 1989. The combination of significant inflation and limited exchange rate flexibility has led to appreciation in the real exchange rate. The International Monetary Fund estimates that by the end of 1988, the real exchange rate had appreciated about 7% from the previous peak level of competitiveness and that a further real appreciation of around 5% may have occurred during 1989. The authorities fear that a more accomodating exchange rate policy would further fuel inflation, but the cost has been impaired competitiveness, leading to a recent influx of imports and a slackening in the rate of increase in exports.

Significant progress was made during the early to mid-1980s in raising deposit interest rates to positive levels in real terms. From negative 10 to 20% during the 1970s, the deposit rate was brought down to negative 3 to 5% during 1983-4. The rate became positive during 1985 and stayed positive in the 2% area through the summer of 1988. The main aspect of this favorable performance was the rapid deceleration of inflation during the mid-1980s and the slower decline in nominal interest rates. Conversely, the resurgence of inflation during 1988 and 1989 pushed real deposit rates downward to negative levels by the fourth quarter of 1988. They were about minus 2.5% by April 1989. A reversal of this recent adverse trend is needed to promote a recovery of household savings and dampen excess consumption which, in turn, would help restrain inflation.

One aspect of interest rate policy has become more favorable. Previously, Portuguese officials tried to keep domestic payments on government debt low by obliging banks to accept government paper at rates well below the rates set on borrowing by the private sector. This subsidy on governmental operations (and implicit taxing of the private sector) has been reduced in recent years as loan interest rates on government debt have been permitted to rise closer to market levels. Loan interest rates in general moved up by about 3 percentage points since the lifting of the ceiling on loan rates in September 1988. This rise came close to offsetting the increase in inflation rates so that loan rates were 9% above the inflation rate during 1987, 8% during the first nine months of 1988 and slightly under 6% since.

The Portuguese government announced a package of reforms in March 1989 in an attempt to restrain inflation. This package included slightly higher bank reserve requirements, tightened enforcement of credit ceilings, limits on credit purchases of automobiles and other durables, a 15% increase in tobacco prices, and a withdrawal of tax benefits from firms which increase prices above targeted inflation rates. It remains to be seen whether the program will lower inflation.

VII. Recent Economic Performance and Outlook

The Portuguese economy made a rapid recovery from the unsustainability of earlier growth which produced the recession of 1983-4. As indicated in Table I, the growth in real GDP was 3.3% in 1985 and above 4% annually during 1986-8. The projected rate for 1989 is 5.0%. The pattern is similar for industry: an annual real increase rate averaging slightly under 4% during 1985-7 and speeding up to 6% during 1988.

The major cause of this output growth was the recovery in investment. Investment levels had been extremely depressed during the recession, with manufacturing especially hard hit. The 1985 level of manufacturing investment was a full 55% lower in <u>nominal</u> terms than it had been during 1982. Total investment in <u>real</u> terms then expanded as follows: 1986- 9.5%; 1987- 19.5%; and 1988- 13.5%. A large element of the investment recovery is then a restocking of inventories and a refurbishing of capital stock. This element by itself would argue for some cooling in the investment surge in the near future. However, a major remaining part of the investment surge has been due, as we have seen, to the general rise in the level of business confidence, associated with rapidly increasing emigrant, tourism and European Community flows. Thus, with the latter stimulant likely to remain strong, investment should continue at high rates, even with the completion of much refurbishing and the higher inventory levels.

The other major aspect of economic buoyancy has been the strong growth of domestic demand. Real incomes and private consumption expenditures have been rising by an average of 6.5% annually during the 1986-8 period. Total expenditures have been rising even faster by nearly 9% per annum. There has been a boom in the purchases of consumer durables, with auto sales increasing by almost 20% annually during 1985-7.

Trends in Portugal's balance of payments on current account have mirrored the recent shifts in domestic demand, service earnings and in the real exchange rate. The current account deficit dropped from 13.4% of GDP in 1982 to 3.4% in 1984 in response to the recession and the sharp devaluation of the escudo. As an aftermath of these same developments, and assisted by a 20% recovery in the terms of trade since 1985, the current account then turned into surplus averaging about 2% of GDP during 1985-7.

This favorable overall trend masks an underlying deterioration in the trade accounts. This deterioration started in 1986 when exports increased by only 9% in volume terms over 1985 while imports increased by 19%. (From 1982-5, the volume increase rate for exports had been, on the average, 15 percentage points higher than for imports). Then, during 1987 and 1988, exports grew nominally by a total of 35%, but imports grew by an astonishing 79%. The import surge derives directly from the recent buoyancy of domestic demand discussed earlier and the relative cheapness of imports: between 1985 and 1987, the prices of non-petroleum imports rose by only 28%, while those of exports rose by 31% and the prices of domestic goods and services rose by 60%. Export growth continued to be substantial mainly in textiles, clothing and footwear. EC structural adjustment assistance to Portuguese industry can be expected to lead to expanded exports in some more technically advanced sectors, if the escudo is allowed to depreciate in line with relative inflation trends.

The trade deficit thus worsened from $3.4 billion in 1987 to $5.1 billion in 1988. The continued steady increases in service receipts were then not sufficient to prevent the current account from shifting from $640 million surplus to $629 million deficit during the two years (see Table II). Continued strong import demand, coupled with higher oil and agricultural prices, may have pushed the current account deficit above $1 billion during 1989. Earlier projections were much worse but apparently the March 1989 credit restrictions were successful in cooling the import demand for durables.

The overall balance of payments remained in surplus during 1988 due to a $1.5 billion rise in foreign investment. Even so, the surplus declined from $2.0 billion in 1987 to $632 million in 1988, after debt prepayments of about $600 or 700 million each year. During 1989, the overall surplus is expected to dwindle

22

to $400 million and debt prepayments to $200 million. Total reserves minus gold have also risen sharply in recent years, from $1.46 billion in 1986 to $3.33 billion in 1987, $5.13 billion in 1988, and to over $6 billion in 1989.

Portugal's external debt burden has gone down substantially since 1985 when it constituted 81% of GDP. Restraint on new borrowings as GDP increased rapidly was responsible for the debt burden falling to below 40% of GDP by the summer of 1989 (see Table III). The health of Portugal's recent debt servicing experience is also reflected by the prepayments made from 1986 onwards and from the declining share of total interest payments in total debt servicing. This share was 58% in 1981 and declined to 12% in 1988. Portugal should continue to have little difficulty in servicing its debts as long as it succeeds in preventing a further deterioration in its balance of payments on current account. The primary measures to arrest this deterioration are renewed vigor in fiscal restraint to bring inflation under control and a speedier liberalization of market structure and exchange rate and other monetary policies to further the competitive dynamism of the economy.

VII. Proposed Assistance

The United States strongly supports the Government of Portugal and wishes to maintain close ties with an old and important ally. It is our intention to continue provision of assistance, both economic and military, for the foreseeable future.

A cash grant of $39,402,248 million is proposed. The purpose of the assistance is to promote political and economic stability and to facilitate the social and economic development of Portugal. The continued stability of Portugal's relatively young democratic institutions can best be assured within a framework of economic stability, where the needs of Portugal's people can be satisfied. Portugal will need continued assistance to meet the challenges presented by its entry into the European Common Market. The country's successful efforts in integrating its economy into Western Europe will reinforce its ties and commitment to democratic political institutions.

U.S. Dollar Assistance

The grant will be used by the Portugese for such uses as commodity imports and/or debt service. A portion may be used by the GOP to support the Luso-American Development Foundation.

1. Commodity Import, debt service or other uses

These uses are consistent with the full range of eligible uses contained in the A.I.D. "Amplified Policy Guidance on ESF Cash Transfer Assistance." Permissible uses include, in the following order of preference:

(a) financing the importation of raw materials, intermediate and capital goods or services and essential consumer goods from the United States;

(b) servicing of external debt owed to the U.S. Government, other than to repay U.S. Foreign Military Sales (FMS) debt;

(c) servicing of debt owed to multilateral development banks, or to the International Monetary Fund; and

(d) other purposes or uses as agreed in writing between the Parties.

As a matter of policy, the U.S. Government would prefer that the dollar assistance provided for balance of payments uses be used for the importation of goods and services from the United States, but is not so limiting its use. Given that the Government of Portugal has a relatively free import regime, we do not wish to introduce a specific requirement which would have the effect of increasing restrictions or interfering with that government's normal, timely settlement of import and debt obligations. In the absence of an identified "big ticket" import transaction from the United States in the offing, tracking of a large number of import transactions would be cumbersome and against the current liberalization trend in the Portugese economy.

In addition, although Portugal's debt service burden has declined in recent years, this remains a significant drain on the economy; more than $3.6 billion is currently required to service debt each year. Thus, Portugal's debt service remains a constraint to its further growth and development.

It is expected that, given Portugal's constraints on tracking imports, and its debt service burden, Portugal may use a portion of the grant to pay debt. Under the Amplified Policy Guidance referred to above, AA/ANE concurrence is required for payment of debt to multilateral institutions and the IMF. Given that Portugal's non-military bilateral debt owed to the U.S. Government is small, it may be necessary, for good management of foreign exchange flows, to utilize grant dollars to service multilateral or IMF debt. Such concurrence is requested in the context of approving this PAAD.

If it should be determined that the Portugal may not be able to utilize any part of the Grant which it reserves for balance of payments purposes in a reasonable period of time and keep within the above categories of uses, A.I.D. will consider a written request to expand eligible categories of uses of the dollar proceeds to include, in order of preference, servicing of commercial debt owed in the United States, servicing of debt owed to A.I.D. Geographic Code 899 countries, and financing of eligible imports from Code 899 countries.

2. Luso-American Development Foundation use.

In the years up to FY 1988, Portugal contributed a portion of the cash transfer to the Luso-American Development Foundation. Due to the precipitous drop in the level of the FY 1988 grant as a result of U.S. budget constraints, Portugal did not contribute to the LADF in FY 1988. However, in FY 1989 Portugal once again provided a contribution of $10,000,000 to the LADF from the cash transfer. Given the more than $10,000,000 drop in the level of the FY 1990 grant, it is uncertain whether there will be a Portuguese contribution to the LADF this year.

The Luso-American Development Foundation (LADF) was legally created in 1985 to support Portugal's economic and social development by promoting scientific, technical, cultural, education, trade and entrepreneurial cooperation between Portugal and the U.S.. As of September 30, 1987 the Foundation had approved 349 projects with a total value of $21.4 million. LADF's goal is to commit 75 percent of its funds to the three major areas of emphasis - private sector development, education, and science and technology. Operating costs are low, running at 8.5 percent of the value of approved projects.

LADF is chartered under Portugese law as a private foundation which provides public benefit. It is neither an extension of nor a project financed by A.I.D.. There is no requirement of reporting by the Foundation to A.I.D. or to either the U.S. Government or the GOP, and the U.S. Government does not, itself, have any formal access to Foundation operations. The U.S. Ambassador, however, sits as one of two American members of the Foundation's Directive Council, which determines the basic policies of the Foundation and approves annual budgets, accounts and reports. In this capacity, he/she has access to internal Foundation operations and reports. In addition, USAID/Lisbon has an informal and collegial relationship with the management of the Foundation, which informally shares information. The LADF Annual Report which contains either a summary of, or a full, independent audit report, is, however, a public document.

Appropriate provisions on information for funds to be transferred by the GOP to the LADF will be included in Implementation Letter No. 1, to be signed by the GOP prior to A.I.D.'s disbursement of the grant. A draft of the proposed Implementation Letter is included in Annex C to this PAAD.

Non-inclusion of Local Currency

The dollars will not result in any setting aside of local currency by the Government of Portugal for mutually agreed upon uses, including development in the Azores by contributions to its Regional Government. The Government of Portugal has heretofore annually allocated its own resources to the Regional Government of the Azores in an amount equal to or greater than half the value of the cash transfer. Since FY 1984, our agreements and associated documents have encouraged or recognized this contribution in support of social and economic development in that poor and strategically located area, but have not contained specific requirements to this effect and there has thus been no setting aside of local currency in prior years for the purpose of mutual programming.

For FY 1990, Portugal has already transferred an amount of its own currency (escudos) to the Azores. This was done by the Government of Portugal in accordance with its own budgeting process, before A.I.D.'s budgeting process was completed and without, therefore, any assurance of the FY ESF 1990 assistance level from the United States, or the timing for its obligation and disbursement. Thus, in no way do the U.S. dollars represented by this cash transfer result in any setting aside of local currency by Portugal for the Azores or otherwise generate any Portuguese local currency. While Portugal may have acted in anticipation of FY 90 ESF assistance, it did so, it should be clearly understood, without any conditionality of such assistance.

A.I.D.'s "Supplemental Guidance on Programming Local Currency" requires that local currency be programmed in conjunction with cash transfers (and other specified forms of assistance), except as may be otherwise approved by the appropriate Regional Assistant Administrator. Amplified PD No. 5 encourages programming of local currency as a tool for moving toward the goal of an overall host country budget that represents a sound, development-oriented allocation of budget resources set within a market-oriented policy framework.

Given that, as described above, Portugal on its own has already completed its transfer of funds to the Azores, and there is no policy or other reason to require any setting aside of local currency for this (or other) purpose, any requirement to program local currency would in this context be meaningless. For these reasons, and in light of Portugal's status as a NATO ally, approval is requested in this PAAD authorization that the FY 1990 cash grant to Portugal not require the setting aside of local currency for purposes of mutual programming.

IX. Implementation and Administration

The draft agreement for the FY 1989 cash transfer to Portugal was prepared following A.I.D.'s "ESF Cash Transfers - Amplified Policy Guidance." This cash transfer is covered by the "separate accounts" provisos contained in the FY 1989 Appropriations Bill. A condition precedent will require that Portugal designate the bank account to which the grant is to be deposited, and provide a statement that such bank account is established and will be maintained in accordance with the relevant section of the grant agreement.

Dollars will be disbursed into a separate account in the name of the Government of Portugal. The Government of Portugal will commit to withdraw such funds only for the uses agreed upon in the grant agreement and to replenish the account if it should be determined that funds were used for other than agreed-upon purposes. Provisions for accountability consistent with the legislative requirements and with A.I.D. policy are also contained in the grant agreement and Implementation Letter No. 1, which is to be countersigned by the GOP. The documents are contained in Annex C.

TABLE I

GOVERNMENT FINANCE 1
(Billions of Portuguese escudos)

	1983	1984	1985	1986	1987	1988
I. BILLION ESCUDOS						
Total Revenue	498.7	580.0	682.4	945.1	1128.3	1419.0
Total Expenditures	746.1	943.0	1237.2	1548.1	1768.0	1844.8
Deficit/Surplus	-247.4	-363.0	-554.8	-603.0	-639.7	-425.8
II. GROWTH RATES						
Total Revenue	33.8	16.3	17.6	38.5	19.4	25.8
Total Expenditure	28.6	24.6	31.2	25.1	14.2	4.3
III. RATIOS (%)						
Deficit/GDP	10.5	13.4	11.6	8.9	8.1	7.2
Current Expenditures/GDP	41.7	42.8	37.3	39.6	39.5	38.9
Capital Expenditures/GDP	6.5	5.6	5.5	5.9	6.3	6.4

(1) Defined as General Government, which includes central government, local governments, and the social security system.

Source: Ministry of Finance

OTHER DATA

Real GDP Growth (%)	-0.3	-1.6	3.3	4.3	4.3	4.2
Inflation Consumer Prices	25.5	29.3	19.3	11.7	9.3	9.7

Source: Bank of Portugal

TABLE II

Balance of Payments
(Billions of US $)

	1984	1985	1986	1987	1988
BALANCE OF PAYMENTS					
1. Current Account					
Trade Balance	-2.026	-1.457	-1.634	-3.375	-5.137
Merchandise Exports	5.206	5.685	7.209	9.170	10.708
Merchandise Imports	7.233	7.142	8.844	12.545	15.845
Services Balance	-0.665	-0.356	-0.032	0.293	0.193
Receipts	1.931	2.281	2.820	3.639	4.044
Payments	2.596	2.637	2.852	3.347	3.851
Transfer	2.177	2.224	2.810	3.723	4.315
Current Account Balance	-0.514	0.410	1.144	0.640	-0.629
2. Capital Account					
Direct Investment	0.186	0.232	0.239	0.327	0.821
Portfolio Investment	0.224	0.095	0.404	0.812	1.800
Other LT Capital	0.740	0.624	-1.145	-1.237	-1.868
ST Capital	-0.235	-0.168	0.254	-0.040	-0.618
Capital Account Balance	0.915	0.783	-0.248	-0.138	0.135
3. Errors & Omissions	-0.398	-0.285	-1.007	1.250	1.373
4. Counterpart Items	-0.015	0.085	0.085	0.263	-0.247
5. Change in Reserves	-0.110	0.792	-0.026	2.015	0.632
I. INTERNATIONAL LIQUIDITY					
1. Total Reserves Minus Gold*	0.516	1.395	1.456	3.327	5.127
Gold (National Valuation)	5.174	5.159	5.139	5.114	5.190
2. Import Coverage of Reserves (number of months)	0.9	2.3	2.0	3.1	3.9

Change in levels not equal to item 5 in BOP section because of valuation changes.

ource: IMF: International Financial Statistics

TABLE III

EXTERNAL DEBT
(Millions of U.S. Dollars)

	1984	1985	1986	1987	1988
. TOTAL EXTERNAL DEBT	14,974	16,682	16,303	18,421	17,261
A. Short-Term	3,015	2,627	1,429	2,206	2,535
Public Enterprises	2,912	2,462	1,211	1,753	1,678
Private Sector	103	165	218	453	857
B. Medium and Long-Term	11,959	14,055	14,874	16,215	14,726
General Government	3,842	4,587	5,005	5,778	5,576
Bank of Portugal	851	856	846	594	5
Other Monetary Inst.	1,677	1,423	1,196	1,006	665
Final Institution	116	124	.138	176	210
Public Enterprises	4,949	6,513	7,025	7,787	7,196
Private Sector	524	552	664	874	1,074
I. EXTERNAL DEBT SERVICE (Public and Publicly Guaranteed Long-Term Debt)	2,503	2,724	3,143	3,349	3,632
Interest Payments	1,035	1,097	1,205	1,032	1,237
Amortization Payments	1,468	1,627	1,938	2,317	2,395
II. DEBT RATIOS					
A. Net Debt/Nominal GDP	78.1	80.6	55.2	50.2	41.3
B. LT Debt Serv/Exports	35.6	37.0	28.8	30.2	29.7*

* Including advance repayments of external debt in 1986, 1987 and 1988, equivalent to 4.0, 8.9 and 8.7% respectively of current account receipts.

Source: Banco de Portugal: Quarterly Bulletin

Country Checklist

and

Non Project Assistance Checklist b

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to: (A) FAA funds generally; (B)(1) Development Assistance funds only; or (B)(2) the Economic Support Fund only.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1.	<u>FY 1990 Appropriations Act Sec. 569(b)</u>. Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully?	No.
2.	<u>FAA Sec. 481(h); FY 1990 Appropriations Act Sec. 569(b)</u>. (These provisions apply to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly affecting the United States, through which such drugs	It has not been so determined.

are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government): (a) Does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement? and (b) Has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (1) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (2) the vital national interests of the United States require the provision of such assistance?

3. 1986 Drug Act Sec. 2013. (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to No.

Congress listing such country as one: (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

4. FAA Sec. 620(c). If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, (b) the debt is not denied or contested by such government, or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity?

Portugal is not known to be in violation of this section.

5. FAA Sec. 620(e)(1). If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

Portugal is not known to be in violation of this section.

6.	<u>FAA Secs. 620(a), 620(f), 620D; FY 1990 Appropriations Act Secs. 512, 548</u>. Is recipient country a Communist country? If so, has the President: (a) determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism, or (b) removed a country from applicable restrictions on assistance to communist countries upon a determination and report to Congress that such action is important to the national interest of the United States? Will assistance be provided either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, South Yemen, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan?	No to all three questions.
7.	<u>FAA Sec. 620(j)</u>. Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property?	Portugal is now known to be in violation of this section.
8.	<u>FAA Sec. 620(l)</u>. Has the country failed to enter into an investment guaranty agreement with OPIC?	There is an Investment Guarantee Agreement between the U.S. and Portugal.
9.	<u>FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5</u>. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made?	Portugal is now known to have taken such action.

10. FAA Sec. 620(q); FY 1990 Appropriations Act Sec. 518 (Brooke Amendment). (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1990 Appropriations Act appropriates funds?

No.

11. FAA Sec. 620(s). If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

Yes, as reported in the Annual Report on Implementation of FAA Section 620(s).

12. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No.

13. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.)

To the best of our knowledge, Portugal is not in arrears in its UN obligations.

14. FAA Sec. 620A. Has the President determined that the recipient country grants sanctuary from prosecution to any individual or group which has committed an act of international terrorism or otherwise supports international terrorism? — No.

15. FY 1990 Appropriations Act Sec. 564. Has the country been determined by the President to: (a) grant sanctuary from prosecution to any individual or group which has committed an act of international terrorism, or (b) otherwise support international terrorism, unless the President has waived this restriction on grounds of national security or for humanitarian reasons? — No.

16. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures? — No.

17. FAA Sec. 666(b). Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA? — No.

18. FAA Secs. 669, 670. Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.) — We have no knowledge that Portugal has delivered or received such items or detonated such a device.

19. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device?

We have no knowledge that Portugal has such exports.

20. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the "Taking into Consideration" memo.)

No.

21. FY 1990 Appropriations Act Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance?

No, assistance has not been terminated.

22. FY 1990 Appropriations Act Sec. 539. Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin?

Yes.

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

a. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

No.

b. FY 1990 Appropriations Act Sec. 535. Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

No.

2. Economic Support Fund Country Criteria

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest?

No, it has not been so determined.

b. FY 1990 Appropriations Act Sec. 569(d). Has this country met its drug eradication targets or otherwise taken significant steps to halt illicit drug production or trafficking?

Yes.

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1990 Appropriations Act Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.

   Congressional Notification was submitted on 3/8/90.

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No further legislative action is required within Portugal.

3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

   No.

4. FAA Sec. 601(a). Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

Assistance funds will help finance imports from U.S. and thus may well increase flow of (a) international trade and (b) promote private initiative and competition. While assistance funds will generally assist the economy, such may not necessarily effect (c) - (f).

5. FAA Sec. 601(b). Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Assistance funds will help finance imports from U.S. and thus may well likely encourage U.S. private trade and possibly investment in Portugal and private U.S. participation in the foreign assistance program with Portugal.

6. FAA Sec. 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds?

Not applicable.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

It will promote economic stability by providing vital foreign exchange required for Portugal's development, and thus ultimately promote political stability.

b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities?

No.

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

No, ESF funds under this cash grant will not be used to generate local currency.

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

Not applicable.

e. FY 1990 Appropriations Act, Title II, under heading "Economic Support Fund," and Sec. 592. If assistance is in the form of a cash transfer: (a) Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) Will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements? (c) Will all such local currencies also be used in accordance with FAA Section 609, which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available? (d) Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

a) Yes.

b) No local currency equivalent will be generated.

c) Not applicable.

d) CN was submitted on 3/8/90.

2. Nonproject Criteria for Development Assistance

a. FAA Secs. 102(a), 111, 113, 281(a). Extent to which activity will: (1) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (2) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?

Not applicable (1-5).

b. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

Not applicable.

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out

Not applicable.

under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach. — Not applicable.

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education — Not applicable.

and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

(4) [106] for energy, private voluntary organizations, and selected development problems; if so, extent activity is: Not applicable.

(i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment; Not applicable.

(ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations; Not applicable.

(iii) research into, and evaluation of, economic development processes and techniques; Not applicable.

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness; Not applicable.

(v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance; Not applicable.

(vi) for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development. Not applicable.

(5) [120-21] for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multidonor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?	Not applicable.

DRAFTER:GC/LP:EHonnold:3/20/90:2169J

ANNEX B

DRAFT GRANT AGREEMENT

IMPLEMENTATION LETTERS 1 & 3

(STATE 070449 Attached)

ACTION: AID INFO: AMB DCM ECON // 4

VZCZCLI0739EHU112 06-MAR-90 TOR: 02:34
PP RUFHLI CN: 06534
DE RUEHC #0449/01 0650232 CHRG: AID
ZNR UUUUU ZZH DIST: AID
P 060225Z MAR 90 ADD:
FM SECSTATE WASHDC
TO AMEMBASSY LISBON PRIORITY 6463
BT
UNCLAS SECTION 01 OF 07 STATE 070449

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: FY 90 PORTUGAL CASH TRANSFER

1. THIS CABLE TRANSMITS THE TEXT OF THE FY 1990 CASH TRANSFER GRANT TO PORTUGAL FOR DOLS. 39,402,248, PLUS SUPPLEMENTAL INFORMATION RELEVANT TO YOUR DISCUSSIONS AND NEGOTIATIONS WITH THE GOVERNMENT OF PORTUGAL, AND PROCEDURES FOR OBTAINING DISBURSEMENT.

THE EMBASSY MAY UTILIZE DRAFT AGREEMENT TRANSMITTED HEREIN TO BEGIN INITIAL DISCUSSIONS AND NEGOTIATIONS WITH THE GOP RELATED TO THE CASH TRANSFER FOR FY 1990. WE WILL HAVE TO APPROVE ANY CHANGES. THE FY 90 APPROPRIATIONS ACT REQUIRES ALL CASH TRANSFERS TO HAVE A CONGRESSIONAL NOTIFICATION (CN) 15 DAYS PRIOR TO OBLIGATION. CN HAS BEEN DRAFTED AND IS IN CLEARANCE. FUNDS WILL BE AUTHORIZED BY MEANS OF A PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD), TO BE APPROVED BY THE A.I.D. ASSISTANT ADMINISTRATOR FOR ASIA, NEAR EAST AND EUROPE (AA/ANE). ONCE OMB APPORTIONMENT HAS BEEN RELEASED, THE PAAD APPROVED BY AA/ANE, AND 15 DAY WAITING PERIOD ON CN HAS EXPIRED, WE WILL FORWARD NOTIFICATION THAT A BUDGET ALLOWANCE HAS BEEN

ESTABLISHED IN AID/W. WE WILL ADVISE EMBASSY OF AUTHORIZATION TO EXECUTE THE AGREEMENT BY SEPTEL.

2. TEXT OF THE DRAFT AGREEMENT FOLLOWS. BEGIN TEXT.

ASSISTANCE AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF PORTUGAL

AGREEMENT, DATED THE DAY OF BETWEEN THE GOVERNMENT OF PORTUGAL ("THE GRANTEE") AND THE UNITED STATES OF AMERICA ACTING THROUGH THE AGENCY FOR INTERNATIONAL DEVELOPMENT ("A.I.D."), TOGETHER REFERRED TO AS THE "PARTIES".

WHEREAS, THE GOVERNMENT OF PORTUGAL HAS UNDERTAKEN A VIGOROUS PROGRAM TO STABILIZE AND DEVELOP ITS ECONOMY, AND

WHEREAS, THE GOVERNMENT OF PORTUGAL HAS PROVIDED SUPPORT

4

TO THE DEVELOPMENT BUDGET OF THE REGIONAL GOVERNMENT OF THE AZORES, AND

WHEREAS, THE GOVERNMENT OF PORTUGAL INTENDS TO PROVIDE FURTHER SUPPORT TO THE LUSO AMERICAN DEVELOPMENT FOUNDATION FOR THE SOCIAL AND ECONOMIC DEVELOPMENT OF PORTUGAL, AND

WHEREAS, THE GOVERNMENT OF THE UNITED STATES, ACTING THROUGH A.I.D., IS DESIROUS OF SUPPORTING THESE EFFORTS,

NOW, THEREFORE, THE PARTIES HERETO AGREE AS FOLLOWS:

ARTICLE I

THE GRANT

SECTION 1.1 THE GRANT

A.I.D., PURSUANT TO THE FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED, AGREES TO GRANT TO THE GRANTEE UNDER THE TERMS OF THIS AGREEMENT NOT TO EXCEED THIRTY-NINE MILLION, FOUR HUNDRED TWO THOUSAND, TWO HUNDRED FORTY-EIGHT DOLLARS (DOLS. 39,402,248) (THE "GRANT") TO SUPPORT AND PROMOTE THE FINANCIAL STABILITY AND ECONOMIC DEVELOPMENT OF PORTUGAL.

ARTICLE II

CONDITIONS PRECEDENT TO DISBURSEMENT

SECTION 2.1. DISBURSEMENT

PRIOR TO DISBURSEMENT OF THE GRANT OR ISSUANCE BY A.I.D. OF DOCUMENTATION PURSUANT TO WHICH DISBURSEMENT WILL BE MADE, THE GRANTEE WILL, EXCEPT AS THE PARTIES MAY OTHERWISE AGREE IN WRITING, FURNISH TO A.I.D. IN FORM AND SUBSTANCE SATISFACTORY TO A.I.D.:

(A) A STATEMENT OF THE NAME OF THE PERSON HOLDING OR ACTING IN THE OFFICE SPECIFIED IN SECTION 5.2, AND OF ANY ADDITIONAL REPRESENTATIVES, TOGETHER WITH A SPECIMEN SIGNATURE OF EACH PERSON IN SUCH STATEMENT;

(B) A DESIGNATION OF THE BANK ACCOUNT TO WHICH THE GRANT IS TO BE DEPOSITED, TOGETHER WITH THE GRANTEE'S STATEMENT THAT SUCH BANK ACCOUNT IS ESTABLISHED AND WILL BE MAINTAINED IN THE MANNER REQUIRED BY SECTION 4.3 OF THIS AGREEMENT.

SECTION 2.2. NOTIFICATION

WHEN A.I.D. HAS DETERMINED THAT THE CONDITIONS PRECEDENT
SPECIFIED IN SECTION 2.1 HAVE BEEN MET, IT WILL PROMPTLY
NOTIFY THE GRANTEE.

SECTION 2.3. TERMINAL DATE FOR CONDITIONS PRECEDENT

IF THE CONDITIONS SPECIFIED IN SECTION 2.1 HAVE NOT BEEN
MET WITHIN NINETY (90) DAYS FROM THE DATE OF THIS
AGREEMENT, OR SUCH LATER DATE AS A.I.D. MAY AGREE IN
WRITING, A.I.D., AT ITS OPTION, MAY TERMINATE THIS
AGREEMENT BY WRITTEN NOTICE TO THE GRANTEE.

ARTICLE III

DISBURSEMENTS

SECTION 3.1. DEPOSIT OF DISBURSEMENT

AFTER SATISFACTION OF THE CONDITIONS PRECEDENT, AT THE
WRITTEN REQUEST OF THE GRANTEE, A.I.D. WILL DEPOSIT THE
GRANT IN A BANK OR BANKS DESIGNATED IN WRITING BY THE
GRANTEE PURSUANT TO SECTION 2.1(B) ABOVE.

SECTION 3.2. DATE OF DISBURSEMENT

DISBURSEMENT BY A.I.D. WILL BEL DEEMED TO OCCUR ON THE
DATE A.I.D. MAKES DEPOSIT TO THE BANK OR BANKS
DESIGNATED PURSUANT TO SECTION 3.1.

SECTION 3.3. TERMINAL DATE FOR REQUESTING DISBURSEMENT

EXCEPT AS A.I.D. MAY OTHERWISE AGREE IN WRITING, THE
TERMINAL DATE FOR REQUESTING DISBURSEMENT OF THE GRANT
SHALL BE SIX MONTHS FROM THE DATE OF THIS AGREEMENT.

ARTICLE IV

SPECIAL COVENANTS

SECTION 4.1. NO USE FOR MILITARY PURPOSES

IT IS THE UNDERSTANDING OF THE PARTIES THAT THE GRANT
WILL NOT BE USED FOR FINANCING MILITARY REQUIREMENTS OF
ANY KIND, INCLUDING THE PROCUREMENT OF COMMODITIES OR
SERVICES FOR MILITARY PURPOSES OR THE REPAYMENT OF DEBT
INCURRED FOR SUCH PROCUREMENT.

SECTION 4.2. USES OF THE GRANT

(A) THE GRANT MAY BE USED BY THE GRANTEE TO CONTRIBUTE
TO THE CAPITAL ACCOUNT OF THE LUSO AMERICAN DEVELOPMENT
FOUNDATION FOR THE SOCIAL AND ECONOMIC DEVELOPMENT OF
PORTUGAL AND STRENGTHENING PORTUGUESE - U.S. RELATIONS,
AND FOR ANY OR ALL OF THE FOLLOWING PURPOSES DETERMINED
BY THE GRANTEE TO BE NECESSARY FOR BALANCE OF PAYMENT
SUPPORT IN THE FOLLOWING ORDER OF PREFERENCE: (1)
FINANCING THE IMPORTATION OF RAW MATERIALS, INTERMEDIATE
AND CAPITAL GOODS OR SERVICES AND ESSENTIAL CONSUMER

GOODS FROM THE UNITED STATES; (2) SERVICING OF EXTERNAL DEBT OWED TO THE UNITED STATES GOVERNMENT, OTHER THAN TO REPAY U.S. FOREIGN MILITARY SALES (FMS) DEBT; (3) DEBT OWED TO MULTILATERAL DEVELOPMENT BANKS, OR TO THE INTERNATIONAL MONETARY FUND; (4) OTHER USES AS AGREED IN WRITING BY THE PARTIES.

(B) IF PORTUGAL INTENDS TO USE ANY PORTION OF THE GRANT FOR FINANCING IMPORTATION OR SERVICING EXTERNAL DEBT AS DESCRIBED IN SECTIONS 4.2(A)(1), (A)(2), OR (A)(3) ABOVE, THEN IT MAY BE NECESSARY FOR A.I.D. TO ISSUE LETTERS GIVING GUIDANCE ON OTHER NON-ALLOWABLE USES, WITH WHICH PORTUGAL AGREES TO COMPLY. FURTHERMORE, IF THE GRANT IS TO BE USED PURSUANT TO SUB-CLAUSES (A)(2) AND (A)(3), IT MAY NOT BE USED TO SERVICE DEBT WHERE IT

IS KNOWN, WITHOUT SPECIFIC REVIEW OF THE LOAN DOCUMENTATION, THAT THIS DEBT WAS INCURRED TO FINANCE NON-ALLOWABLE ITEMS, OR WHERE IT COULD HAVE BEEN REASONABLY ANTICIPATED THAT THIS DEBT MIGHT BE SERVICED IN WHOLE OR IN PART OUT OF THE GRANT.

(C) ANY INTEREST EARNED ON THE GRANT PLACED INTO THE SEPARATE ACCOUNT SHALL BE TREATED AS IF IT WERE PRINCIPAL (I.E., THE GRANT ITSELF). SHOULD THERE BE A PERIOD OF TIME BETWEEN THE DISBURSEMENT OF THE CASH TRANSFER AND ULTIMATE DISPOSITION OF THE GRANT IN THE SEPARATE ACCOUNT FOR ACTUALLY AGREED PURPOSES, IT IS AGREED THAT, IN THE INTEREST OF GOOD CASH MANAGEMENT PRINCIPLES, THE GRANTEE MAY PLACE THE GRANT IN VARIOUS LOW-RISK, NON-SPECULATIVE FINANCIAL INSTRUMENTS IN THE UNITED STATES PENDING ITS ULTIMATE USE. SUCH INTEREST-BEARING FINANCIAL INSTRUMENTS MAY INCLUDE UNITED STATES TREASURY SECURITIES, CERTIFICATES OF DEPOSIT, AND HIGH QUALITY MONEY MARKET ACCOUNTS. PRIOR TO THE TIME OF ULTIMATE DISPOSITION OF THE GRANT FOR IMPORT FINANCING, DEBT SERVICING, OR OTHER AGREED USES,

THIS SHOULD NOT BE CONVERTED TO OR EXCHANGED FOR THE CURRENCIES OF COUNTRIES OTHER THAN THE UNITED STATES OR OTHERWISE PLACED IN INTERNATIONAL FINANCIAL MARKETS. THE TEMPORARY PLACEMENT OF THE GRANT IN FINANCIAL INSTRUMENTS, OTHER THAN THOSE STIPULATED ABOVE, SHALL BE A MATTER OF CONSULTATION AND AGREEMENT BETWEEN THE TWO PARTIES.

(D) NEITHER PARTY EXPECTS THAT THE GRANT WOULD BE USED OTHER THAN FOR THE ELIGIBLE USES SET FORTH ABOVE. SHOULD THIS TURN OUT FOR WHATEVER REASONS NOT TO BE THE CASE, HOWEVER, THE GRANTEE SHALL PROMPTLY DEPOSIT, FROM ITS OWN FOREIGN EXCHANGE, A COMMENSURATE AMOUNT OF DOLLARS IN THE SEPARATE BANK ACCOUNT AND TO TREAT SUCH DEPOSIT AS PRINCIPAL UNDER THE CASH TRANSFER AGREEMENT. THAT IS TO SAY, SUCH DEPOSITS WOULD BE SPENT FOR ELIGIBLE USES AS NOTED ABOVE AND ACCOUNTING WOULD TAKE PLACE IN ACCORDANCE WITH THE PROCEDURES SET FORTH IN THE AGREEMENT.

SECTION 4.3. ACCOUNTING FOR THE GRANT

THE PARTIES AGREE ON THE FOLLOWING APPLICABLE PROCEDURES:

(A) THE GRANT WILL BE DEPOSITED TO A BANK ACCOUNT ESTABLISHED BY THE GRANTEE SOLELY FOR THE RECEIPT OF CASH TRANSFER ASSISTANCE FROM A.I.D. THE GRANT FUNDS

MAY NOT BE COMMINGLED WITH OTHER FUNDS FROM WHATEVER SOURCE PRIOR TO THEIR USE FOR ELIGIBLE PURPOSES PURSUANT TO SECTION 4.2 HEREUNDER. IN OTHER WORDS, THE DOLLARS DEPOSITED IN THE SEPARATE ACCOUNT SHOULD BE USED DIRECTLY FROM THAT ACCOUNT WITHOUT COMMINGLING WITH OTHER FOREIGN EXCHANGE ACCOUNTS.

(B) THE GRANTEE WILL MAINTAIN FINANCIAL DOCUMENTATION, BOOKS, AND RECORDS, IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND PRACTICES, CONCERNING DEPOSIT AND USE OF THE GRANT FOR A PERIOD OF THREE YEARS FROM THE DATE OF THIS AGREEMENT. WITHIN ONE YEAR OF THE DISBURSEMENT BY A.I.D. OF GRANT PROCEEDS, THE GRANTEE WILL ADVISE A.I.D. IN WRITING, WITH APPROPRIATE DETAIL, ON THE USES TO WHICH THE GRANT HAS BEEN PUT. THE DOCUMENTATION, BOOKS AND RECORDS REQUIRED HEREUNDER SHALL BE AVAILABLE FOR INSPECTION BY A.I.D. OR ANY OF ITS AUTHORIZED REPRESENTATIVES AT ALL TIMES AS A.I.D. MAY REASONABLY REQUEST FOR A PERIOD OF THREE(3) YEARS AFTER THE DATE OF FINAL DISBURSEMENT BY A.I.D. UNDER THIS AGREEMENT.

(C) FINANCIAL RECORDS SHOULD AT LEAST BE SUITABLE TO DOCUMENT THE WITHDRAWAL AND DISPOSITION OF DOLLAR FUNDS DIRECTLY FROM THE SEPARATE ACCOUNT FOR ELIGIBLE USES. THIS DOCUMENTARY EVIDENCE MIGHT, FOR EXAMPLE, TAKE THE FORM OF LETTERS OF CREDIT OR BANK STATEMENTS IN SUPPORT OF ACTUAL TRANSACTIONS FOR SPECIFIC PURPOSES. IN THE CASE OF DEBT, THIS MAY INCLUDE CENTRAL BANK AND COMMERCIAL BANK DOCUMENTS DEMONSTRATING THAT SEPARATE

ACCOUNT DOLLARS WERE TRANSFERRED TO AN ACCOUNT FOR EXTERNAL DEBT REPAYMENT, AND THAT DEBT SERVICE PAYMENTS WERE MADE WITH THOSE FUNDS. ANY QUESTION ON THE REQUIREMENTS OF ACCOUNTING SET FORTH IN THIS SECTION SHOULD BE THE SUBJECT OF CONSULTATION BETWEEN THE PARTIES.

ARTICLE V

MISCELLANEOUS

SECTION 5.1. COMMUNICATIONS

THE GRANTEE UNDERTAKES TO PROVIDE TO A.I.D. SUCH INFORMATION RELATING TO THE ECONOMIC AND FINANCIAL SITUATION AND RELATED PROBLEMS OF THE GRANTEE AS REASONABLY MAY BE REQUESTED IN WRITING BY A.I.D. ANY NOTICE, REQUEST, DOCUMENTS, OR OTHER COMMUNICATION

SUBMITTED BY EITHER PARTY TO THE OTHER UNDER THIS AGREEMENT WILL BE IN WRITING OR BY TELEGRAM OR CABLE, AND WILL BE DEEMED DULY GIVEN OR SENT WHEN DELIVERED TO SUCH PARTY AT THE FOLLOWING ADDRESS:

TO PORTUGAL: MINISTRY OF FINANCE
GOVERNMENT OF PORTUGAL
LISBON, PORTUGAL

TO U.S.: U.S. AMBASSADOR
U.S. EMBASSY
LISBON, PORTUGAL

ALL SUCH COMMUNICATION WILL BE IN ENGLISH, UNLESS THE PARTIES OTHERWISE AGREE IN WRITING. OTHER ADDRESSES MAY BE SUBSTITUTED FOR THE ABOVE UPON GIVING OF NOTICE. THE GRANTEE, IN ADDITION, WILL PROVIDE THE DIRECTOR, OFFICE OF PROJECT DEVELOPMENT, ASIA, NEAR EAST AND EUROPE (ANE/PD) BUREAU, A.I.D. WASHINGTON, D.C. 20523, WITH A

COPY OF EACH COMMUNICATION SENT TO THE U.S. EMBASSY IN LISBON.

SECTION 5.2 REPRESENTATIVES

FOR ALL PURPOSES RELEVANT TO THIS AGREEMENT, THE GRANTEE WILL BE REPRESENTED BY THE INDIVIDUAL HOLDING OR ACTING IN THE OFFICE OF MINISTER OF FINANCE AND A.I.D. WILL BE REPRESENTED BY THE U.S. AMBASSADOR, EACH OF WHOM, BY WRITTEN NOTICE, MAY DESIGNATE ADDITIONAL REPRESENTATIVES. THE NAMES OF THE REPRESENTATIVES OF THE GRANTEE, WITH SPECIMEN SIGNATURES, WILL BE PROVIDED TO A.I.D., WHICH MAY ACCEPT AS DULY AUTHORIZED AN INSTRUMENT SIGNED BY SUCH REPRESENTATIVES IN IMPLEMENTATION OF THIS AGREEMENT, UNTIL RECEIPT OF WRITTEN NOTICE OF REVOCATION OF THEIR AUTHORITY.

SECTION 5.3 AMENDMENT

THIS AGREEMENT MAY BE AMENDED BY THE EXECUTION OF WRITTEN AMENDMENTS BY THE AUTHORIZED REPRESENTATIVES OF BOTH OF THE PARTIES.

IN WITNESS WHEREOF, THE GOVERNMENT OF PORTUGAL AND THE UNITED STATES OF AMERICA, EACH ACTING THROUGH ITS DULY AUTHORIZED REPRESENTATIVES, HAVE CAUSED THIS AGREEMENT TO BE SIGNED IN THEIR NAMES AND DELIVERED AS OF THE DAY AND YEAR FIRST ABOVE WRITTEN.

FOR THE UNITED STATES OF AMERICA

U.S. AMBASSADOR

FOR THE GOVERNMENT OF PORTUGAL

MINISTER OF FINANCE

END TEXT OF AGREEMENT.

3. WE PROPOSE THAT A SEPARATE IMPLEMENTATION LETTER BE PROVIDED AND COUNTERSIGNED BY THE GOP REPRESENTATIVE IN CONJUNCTION WITH AND AT THE TIME OF SIGNATURE OF THE AGREEMENT ITSELF. THIS LETTER WILL SET FORTH THE UNDERSTANDINGS OF THE TWO GOVERNMENTS ON ANY SPLIT OF FUNDS BETWEEN THE LAIF AND OTHER AGREED-UPON USES, AND ON ACCOUNTING FOR THE USES OF THE DOLLAR PROCEEDS. THE TEXT OF THE PROPOSED IMPLEMENTATION LETTER FOLLOWS.
BEGIN TEXT

IMPLEMENTATION LETTER NO. 1
A.I.D. PROJECT NO. 150-K-616
FY 90 CASH TRANSFER

(NAME-ADDRESS)

DEAR (NAME OF REPRESENTATIVE):

THIS LETTER WILL CONFIRM AGREEMENTS MADE BY PORTUGAL AND A.I.D. UNDER THE REFERENCED GRANT AGREEMENT AND SECTION 2.1 THEREOF.

USES

WITH RESPECT TO THE THIRTY-NINE MILLION, FOUR HUNDRED TWO THOUSAND, TWO HUNDRED FORTY-EIGHT U.S. DOLLARS BEING DISBURSED UNDER THE GRANT ("U.S. DOLLAR GRANT PROCEEDS"), IT IS AGREED THAT (A) MILLION U.S. DOLLARS WILL BE CONTRIBUTED BY PORTUGAL TO THE LUSO AMERICAN DEVELOPMENT FOUNDATION ("LADF") FOR THE ECONOMIC AND SOCIAL DEVELOPMENT OF PORTUGAL AND STRENGTHENING OF PORTUGUESE-U.S. RELATIONS, AND (B) MILLION U.S. DOLLARS WILL BE USED BY PORTUGAL FOR ANY OR ALL OF THE FOLLOWING PURPOSES, AS DETERMINED BY PORTUGAL TO BE NECESSARY FOR BALANCE-OF-PAYMENT PURPOSES, IN THE FOLLOWING ORDER OF PREFERENCE: (1) FINANCING THE IMPORTATION OF RAW MATERIALS, INTERMEDIATE AND CAPITAL GOODS OR SERVICES AND ESSENTIAL CONSUMER GOODS FROM THE UNITED STATES; (2) SERVICING OF EXTERNAL DEPT OWED TO THE UNITED STATES GOVERNMENT (OTHER THAN TO REPAY U.S. FOREIGN MILITARY SALES (FMS) DEBT); (3) SERVICING OF DEBT OWED TO MULTILATERAL DEVELOPMENT BANKS OR TO THE INTERNATIONAL MONETARY FUND; AND (4) OTHER PURPOSES OR USES AS AGREED IN WRITING BETWEEN THE PARTIES.

ACCOUNTS

PORTUGAL AGREES WITH A.I.D. TO DESIGNATE A SEPARATE BANK ACCOUNT SOLELY FOR THE RECEIPT OF U.S. DOLLAR GRANT PROCEEDS. PORTUGAL FURTHER AGREES WITH A.I.D. THAT THE U.S. DOLLAR GRANT PROCEEDS, ONCE DEPOSITED, WILL BE MAINTAINED IN THE ACCOUNT UNTIL USED AND THAT IN NO EVENT WILL THEY BE COMMINGLED WITH FUNDS FROM ANY OTHER SOURCE PRIOR TO USE. ANY INTEREST EARNED ON U.S. DOLLAR GRANT PROCEEDS AFTER DEPOSIT IN THE ACCOUNT WILL BE TREATED FOR ALL PURPOSES AS THOUGH IT WERE U.S. DOLLARS BEING DISBURSED UNDER THE GRANT AND BEING MADE AVAILABLE UNDER THE GRANT AGREEMENT.

REDEPOSIT

NEITHER A.I.D. NOR PORTUGAL EXPECTS, THAT THE U.S. DOLLAR GRANT PROCEEDS WILL BE USED OTHER THAN AS AGREED UPON ABOVE. SHOULD THIS TURN OUT FOR WHATEVER REASON NOT TO BE THE CASE, A.I.D. WILL EXPECT PORTUGAL TO REDEPOSIT, FROM ITS OWN FOREIGN EXCHANGE, A COMMENSURATE AMOUNT OF U.S. DOLLARS INTO THE APPROPRIATE DESIGNATED BANK ACCOUNT AND TO TREAT SUCH REDEPOSIT AS PART OF U.S. DOLLAR GRANT PROCEEDS, WHICH IS TO SAY THAT SUCH REDEPO IT WILL BE USED AS AGREED UPON ABOVE AND ACCCOUNTING WILL TAKE PLACE AS ELABORATED BELOW.

ACCOUNTING

IN ORDER FOR A.I.D. TO COMPLY WITH RECENT LEGISLATION ON ACCOUNTING FOR CASH TRANSFER ASSISTANCE, A.I.D. EXPECTS THAT PORTUGAL WILL MAINTAIN, OR CAUSE TO BE MAINTAINED, FINANCIAL DOCUMENTATION, BOOKS AND RECORDS SUITABLE TO EVIDENCE THE DEPOSIT OF U.S. DOLLAR GRANT PROCEEDS INTO THE DESIGNATED BANK ACCOUNT AND THEIR WITHDRAWAL AND TRACKING TO LADF AND TO THE OTHER USES AGREED UPON ABOVE, AND WILL, ON REASONABLE REQUEST DU ING THE NEXT THREE (3) YEARS, MAKE AVAILABLE TO REPRESENTATIVES OF A.I.D. SUCH DOCUMENTARY EVIDENCE FOR INSPECTION. (FOR THESE AND ALL OTHER PURPOSES HEREOF, A USE OF U.S. DOLLAR GRANT PROCEEDS SHALL BE DEEMED TO OCCUR WHEN ANY PART THEREOF IS DISBURSED BY PORTUGAL FROM A DESIGNATED BANK ACCOUNT.)

WITH RESPECT TO U.S. DOLLAR GRANT PROCEEDS WHICH MAY BE USED BY PORTUGAL AS A CONTRIBUTION TO THE LUSO AMERICAN DEVELOPMENT FOUNDATION, OR FOR OTHER PURPOSES PURSUANT TO CLAUSE (B) OF THAT SECTION OF THIS LETTER ENTITLED QUOTE USES UNQUOTE, PORTUGAL WILL ADVISE A.I.D. IN WRITING WITH APPROPRIATE DETAIL AND IN A TIMELY MANNER AFTER ITS LAST USE (BUT NO LATER THAN ONE (1) YEAR AFTER THE DATE OF THE LAST DISBURSEMENT BY A.I.D. OF THE GRANT), OF THE USES TO WHICH SUCH U.S. DOLLAR GRANT PROCEEDS HAVE BEEN PUT.

AS FOR ANY U.S. DOLLAR GRANT PROCEEDS TO BE USED BY THE LUSO AMERICAN DEVELOPMENT FOUNDATION (LADF) FOR ECONOMIC AND SOCIAL DEVELOPMENT PURPOSES, A.I.D. WISHES TO BE ABLE TO VERIFY THAT THE LADF IS CARRYING OUT ITS PROGRAM AS REPRESENTED. FOR THIS PURPOSE, A.I.D. WOULD LIKE TO REVIEW THE ANNUAL REPORTS OF THE LADF AND ANY ANNUAL (OR OTHER PERIODIC) INDEPENDENT AUDITOR'S REPORTS OF LADF OPERATIONS (IF NOT OTHERWISE CONTAINED IN THE ANNUAL REPORT) DURING THE TERM OF THE GRANT AGREEMENT. THE GOVERNMENT OF PORTUGAL AGREES THAT PRIOR TO ANY CONTRIBUTION OF U.S. DOLLAR GRANT PROCEEDS BY IT TO THE LADF, IT WILL MAKE APPROPRIATE ARRANGEMENTS WITH THE LADF TO INSURE THAT A.I.D. WILL RECEIVE COPIES OF SUCH REPORTS. SHOULD A.I.D., FOLLOWING ITS REVIEW OF THE FURNISHED REPORTS, MAKE A REASONABLE REQUEST FOR ADDITIONAL INFORMATION ON LADF OPERATIONS, THE

GOVERNMENT OF PORTUGAL WILL OBTAIN THE REQUESTED INFORMATION FROM THE LADF ON BEHALF OF A.I.D.

PLEASE INDICATE YOUR CONCURRENCE BY SIGNING IN THE PLACE PROVIDED BELOW.

VERY TRULY YOURS,
AGREED AND ACCEPTED
THIS DAY OF 1990

(NAME)

(DATE)

END TEXT OF IMPLEMENTATION LETTER.

4. ITEMS PARTICULARLY TO NOTE DURING DISCUSSIONS AND NEGOTIATIONS OF DRAFT AGREEMENT WITH THE GOP INCLUDE THE FOLLOWING:

A. THE U.S. DOLLAR AMOUNT IS DOLS U.S. THIRTY-NINE

MILLION, FOUR HUNDRED TWO THOUSAND, TWO HUNDRED FORTY-EIGHT (DOLS. 39,402,248). FYI: THIS AMOUNT REPRESENTS THE DOLS. 40,175,000 ALLOCATED TO PORTUGAL UNDER THE FY 1990 APPROPRIATIONS ACT LESS A 0.43 PERCENT SEQUESTRATION APPLIED WORLDWIDE TO ALL ESF ACCOUNTS TO MEET THE PRESIDENT'S DRUG INITIATIVE PROGRAM REQUIRED UNDER THE TRANSPORTATION APPROPRIATIONS BILL FOR FY 1990, LESS DOLS. 600,000 RESERVED FOR TECHNICAL ASSISTANCE IN CONJUNCTION WITH THE HOUSING GUARANTY PROGRAM. END FYI.

B. SECTION 4.2(A) OF THE DRAFT AGREEMENT WOULD PERMIT PORTUGAL TO USE THE CASH TRANSFER AS A CONTRIBUTION TO THE LUSO AMERICAN DEVELOPMENT FOUNDATION (LADF). IT MAY ALSO BE USED FOR NON-MILITARY DEBT SERVICE PAYMENTS IN ADDITION TO FINANCING IMPORTATION OF SPECIFIED GOODS

FROM THE U.S.. PLEASE NOTE, HOWEVER, THAT THERE IS AN ORDER OF PREFERENCE WITH RESPECT TO FUNDS USED FOR BALANCE OF PAYMENTS PURPOSES, FIRST FOR IMPORTS FROM THE UNITED STATES, SECOND, FOR BILATERAL DEBT OWED TO THE UNITED STATES, AND THEN FOR PORTUGUESE OFFICIAL DEBT OWED TO MULTILATERAL DEVELOPMENT BANKS OR THE IMF. INCLUSION OF PROVISIONS WHICH ALLOW THE GOVERNMENT OF PORTUGAL TO USE THE CASH TRANSFER TO PAY FOR DEBT SERVICE TRANSACTIONS ARE BEING JUSTIFIED IN THE PAAD. THE PROVISION TO PAY DEBT OWED TO MULTILATERAL DEVELOPMENT BANKS AND THE IMF REQUIRES SPECIFIC CONCURRENCE OF AA/ANE PER AID'S ESF CASH TRANSFERS - AMPLIFIED POLICY GUIDANCE.

PLEASE NOTE THAT IF PAAD IS APPROVED WITH DEBT SERVICE FINANCING PROVISIONS INCLUDED, NON-MILITARY BILATERAL DEBT TO U.S. GOVERNMENT WILL, NEVERTHELESS, TAKE PRECEDENCE OVER PAYMENT OF DEBT TO MULTILATERAL INSTITUTIONS. WE WOULD EXPECT GOP TO GIVE PRIORITY TO MEETING SUCH OBLIGATIONS WITHIN THE NORMAL CONFINES OF GOOD MANAGEMENT OF FOREIGN EXCHANGE FLOWS/RESERVES.

C. WITH RESPECT TO SECTION 4.2(A)(4), IF IT SHOULD BE DETERMINED THAT PORTUGAL MAY NOT BE ABLE TO UTILIZE THAT PORTION OF THE GRANT RESERVED FOR BALANCE OF PAYMENTS PURPOSES IN A REASONABLE PERIOD OF TIME AND KEEP WITHIN THE ELIGIBLE USES AS DEFINED IN SECTIONS 4.2(A-C) OF THE DRAFT AGREEMENT, A.I.D. COULD CONSIDER A REQUEST, EITHER AT THIS TIME, OR SUBSEQUENT TO THE SIGNING OF THE AGREEMENT, AND SUPPORTED BY APPROPRIATE INFORMATION AND JUSTIFICATION, TO FURTHER EXPAND ELIGIBLE CATEGORIES OF USES OF THE GRANT CONSISTENT WITH A.I.D.'S POLICY ON USE

OF CASH TRANSFERS. FOR EXAMPLE, AA/ANE COULD BE REQUESTED TO AUTHORIZE PAYMENT OF PORTUGAL'S OFFICIAL DEBT TO U.S. PRIVATE SECTOR ENTITIES.

D. SINCE THE AGREEMENT WOULD PERMIT GRANT DOLLARS TO BE USED FOR PURCHASE OF IMPORTED GOODS, A PROJECT IMPLEMENTATION LETTER WHICH CLEARLY DEFINES NON-ALLOWABLE ITEMS WILL NEED TO BE SENT. THIS IS ALSO COVERED BY SECTIONS 4.1 AND 4.2(A)(1) OF THE AGREEMENT. THIS IMPLEMENTATION LETTER WILL NOT REQUIRE GOP COUNTER-SIGNATURES.

E. SIMILARLY, SINCE THE AGREEMENT WOULD PERMIT GRANT DOLLARS TO BE USED TO PAY BACK DEBT, PARTICULAR ATTENTION MUST BE PAID TO GUIDANCE ON THE PROHIBITION OF FINANCING ITEMS WITH SPECIFIC LEGAL PROHIBITIONS, E.G., ABORTION EQUIPMENT, WHICH WILL BE SPELLED OUT IN SUBSEQUENT IMPLEMENTATION LETTERS(S). THIS IS IN ADDITION TO PRECLUSION OF DEBT FOR MILITARY ITEMS. SECTIONS 4.1, 4.2(A)(2-3), AND 4.2 (B) OF THE AGREEMENT TEXT COVER THIS PROBLEM.

THE TEXT OF SUCH A PROPOSED IMPLEMENTATION LETTER FOLLOWS: BEGIN TEXT.

IMPLEMENTATION LETTER NO. 2
A.I.D. PROJECT NO. 150-K-616
FY 90 CASH TRANSFER

(NAME-ADDRESS)

DEAR (NAME OF REPRESENTATIVE):

THE PURPOSE OF THIS LETTER IS TO PROVIDE ADDITIONAL INFORMATION TO ASSIST THE GOVERNMENT OF PORTUGAL IN IMPLEMENTING THE GRANT AGREEMENT SIGNED WITH THE UNITED STATES ON (DATE), 1990. THIS INFORMATION FURTHER DEFINES NON-ALLOWABLE USES OF GRANT DOLLARS, IN ADDITION TO THE PROVISION CONTAINED IN ARTICLE IV, SECTION 4.1. WHICH PROHIBITS THEIR USE FOR MILITARY PURPOSES. THE SECTIONS OF THE AGREEMENT WHICH WE WISH TO ELABORATE, AND THE GUIDANCE PERTAINING TO EACH OF THESE FOLLOWS:

ARTICLE IV, SECTION 4.2 (A)(1) - IF THE GOVERNMENT OF PORTUGAL INTENDS TO USE ANY OR ALL OF THE GRANT DOLLARS TO FINANCE IMPORTS FROM THE UNITED STATES AS PROVIDED FOR BY THIS SECTION, THESE FUNDS MAY NOT BE USED FOR FINANCING ANY OF THE FOLLOWING: SURVEILLANCE EQUIPMENT;

ABORTION EQUIPMENT AND SERVICES; LUXURY GOODS AND GAMBLING EQUIPMENT; COMMODITIES AND SERVICES FOR SUPPORT OF POLICE OR OTHER LAW ENFORCEMENT ACTIVITIES; OR WEATHER MODIFICATION EQUIPMENT. THIS SAME PROVISION WOULD ALSO APPLY IF THE UNITED STATES WERE TO AGREE IN WRITING TO OTHER USES, INCLUDING IMPORTS FROM OTHER COUNTRIES, AS PROVIDED FOR UNDER ARTICLE IV, SECTION 4.2. (4).

I CALL TO YOUR ATTENTION, ARTICLE IV, SECTION 4.2 (D) OF THE AGREEMENT WHICH WOULD REQUIRE THAT ANY GRANT DOLLARS USED FOR OTHER THAN ELIGIBLE USES BE REDEPOSITED BY THE GOVERNMENT OF PORTUGAL INTO THE SPECIAL ACCOUNT ESTABLISHED PURSUANT TO ARTICLE IV, SECTION 4.3.

-IF YOUR GOVERNMENT HAS ANY QUESTIONS CONCERNING THE ELIGIBILITY OF ANY PROPOSED IMPORT ITEM OF DEBT SERVICE PAYMENT, WHICH WOULD BE MADE WITH THE GRANT DOLLARS PROVIDED UNDER THIS PROJECT, I INVITE YOU TO CONSULT WITH ME OR MY STAFF SO THAT WE CAN PROVIDE FURTHER DETAIL OR CLARIFICATION.

(EMBASSY MAY PROVIDE APPROPRIATE CLOSING REMARKS.)

END TEXT.

5. WITH RESPECT TO PROCEDURES FOR DISBURSEMENT, THE FOLLOWING APPLY:

AID/W MUST BE ADVISED BY USAID/LISBON THAT GOP HAS MET CONDITIONS PRECEDENT SPECIFIED IN ARTICLE II, SECTION 2.1 OF THE GRANT AGREEMENT. IMMEDIATELY UPON RECEIPT OF SUCH ADVICE, AID/W CAN ISSUE NOTIFICATION (UNDER ART. II, SEC. 2.2) TO GOP/USAID, VIA CABLED IMPLEMENTATION LETTER (WITH COPY TO GOP MOF AS PER ART. V, SEC. 5.1) THAT GOP CAN FORMALLY REQUEST (UNDER ART. III, SEC. 3.1) DISBURSEMENT OF FUNDS. DISBURSEMENT USUALLY OCCURS WITHIN TWO WORKING DAYS AFTER AID/W RECEIVES GOP'S FORMAL REQUEST. THIS PROCESS CAN BE EXPEDITED BY ONE OR ALL OF THE FOLLOWING MEANS: (1) GOP CAN INCLUDE REQUEST FOR DISBURSEMENT OF CASH TRANSFER WITH DOCUMENTS REQUIRED TO MEET CONDITIONS PRECEDENT (UNDER ART. II, SEC. 2.1), AND WE WILL WORD IMPLEMENTATION LETTER (CABLE) TO DEAL WITH SEQUENCING OF THESE STEPS; (2) ALTERNATIVELY, GOP CAN DESIGNATE (UNDER ART. V, SEC. 5.2) THEIR AMBASSADOR TO THE U.S., OR OTHER SENIOR EMBASSY OFFICIAL, TO REPRESENT THE GOP FOR PURPOSES OF SIGNING AGREEMENT IN WASHINGTON, FURNISHING CONDITIONS

PRECEDENT DOCUMENTS, AND REQUESTING DISBURSEMENT. THIS SECOND OPTION ASSUMES SIGNATURE OF THE AGREEMENT BY AN APPROPRIATE A.I.D. OFFICIAL IN WASHINGTON.

IN ADDITION TO INFORMATION CONCERNING GOP COMPLIANCE WITH CPS, FM REQUIRES INFORMATION PERTAINING TO USE/MANAGEMENT OF SPECIAL ACCOUNT AS BASIS FOR DISBURSING. SEE CABLE REFERENCE PROVIDED IN CONJUNCTION WITH FY 89 GUIDANCE. SUCH INFORMATION CAN BE PROVIDED AT THE TIME USAID NOTIFIES AID/W THAT CPS HAVE BEEN MET, OR IN ADVANCE, TO HELP EXPEDITE DISBURSEMENT.

6. IN ORDER TO ASSURE COORDINATION OF ALL ACTIONS REQUIRED TO APPROVE PAAD AND AUTHORIZE DISBURSEMENT, REQUEST MISSION SLUG ALL CABLES FOR ANE/PD ACTION. CABLES PROVIDING INFORMATION ON CPS AND USE/MANAGEMENT OF SPECIAL ACCOUNT AS REQUESTED PARA. 5 ABOVE SHOULD ALSO INCLUDE SLUG FOR INFORMATION COPY TO FM.

7. PLEASE DO NOT HESITATE TO BE IN TOUCH WITH JOAN SILVER (PHONE 202 - 647-8965) OR TOM JOHNSON (202 - 647-6905) ON ANY QUESTIONS YOU OR THE GOP MAY HAVE ON TEXT OF THE AGREEMENT OR DISBURSEMENT PROCEDURES, OR WITH AID DESK OFFICER CHRISTINE ADAMCZYK (202 -

647-7654) ON OTHER ISSUES. BAKER
BT
#0449

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