

UNCLASSIFIED

PN-ACZ-748

MSPSG - ICA - 26
March 7, 1957

MUTUAL SECURITY PROGRAM
FY 58 CONGRESSIONAL PRESENTATION

MEMORANDUM FOR MSP STUDIES GROUP - ICA

FROM: Office of the Assistant to the Director for
Congressional Presentation

RE : Report -- On-the-Spot Survey in Portugal, Spain, France, Italy,
The United Kingdom and on NATO (by former Ambassador
Jefferson Caffery)

Attached is the agreed I C A position paper on the above report.

DECLASSIFIED ON 11/13/81
BY Cowell SEA/MD/CRM
AUTHORITY: EO 12065 & para 923, Uniform Security
Regulations

ATTACHMENT

~~CONFIDENTIAL~~
UNCLASSIFIED

BEST AVAILABLE

ICA Staff Review of
Special Senate Committee Studies of Foreign Aid

Report by Jefferson Caffery

Mr. Caffery reported on France, Italy, Portugal, Post-Suez United Kingdom, NATO and Spain. Separate memoranda on his country reports follow below. This comment is on his cover note, and his report on NATO.

Cover Note

The brief cover note contains no explicit recommendations. Implicitly, it recommends:

- (a) continued U.S. support of NATO, as a keystone of U.S. security;
- (b) continued selected U.S. action (as indicated in the country reports) to promote European economic strength, in order to prevent NATO collapse and to bolster the U.S. economy;
- (c) that, in view of the Suez crisis, we may in the future be obliged to reassess the economic and military situation in Italy, France, UK, Portugal and Spain.

Ambassador Caffery concludes that the aid program has in general been efficiently administered and worthwhile. "Without such aid, there exists the real possibility that the Iron Curtain would now be on the shores of the Atlantic."

The views expressed in (a) and (b) above are in full support of administration policy. With respect to the suggestion in (c) above, it should be pointed out that consequences of the Suez operation are not the only reason, and may not be the most important reason, that a reassessment of U.S. aid policies in Europe will be required in the future. It should be noted that pursuant to U.S. policy to support a strong and effective NATO military effort, as endorsed by the report, the need to modernize NATO forces to provide a dual capability to deal effectively not only with a major atomic aggression but also with local incidents and incursions of a non-atomic

ICA Staff Review of -2-
Special Senate Committee Studies of Foreign Aid

character, and to provide the modern weapons systems as well as to maintain the necessary conventional strength necessary for this dual capability, in the light of current political, psychological and economic conditions in Europe, may well require that U.S. aid policies toward its NATO allies, (e.g. the UK) be reviewed and possibly revised in the not too distant future. As is clearly implied in a number of the country sections of the report, it is possible that such a review will indicate upward revisions in U.S. aid levels.

NATO

This one page report recommends:

- (a) as in the cover note, continued U.S. support of NATO, as a keystone of U.S. security;
- (b) maintenance of maximum NATO retaliatory strength to increase deterrents to aggression;
- (c) greater political consultation and more agreement among member countries, to provide greater sense of participation by member peoples and thus strengthen NATO. While of importance, this need is stated to be minor in relation to the importance of maintaining NATO's military strength."

Administration policy supports all three recommendations. State can elaborate Administration support of efforts to implement recommendations of NATO's "Committee of Three" to further the purposes of recommendation (c) above. With respect to the relative importance of increasing NATO political consultation as opposed to maintaining its defensive military strength, as noted in (c) above, it should be pointed out that, in the last analysis, the ability to build and maintain a strong, effective and mutual NATO military effort depends upon the political cohesion and identity of interest of the members of the alliance. The possible future implications for U.S. aid programs

CONT'D.

-3-

of building and maintaining NATO military strength have been noted above. In addition, it may be noted that the emphasis placed in this section of the report on the importance to the U.S. of maintaining NATO military strength may not, over the long run, be consistent with the various specific recommendations made in the country reports as to the nature and size of future U.S. military aid programs; i.e., the limited types of aid recommended may prove to be insufficient to achieve this objective. It is believed, however, that the acknowledgment in the report of a possible need for a "new look" in the future covers this point.

JA:gej:O/AFE/P
February 28, 1957

ICA Staff Review of
Special Senate Committees on Foreign Aid

Caffery Report on France

I. Recommendations and Comments

A. Recommendation:

Opposed to any additional economic aid at this time.

Comment:

No additional economic aid under MSP is contemplated at this time, although it may prove to be desirable as an immediate step to try to be of assistance to France by approving appropriate Export-Import Bank loans if necessary to avoid serious economic setbacks.

B. Recommendation:

Opposed to further offshore procurement except in unusual circumstances such as a) clearly established military justification, b) where there are genuine cases of economy or c) where there are special political problems.

Comment:

Amounts available in FY 1957 and proposed for FY 1958 for OSP worldwide are extremely limited in comparison with amounts available in former years. However, both from a purely economic point of view and in relation to the military budgetary problem, it should be noted that OSP could be a useful means of alleviating strain on the French economic position, particularly the dollar balance of payments problem which in part results from French military purchases in the U.S. in support of its North African policies. The latter may be expected to continue from the French point of view, to take priority, in the allocation of scarce resources, over French support of the NATO effort. As in the case of the recommendation on military end-item aid, the recommendation on OSP must be presumed to be subject to proviso that a reassessment may be required in the near future.

(Caffery Report on France, cont.) - 2 -

From an economic point of view, OSP could be quite helpful in alleviating strains on the French economic position resulting from the closing of the Suez Canal and other factors.

C. Recommendation:

Continue the ICA-financed and supervised labor technical exchange program for several years.

Comment:

Plans have been made to implement a FY 57 bilateral technical exchange program in the labor field with a value of \$150,000 and to request funds in the same amount for FY 58.

D. Recommendation:

At this time no new aid allocations in support of the military budget should be made.

Comment:

Currently planned programs do not contemplate a resumption of this type aid. However, the various factors which may affect the size and nature of future military end-item and OSP programs to France, as noted above, may also indicate that consideration should be given to the question of whether a resumption of this type of aid might be in the U.S. interest in the future and under certain circumstances.

E. Recommendation:

Continuation of the agricultural sales programs.

Comment:

During FY 57 triangular trade sales program under Section 402 Mutual Security Act will be implemented. Continuation during FY 58 and future years will depend in large part upon legislative requirements with respect to use of MSP funds to finance the sale of surplus agricultural commodities. Triangular trade

(Caffery Report on France, cont.) - 3 -

transactions will probably not be undertaken in the future unless, given legislative requirements, it appears unlikely that sufficient quantities of surplus commodities can be moved directly to aid-receiving countries.

PL 480 sales have been very small and prospects for increase are not encouraging in view of the fact that France is a net exporter of at least some major items such as wheat.

F. Recommendation:

Continuation of military end-item aid in the form of certain modern weapons and limited amounts of spares and replacement parts for equipment not produced in France.

Comment:

This recommendation is consistent with presently planned MAP programs for FY 1957 and FY 1958. The report amply acknowledges the importance of France to the NATO defense effort and the essential role of French forces in the NATO shield and of installations in France to NATO air defense. The question of the level and nature of U.S. military aid to France, however, must be considered in relation to the overall economic situation in France and in relation to the military requirements for modernizing and effectively maintaining French NATO forces. Costs of the latter are likely to increase steadily whereas the resources available under the former may well decrease. It is the opinion of Embassy France that as the French economic crisis heightens, France will seek relief, in the first instance, through a reduction in its defense contributions under NATO. It is possible, therefore, that the limited forms of military assistance recommended in the report may, as events develop, prove inadequate to support the over-riding U.S. objective, also endorsed by the report, of a strong and effective NATO military effort.

(Caffery Report on France, cont.) - 4 -

G. Recommendation:

The French should be urged to take forthright action designed to bring the economic position into balance.

Comment:

This will be the line taken by U.S. representatives at the OEEC Ministerial meeting in February 1957, and by U.S. Executive agencies in further communications with the French.

In this connection, however, the following comment from the Report should be noted, "Aside from the possibility that France might join a common market and the encouraging evidence of increased productivity in certain areas, there seems at this time little prospect of France taking the vigorous steps needed to achieve a more competitive economy."

II. Implications for ICA Programs

The report recognizes quite clearly that France has serious economic problems brought about in large part by its obligations in North Africa and increased by the Suez crisis. Although no economic aid is recommended at this time, it is agreed that prospective deterioration of the French situation may require the U.S. to take a new look and possibly to reconsider its position on the aid question. To the extent that the situation does in fact deteriorate - and in our judgment France will be in serious economic difficulties by mid-summer 1957 - ICA may be involved in new operational problems and responsibilities relating to recommendations for and administration of bilateral aid programs.

O/AFE-WE:LBM
2/28/57

ICA Staff Review of
Special Senate Committees on Foreign Aid

Caffery Report on Italy

I. Recommendations and Comments

A. Recommendation:

No direct economic grant aid at this juncture.

Comment:

No direct economic grant aid to Italy is presently being planned.

B. Recommendation:

Appropriate loans out of counterpart funds, technical assistance for economic development and encouragement of private investment can be recommended.

Comment:

Counterpart programs will, in fact, continue as well as bilateral technical assistance in the labor field. No plans exist for loans involving the use of new Mutual Security funds.

C. Recommendation:

Continue sales and other programs under Titles I, II, and III of PL 480.

Comment:

As is acknowledged in the report, sales and deliveries under the various titles of PL 480 are an important and necessary source of aid for Italy and they are expected to continue.

D. Recommendation:

The USOM should be phased-out and its work integrated with the Economic Section of the Embassy.

Comment:

The USOM as such will be closed-out by the end of February 1957. A small ICA staff will remain with the Embassy to handle continuing ICA responsibilities connected with counterpart programs, bilateral technical exchange programs in the labor field, and the administration of PL 480 programs.

(Caffery Report on Italy, cont.) - 2 -

E. Recommendation:

"I do not recommend at this time aid allocations to the Italian Military Budget."

Comment:

No aid of this type is currently planned. However, comment under the similar Recommendation on France would apply equally here.

F. Recommendation:

That we continue to program certain selective end-item military aid for Italy, notably in the form now of dual purpose weapons (not including nuclear war-heads), plus certain limited amounts of spares for equipment not produced in Italy, and a continuation of the present limited program of maintenance assistance.

Comment:

The recommendation is consistent with current planning for FY 1957 and FY 1958 MAP programs. However, as in the case of other European NATO countries, the extent to which the economic and political capabilities of Italy will permit an expansion of its defense effort sufficient to meet the requirements of maintaining effective conventional forces as well as the costs of absorbing, maintaining and utilizing highly technical and expensive new weapons systems is open to question. Furthermore, Italy is extremely anxious to develop a production capability for new weapons, and the U.S. has encouraged this interest. Whether Italy can undertake such production on a significant scale without outside financial assistance or whether Italian financing can be achieved only at the expense of foregoing other activities, the continuation of which might be more in the U.S. overall interests, are questions which will have to be considered in planning the nature and level of future U.S. military assistance to Italy.

(Caffery Report on Italy, cont.) - 3 -

II. Implication for ICA Programs

In recommending continuation of, inter alia, Title I PL 480 sales programs, deals under Title II, counterpart programs, and of the bilateral technical exchange program in the labor field, the report virtually ignores ICA responsibilities connected with these operations and the associated need for ICA personnel. For example, loans under Section 104(g), PL 480 deriving from sales programs already approved will total \$82 million local currency equivalent. By Executive Branch Decision it will be necessary to participate in considerable detail in review and approval of PL 480 loans for economic development. Moreover, ICA representation is also required in the review and approval of recommended continuing activities on the various counterpart programs. In fact, of course, this situation has been recognized as noted previously. ICA has made arrangements to leave ICA personnel in the Embassy in Rome following the abolition of the USOM as such.

Thus, the overall implication of the Caffery report is to approve actual economic programs in Italy.

O/AFE-WE:LBM
2/28/57

ICA Staff Review of
Special Senate Committees on Foreign Aid

Caffery Report on Portugal

I. Recommendations and Comments

A. Recommendation:

The report recommends no changes in "objectives, type or magnitude" of present aid programs in Portugal. It recommends that the end-item program include dual-purpose weapons but not nuclear warheads.

Comment:

Although Portugal certainly possesses the economic capability for maintenance of more MDAP equipment than it is now receiving, its extremely conservative fiscal policy makes it doubtful that defense expenditures would be increased sufficiently to support a major program increase including modern weapons. Defense expenditures are now only 4.3 percent of GNP.

Nevertheless, the nature and extent of U.S. security interests vis-a-vis Portugal, especially in respect to U.S. base rights, may lead the U.S. to undertake military assistance programs which are not only beyond the economic and political capabilities of Portugal but possibly even in excess of that indicated from a strictly military requirements point of view, (e.g. advanced weapons systems), in order to maintain or extend our base rights.

II. Implications for ICA Programs

None.

ICA Staff Review of
Special Senate Committees on Foreign Aid

Caffery Report on Spain

I. Recommendations and Comments

A. Recommendation:

Continuance of the present program in Spain for military end-item equipment and related spare parts, as well as the Defense Support Program and the Program of U.S. Agricultural Sales and Grants under Public Law 480.

Comment:

U.S. policy with respect to type and level of future U.S. assistance, both military and economic, to Spain is currently under review. While it is safe to assume that military assistance will be continued in the future in view of the U.S. interest in the defense of the Iberian peninsula including the important U.S. base complex there and the mission of Spanish forces, especially the air force, in this defense, the relative emphasis to be placed on military as opposed to economic aid and the nature and timing of the former (e.g. as between further build-up or continued maintenance or both) has not yet been determined. Obviously, Spanish desires in these respects will have an important bearing on future U.S. programs since an over-riding objective of U.S. assistance is the establishment and maintenance of a cooperative Spanish attitude toward the U.S. base construction program.

B. Recommendation:

The special request for \$30,000,000 additional defense support assistance for FY 1957 be granted. "However, we should insist that the Spanish Government make serious efforts to control inflation."

Comment:

ICA has signified its willingness to discuss an increase of \$25,000,000 in FY 1957 Defense Support to Spain if the Spanish Government is prepared to undertake appropriate monetary and fiscal measures to curb inflation. Such measures might

(Caffery Report on Spain, cont.) - 2 -

include reduction in both ordinary and extraordinary budget expenditures, increase in consumption taxes and selective credit restrictions. Spain has already reimposed direct price controls and has increased the bank rate.

C. Recommendation:

Included in the recommendation section is a statement attributed to the country team protesting normal requirements for PL 480 sales. The report presents no direct recommendation on this point but the inclusion of the statement in this section would imply acceptance of it as a valid complaint.

Comment:

It should be pointed out to the Special Committee that normal marketing requirements are furnished by the Department of Agriculture in consultation with other agencies, in compliance with the law.

II. Implication for ICA Programs

A. General U.S. Economic Objectives:

The report indicates that keeping "the Spanish economy on an even keel" is a present U.S. objective in Spain. This is not an NSC objective and obviously could not be undertaken as a commitment unless the aid program were greatly expanded. We can only hope to do what we are now doing, that is to attempt to influence the Government of Spain to pursue appropriate stabilizing actions by offering aid contingent upon them.

The report tends to give Spain more excuse of delay on the subject of provision of foreign exchange for remittance of capital and earnings of foreign investors than the Spanish situation may warrant. The figure for blocked pesetas awaiting repatriation is three times that of any previous estimate. Though previous estimates were probably misleading as the existence of blocking of accounts undoubtedly affected investors' propensity to reinvest, we believe the figure given in the report to be much too large.

(Caffery Report on Spain, cont.) - 3 -

The report also states that few applications for guarantees of investment other than patents have been received. This is not surprising. The fact is that such applications tapered off sharply after refusal by the Spanish Government to give convertibility guarantees to any of the rush of applicants coming in immediately after the signature of the 1953 agreements.

We believe the U.S. should continue to press for an early solution to these problems.

B. The Defense Support Program:

One important aspect of the U.S. defense support program to Spain is nowhere mentioned in the report; viz. that 60 percent of the local currency generated by U.S. commodity assistance is used by the U.S. to meet the local costs of U.S. base construction programs in Spain. A further 10 percent is retained for general U.S. uses in Spain.

Comments were made relative to programs in the following fields:

(1) Agriculture: The report is favorable to all agricultural programs recently approved in Spain. There are indications in the report that they would not look with favor on extending these to aiding in the production of sensitive commodities, specifically singling out Spanish wheat production for criticism.

(2) Industry and Mining: The report favors programs in those industries in which we have concentrated, electric power, cement and steel. It is significant to note that it favors development in such sensitive fields as coal mining and nitrogenous fertilizer production. The last is inconsistent with the policy of disapproving programs aiding the expansion of production abroad of agricultural commodities now in U.S. surplus.

(Caffery Report on Spain, cont.) - 4 -

(3) Transportation and Communications: The attitude of the report toward assistance to Spanish railroads is not entirely clear. On the one hand, it recommends (p.11) that the present inadequate level of rail transport be merely maintained and not improved "until there is a firm basis for economic growth." At the same time, the report (p.8) acknowledges the significance to the U.S., from a military point of view, of procurement of rail transportation and telecommunication systems, and, further, on p.10, the retarding effect of the present transportation system on economic development and a competitive export position is directly recognized. Both in view of the military aspects of the transportation system and because it is believed that adequate transportation facilities are themselves an indispensable part of the "firm basis for economic growth," the assistance program to Spain has included considerable assistance to Spanish railroads.

C. The PL 480 Program:

Title I sales are noted in the report as having been of great help in reducing inflationary pressures and continuance is strongly urged on this basis. While Title I sales may serve the indicated purpose, it should be recognized that the nature and objectives of the sales programs limits U.S. flexibility in timing PL 480 shipments to counter inflation.

The report is favorable to Title III voluntary agency programs.

O/AFE:WE:SL
2/28/57

ICA Staff Review of
Special Senate Committees on Foreign Aid

Caffery Report on United Kingdom

I. Recommendations and Comments

A. Recommendation:

No new direct military or economic grant aid to the United Kingdom at this juncture.

Comment:

The only new grant aid to the U.K. presently under consideration from FY 1957 programs consists of Facilities Assistance and Mutual weapons Development programs totalling about \$50 million. The dollar value of programs planned for FY 1958 is not yet available to ICA. No military end-item aid or direct economic grant assistance is presently planned for those years.

The conclusion of the report to the effect that the situation in the U.K. requires careful watching and that closer U.S. and U.K. cooperation in advanced weapons development is needed are endorsed. Steps have recently been taken in the latter direction and study is being given to the effect of the proposed U.K. defense cuts on U.S. security interests with a view to determining, inter alia, the implications of these actions on future U.S. military and economic aid programs.

If it should be determined that the current U.K. situation and the proposed U.K. defense retrenchment pose a serious threat to the NATO defense effort and U.S. security interests sufficient to warrant further U.S. assistance to the U.K., a number of considerations are relevant. Contemplated U.K. defense cutbacks are designed as much to relieve manpower shortages as burdens on the economy, including the foreign exchange position. Any transfer of defense production burdens to the United States by a U.S. policy of new grant aid for weapons should free up manpower for U.K. export industries, thereby contributing to the solution of their difficulties as well as alleviating the financial burdens of defense upon the British budget, industry, and

the foreign exchange position.

B. Recommendation:

Continue to program military hardware in the form of dual purpose weapons, not including warhead at this juncture.

Comment:

This recommendation appears to be at variance with the first recommendation noted above. Since it is most unlikely that such an obvious inconsistency is intentional, this recommendation may refer to the utilization of U.S. assistance funds now in the pipeline but, for various reasons, now available for reprogramming. If so, active consideration is being given at the moment to the disposition of such funds (approximately \$120 million of so-called Plan K funds) for a number of purposes including the one here recommended. In this connection, however, it should be noted that the costs, both initial and continuing, of establishing and maintaining an effective dual capability in the U.K., including substantial amounts of advanced weapons, cannot, by any means, be met with the limited funds available for reprogramming in the U.K. Embarking on a program such as is here recommended would therefore imply either a substantial increase in expenditures for this purpose by the U.K. (possibly offset to some degree by saving elsewhere in their defense budget), or U.S. assistance beyond funds currently available.

C. Recommendation:

Continue a program of financing the export of surplus agricultural commodities.

Comment:

A modest P.L. 480 program for the U.K. is possible. A really large scale program would encounter difficulty from U.K. insistence on (1) preserving the trade position of its colonial and commonwealth suppliers and (2) the U.S. using the local currency derived from such sales in U.K. for housing for temporary use of U.S.

troops, for U.K. defense production support, or for the shipment of pre-agreed U.K. items to be purchased with such U.S.-owned local currency to pre-agreed third countries in which the U.K. has a significant political, military, or economic interest.

D. Recommendation:

Waive interest payments (\$81.6 million) due on the Anglo-American Financial Agreement.

Comment:

This recommendation should be commented on by Treasury. This recommendation does not seem to be consistent with the recommended withholding of grant aid to the U.K. at this time. The relief to the U.K. afforded by a complete waiver, as distinguished from a mere postponement of payment, would be most helpful at the present juncture, but this would be tantamount to an equivalent grant of aid to the U.K.

E. Recommendation:

At a future date, a new look at the economic and military aspects of the U.K. situation may be required.

Comment:

As noted above, the situation in the U.K. is subject to continuing scrutiny.

II. Implication for ICA Programs

The situation in the U.K. has not, as yet, led to any decision which would affect the FY 1957 or planned FY 1958 MSP. However, the possibility that current plans will have to be revised and/or that planning for FY 1959 and subsequent years may include provisions for assistance to the U.K. cannot be ruled out.

O/AFE-GWS:at
3/1/57