~~01~~ 2 Part. A

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Begins: 30/7/80.
Ends: 14/4/81.

PO -CH /GH/0082

PART A

Chancellor's (Howe) Papers):

VISIT OF MEXICAN FINANCE MINISTER APRIL 1981

Disposal Directions: 25 Years

26/7/95.

PART A

30/7/80.

SIR KENNETH COUZENS

cc Sir Douglas Wass
Mr Hancock
Mrs Hedley-Miller
Mr Lavelle
Mr Mountfield
Mr Turnbull
Mr Hawtin
Miss Baker

Mr Bayne (FCO)
Mr Ewbank (Bank of England)
Mr Coltman (HM Embassy, Mexico City)

MEXICO: 20-24 JULY 1980

After my visit to Washington for the last meeting of the Task Force on Private Foreign Investment (I shall be letting you have a note later about this bizarre affair), I spent three working days in Mexico City last week. The suggestion that I might visit there had originated with Bernardo Sepulveda of the Mexican Ministry of Finance, one of my colleagues in the Task Force, and he and the Embassy had arranged a full programme, including talks with the Deputy Ministers at the Ministries of Finance, Industry, Commerce and Planning and the Budget, a Deputy Director of the Bank of Mexico, the Finance Director of PEMEX, and the Deputy Minister for Economic Affairs at the Ministry of Foreign Affairs. The Embassy, to whom my great thanks are due for their help during my visit, will be producing notes of the main points which arose during these meetings. Here I record some general impressions.

2. I last visited Mexico City in 1952, and liked it very much. Nowadays it is not an appealing place. With its desolate urban sprawl, dense traffic, smog and sharp contrasts between opulence and squalor, it seemed like some grim parody of Los Angeles - without the freeways. But if the environment was unattractive, the people I met were very friendly, and prepared to talk informally and freely. (In the Ministry of Foreign Affairs, where there was a certain amount of North/Southery on fairly predictable lines, the discussions were perhaps a bit more formal than elsewhere.) I formed the distinct impression too that the

nior people in the Mexican Economic Ministries are of a very high standard. They evidently know each other well, and work closely together, notwithstanding evident differences of view between them. They all appear to be in some sense the President's men, in that they depend on him for their present offices, in which the next President (to be elected in 1982) might or might not confirm them.

3. I was also struck by their evident interest in and knowledge of the UK. Many of the people I met had connections of one kind or another with this country - having themselves been at, or had children at, UK universities, or having recently visited here. The Deputy Minister of Finance, Silva Herzog, had, for example, just been in the UK with a Mexican Parliamentary Delegation. He had had HMG's economic policies expounded to him and evidently been impressed - especially with our public expenditure cuts; he mentioned these almost with awe.

The Mexican Economy

4. This is clearly a good time to be visiting Mexico. Oil is opening up tremendous possibilities. In addition to the oil, Mexico has great mineral wealth. There is a great deal of debate about the best way forward. But the problems are enormous. When I last visited Mexico the population was I suppose around 30 million. In 1960 it was 35 million. It is now 70 million. Various figures are given for possible population levels by the year 2000. None are lower than 100 million, and one figure goes as high as 140 million. The Government are making efforts at population control, but as in all developing countries, it is an uphill struggle. The exploding population, the already high rates of un- and under-employment, and a widespread expectation that the new oil wealth will be used to alleviate poverty quickly mean that the overriding priorities in economic policy are growth and employment creation. 8% growth and the creation of 700,000 new jobs a year are envisaged under the National Development Plan. One suspects that some Mexicans would like to be even more ambitious.

5. Everyone admitted his fear of inflation, now nearly 30%, but no-one seemed to give much priority to anti-inflationary policies. There are no monetary targets and apparently no serious attempt to control the growth of the money supply, now running at over 30%; as

the Central Bank put it, when you have a public sector deficit as large as Mexico's, it is not possible to control money supply. The Unions, hitherto co-operative under responsible but ageing leadership, may become less so. If wage claims were to soar, hyper-inflation might not be far away, and Mexico's expansion would be put at risk.

6. Given the basic policy stance, I found it hard to follow what I was told about the plans to reduce the public sector deficit over the next two years from its present level of over 7% of GNP to 3% of GNP. This is apparently to be done by cutting food subsidies, curbing the activities of the nationalised industries and putting up petrol prices to nearer the United States levels (petrol now costs less than 25p a gallon, which helps to explain the pollution and traffic jams of Mexico City). But most of these measures had apparently not yet been taken (though the sugar subsidy had been cut) and their possible impact on wage claims and inflation do not need spelling out. Nor is a dramatic cut of this sort in the public sector deficit obviously compatible with the growth target. But I forebore to express my scepticism, merely commenting that the objectives on public finance seemed very ambitious.

7. On the external side, I was told that the Mexicans expect to continue to run a moderate current account deficit (say $3 billion or so). But they have an enormous demand for imports, resulting largely from the inadequacies of Mexican industry, and no doubt to some extent too from an over-valued exchange rate. Moreover, Mexico may now be becoming a net agricultural importer and agricultural imports must grow. They expect (no doubt rightly) to be able to finance a moderate deficit without difficulty, and with some decline in the debt service ratio.

8. In the Ministry of Industry there was a good deal of optimism about the prospects for job creation and Mexican industry. Selective inward investment flows should, it was thought, lead to a take off of non-oil industry, with substantial exports and job-creation, by around 1984. I asked with what labour-intensive exporting industries Mexico expected to achieve this. The only answer I heard was cotton textiles - hardly perhaps the most promising area for export-led growth.

9. The Ministry of Industry admitted that the high peso exchange rate created problems, but claimed that the effects of this on competitiveness were largely offset by growing productivity and low labour and construction costs. They admitted however that some depreciation of the peso might well be necessary at some stage. The need for depreciation was indeed widely accepted by those I spoke to: some favoured a series of small moves, and others a larger step-change.

10. Elsewhere a less optimistic tone prevailed. In the Ministry of Commerce, I was told that inward investment, so far from having increased, had not risen at all in real terms, and was likely to be insufficient to support a continuing growth rate of 8% a year. There was a real danger that Mexican industry would remain uncompetitive: the large imports of semi-manufactures showed the inadequacy of the industrial base. Mexico ought to take advantage of the opportunities presented by oil to lower tariff barriers, remove the remaining QRs, and concentrate on improving industrial competitiveness. In any case, agriculture would be a continuing burden - the problems here were structural. They could only be resolved at the price of adding unacceptably to the pool of urban unemployment, and the prospect of substantial agricultural imports would have to be faced.

11. The recent Mexican decision not to join the GATT was of course a big talking point. Some people suggested that this might not prove very significant in the long run, given the extent to which multinationals were investing in Mexico for export to the US market. QRs were not nowadays that important anyway. In any case, I was told, the decision would not be reversed during the lifetime of the present Administration. And there is evidently a continuing debate about the right course for the Mexican economy in the future. Some people are clearly thinking in terms of the creation of new quantitative and tariff barriers to imports, behind which import-substituting industries can be created or expanded. For them no doubt the decision not to join GATT must have seemed a significant success, on which they will no doubt try to build. Others argue that protection will merely produce an uncompetitive assortment of industries with long run damage to the economy. I found it hard to assess how far the decision not to join GATT should be regarded as some kind of watershed, inclining the economy firmly towards

protectionism. It is possible that under the pressure of events the decision may later appear less significant than it seemed at the time. On the other hand, protectionist forces are strong in Mexico and may well affect decisions yet to be taken.

Conclusion

12. It is hard to say exactly how Mexico's decision to go for growth will turn out. The economy will no doubt continue to grow at a smart pace. But even given Mexico's great natural resources, it does very much remain to be seen whether continuing growth at 8% can be achieved, when most of the rest of the world is growing much more slowly, and the Mexican transport etc infrastructure is so inadequate. On balance one must expect inflation to accelerate, though it is a fair bet, I think, that Mexico will manage to avoid the worst extremes of Latin American hyper-inflation.

13. One other conclusion suggests itself. The growth objectives, the demand for imports, both industrial and agricultural, the dubious prospects for the non-oil sector of the economy and even perhaps the inflationary pressures themselves seem likely to make the recently announced oil production plateau of 2.7 mbpd inadequate. One must doubt very much whether it will be long adhered to after it has been reached about the middle of next year. At PEMEX indeed I was told that plans to increase Mexican oil production capacity beyond this level were already being made. I asked what capacity was being foreseen, but got no reply. Nevertheless, one could infer that PEMEX were expecting to be authorised to go ahead with higher production levels before too long.

FB

F R BARRATT
30 July 1980

474

TD

Annex 2

cc: FST
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Barratt
Mrs. Hedley Miller
Mr. Mountfield
Mr. Slater
Mr. Gilhooly

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

25 March 1981

Senor David Ibarra,
Chairman,
Development Committee.

Dear Colleague

Thank you for your telex message dated 9 March proposing the establishment of a new task force on concessional assistance parallel to the existing task force on non-concessional flows established last year.

I have no objection to the establishment of this group and I note your intentions about its composition. I note also that the Executive Secretary of the Committee will be consulting members with a view to establishing the group and arranging meetings.

Geoffrey Howe

GEOFFREY HOWE

Annex 2

SecM81-221

March 26, 1981

FROM: Vice President and Secretary

DRAFT ANNOTATED AGENDA FOR DEVELOPMENT COMMITTEE

MEETING - MAY 22, 1981

1. Attached is a communication dated March 25, 1981 from the Executive Secretary of the Development Committee, on its draft annotated agenda for the Development Committee meeting on May 22, 1981.

2. This will be considered by the Executive Directors meeting as a Committee of the Whole on April 9, 1981.

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
President's Council
Vice Presidents, IFC

Annex 2

FOR OFFICIAL USE ONLY

DEVELOPMENT COMMITTEE

OFFICE MEMORANDUM

TO: Mr. Ernest Stern

DATE: March 25, 1981

FROM: Hans E. Kastoft

SUBJECT: Annotated Agenda

Attached is the annotated agenda of the Development Committee for distribution to the Executive Directors of the Bank for consideration at their meeting on Thursday, April 9.

cc: Mr. T. Thahane
Mr. S. Chernick (on return)

FOR OFFICIAL USE ONLY

DRAFT March 25, 1981

ANNOTATED AGENDA FOR THE GABON MEETING OF THE DEVELOPMENT COMMITTEE

Libreville, May 22, 1981

In the period since the last meeting of the Committee the growth prospects and, more particularly, the external financing prospects of many developing countries have deteriorated. The near-term outlook has been examined by the Fund as part of its World Economic Outlook exercise and the medium-term prospects will be taken up in the World Development Report, which is currently under preparation in the World Bank. A full review of these prospects will be taken up by the Committee at later meetings.

The proposed agenda for the Gabon meeting concentrates on selected topics which are both relevant to the overall recycling problem and which offer the prospect of concrete and constructive action in the relatively near term.

After the introductory statement by the Chairman of the Development Committee, the Managing Director of the Fund will give an oral report on the current status of several policy issues, incorporating the results of the meeting of the Interim Committee. Special attention will be given to Fund assistance to finance food imports, SDR matters and voluntary contributions to the Subsidy Account.

RB

Item 1: Increase in the Five-Year Lending Program of the World Bank (IBRD/IDA)

Subsequent to the discussions at the September meeting of the Committee, the management prepared proposals to expand the lending program over previously planned levels to take account of higher than anticipated inflation, and the additional requirements created by structural adjustment lending, the need for increased energy investments and the change in representation of China. The pressing needs of many developing countries, particularly in Africa, have also to be considered.

In January the Executive Board of the Bank considered a memorandum on possible expansion in IBRD/IDA lending over levels presently planned and the means of financing such expansion. The longer-term issues raised in this memorandum concerning the appropriate scale and composition of lending over the FY82-86 period, and the steps which might be taken to augment the World Bank's future lending capacity, were not expected to be resolved in this initial discussion. They will continue to occupy the Board for some time to come.

- Ministers may wish to urge the Executive Board to continue its efforts to reach a consensus on the scale of World Bank activity appropriate to the changed circumstances of the early 1980s, and to seek means of financing that activity which take account of the pressures on governments to minimize increases in budgetary expenditures in the near term.

The documentation for this item is the memorandum entitled "An Examination of Possible Expansion of IBRD/IDA Lending over Levels Presently Planned for FY82-86 and Means of Financing Such Expansion".

Item 1(a): Sixth IDA Replenishment

RB

The continuing discussion of medium-term expansion possibilities will be taking place against the background of a hiatus in IDA's commitment authority. Because the Sixth Replenishment agreement has not yet become effective due to delay in ratification of the agreement, IDA ran out of new commitment authority in April 1981. The United States Government has stated its intent to avoid a renegotiation of the Sixth Replenishment agreement and, to that end, has submitted legislation authorizing U.S. participation on the scale originally agreed.

The IDA Deputies met on March 30 and 31 to consider the status of the Sixth Replenishment. (Brief description of outcome to be added after the Deputies meeting.)

- Ministers may wish to stress the gravity of the circumstances now facing the poorest developing countries and, in that context, to underline the urgency of restoring IDA's commitment authority at the earliest possible date.

The documentation for this item is a note prepared by the Chairman of the IDA Deputies (to be circulated after the Deputies meeting).

Item 1(b): Expanded IBRD Lending in FY82

RB

The January discussion of the World Bank lending program took up two recommendations for early action. One was for the Bank management to formulate a specific proposal for an Energy Affiliate. Progress on that

issue is considered below (item 1(c)). The second recommendation was that the Executive Directors consider transitional arrangements for financing some expansion in the IBRD lending currently planned for FY82, particularly some expansion of energy lending and lending for China, on an interim basis. This recommendation recognized that implementation of an expanded IBRD lending program would have to be phased in a manner consistent with country and project-specific operation plans, so that the actual expansion proposed in FY82 could be somewhat less than the maximum program shown in the memorandum itself. A substantial increase over the $9.6 billion in IBRD commitment currently planned for FY82--covering some part of the incremental $1.2 billion "desirable" energy lending and the initiation of lending to China as additions to current plans--would be operationally feasible. Since the level of lending which can be sustained indefinitely on the capital base already approved for the IBRD (including the General Capital Increase) exceeds $13.5 billion per annum, a decision to increase the FY82 IBRD program could be taken without requiring additional resources from governments and without prejudging the question of what the appropriate level of IBRD lending should be in the following years.

- Ministers may wish to request the Executive Directors to give prompt and favorable consideration to an increase in the presently planned IBRD lending program for FY82, when considering the management's proposals for the FY82 Lending Program and Budget.

The documentation for this item is the memorandum already cited above.

RB, PM

Item 1(c): Expanded World Bank Lending for Energy

The current and prospective world energy situation poses problems of adjustment for producers and consumers on a global scale. It is essential that all countries develop an integrated approach to energy which would include measures to expand the supply of energy, to diversify its sources and to conserve scarce fuels. Expanded World Bank lending for energy, for instance, through an Energy Affiliate can assist developing countries in designing and implementing such a comprehensive approach. Discussions in the U.N. and other fora will have to continue to deal with the energy situation and with measures countries, which are not borrowers from the Bank or IDA, might take.

The oil-importing developing countries face an acute external financing problem and it is urgent that they reduce their dependence on imported oil. This will involve expanding exploration for and development of domestic oil and gas resources, increased development of coal, major expansion of renewable resources, the most rapid possible utilization of hydropower capacity and conservation both through appropriate price policies and the application of energy saving technology. A World Bank program for energy would help to finance, in cooperation with other sources of capital, the large investments required for such programs.

Since the last meeting of the Committee, informal consultations on the Energy Affiliate have established a broad consensus for the need to expand lending for the energy sector. As a next step, the Bank management is preparing proposals as a basis for more formal negotiations.

- Ministers may wish to reiterate their support for the Bank's initiative to expand its lending operations in the energy sector.

- Ministers may also wish to urge that, in light of the pressing need to reduce the strains on the balance of payments of the oil-importing developing countries, the negotiations be completed expeditiously and express their hope that the willingness of members to contribute the necessary capital will reflect the global nature of the problem and the international community's interest in a comprehensive approach to energy.

Item 2: Lending Operations of the Regional Development Banks

The future lending levels of the African Development Bank, the Asian Development Bank and the Inter-American Development Bank, are also currently under review in the context of discussions on the replenishment of resources for both the concessional and ordinary capital operations of these institutions. A status report on these discussions will be circulated.

Item 3: Report on Selected Issues by the Task Force on Non-concessional Flows

The Task Force has had two meetings since the last Development Committee meeting. The first was in October 1980 and was chiefly concerned with obtaining the views of selected international bankers on a variety of subjects of interest to the Task Force. The second meeting

in March considered an IMF study on the external indebtedness of developing countries and a report prepared for the Task Force by the Bank staff on means of expanded cooperation between the World Bank and commercial lenders.

The Task Force now expects to make its final report to the Development Committee at the September 1981 meeting. In its progress report the Task Force has limited its comments to the following issues: (1) cooperation between multilateral development institutions and financial institutions; (2) external indebtedness of developing countries; and (3) increases in lending capacity of multilateral development institutions.

The documentation for this item is the progress report of the Task Force. On the issues that have been discussed, the Task Force looks to guidance from Ministers on priority options.

The Task Force considers that a degree of additionality in non-concessional capital flows could be achieved by actions on the part of multilateral development institutions to help broaden the range of financial instruments and improve the attractiveness of lending to developing countries. The Task Force has therefore made a number of recommendations, which include:

(i) the improvement of co-financing arrangements between multilateral development institutions and commercial lenders;

(ii) the sale of portfolio and loan participations by multilateral development institutions;

(iii) the use of guarantees by multilateral development institutions;

(iv) the issue and placement of pass-through Loan Certificates by multilateral development institutions.

- Ministers may wish to endorse the proposals made by the Task Force on this subject, and recommend that the multilateral development institutions discuss, as speedily as possible, these proposals with banks and other financial institutions in major financial centers.

MA
CS

The Task Force has discussed some of the main issues relating to the external indebtedness of developing countries. The Task Force emphasizes that developments regarding external debt must be viewed in the broader context of the world economic situation. It notes that debt problems are due to many factors and may have a negative impact on non-concessional flows. Therefore, the Task Force believes that both short and long-term aspects of the debt question must be kept under constant vigilance. The Task Force stresses the importance of sound debt management in order to avoid debt servicing problems and thus help sustain inflows of capital. At the same time, the Task Force continues to believe that sustained large capital inflows will be necessary for the economic development of developing countries. The Task Force has discussed the question of debt indicators; it emphasizes that these, taken on their own, are not a substitute for comprehensive reviews of the economic situation and prospects of the countries involved.

The Task Force also discussed the impact of inflation on external debt, and expressed its concern that failure by creditors to take this

factor into account in their assessments of economic conditions in borrowing countries may have a negative impact on financial flows. The Task Force encourages further study of this subject. The Task Force recognizes the importance of a multilateral framework for the rescheduling of debt. In cases where a debt rescheduling is sought, it is important that it be viewed as part of a comprehensive effort to assist the debtor country implement necessary adjustment policies and to restore flows. The IMF, the World Bank, and the regional development banks might be able to provide good offices in facilitating these matters. In regard to the long-term aspects of the debt problem, the Task Force feels that questions regarding the relationship between different sources of finance for developing countries, especially taking into account the magnitude and nature of their financing requirements, must be kept under review.

- Ministers may wish to discuss the above-mentioned issues and to endorse the general approach of the Task Force with respect to the debt problem.

The documentation for this items is the Report on Selected Issues by the Task Force on Non-concessional Flows.

Regarding ways of increasing the flow of funds from the multilateral development institutions, the Task Force will be examining several proposals, such as the change in the gearing ratio, establishment of affiliates in the multilateral development institutions, including the Energy Affiliate of the World Bank, and others. For these discussions a World Bank paper has been requested. It is expected that the Task Force will consider these topics at its July meeting.

5a

Item 4: Task Force on Concessional Flows

Committee Members were advised by telex on March 9 by the Chairman of the Development Committee that, pursuant to the decision of the Committee in September that there should be a continuing study of the volume and quality of concessional assistance, the Governments of Canada, the Netherlands and the Nordic Group have taken the initiative to establish a Task Force on Concessional Flows.

The Chairman has asked the Executive Secretary of the Committee to undertake consultations with a view to establishing its composition and arranging for an informal meeting to formulate the work program. The Chairman will report orally to the Committee on the membership of the Task Force and the program of work envisaged.

- Ministers may wish to welcome the initiative of the sponsors in establishing this Task Force and, in view of the urgent requirements for concessional assistance, endorse the proposals to explore ways and means to expand the supply and improve the quality of concessional flows both in the near and longer-term.

C5

Item 5: Role of the Development Committee in the Global Negotiations

The Committee at its meeting in September 1980 indicated that it wished to consider the role of the Committee in the U.N. global negotiations, once those negotiations had been agreed on. If the preparatory discussions have been completed by the time of the Gabon meeting, Ministers

may wish to discuss the nature and scope of the link between the Development Committee and the global negotiations. If the preparatory discussions are not yet completed, Ministers may wish to reiterate their interest in a relation between the Committee and the global negotiations when these have been agreed on.

CS

Item 6: Africa Study

The study of the development prospects of sub-Saharan countries, and a program of action to improve on those prospects was undertaken by the staff of the Bank in response to a request by the African Governors in 1979. Successive issues of the World Development Report have highlighted the poor, and deteriorating prospects for growth in these countries. The 1980 World Development Report projected, in the best circumstances, annual growth in sub-Saharan Africa for the decade of the 80s at about one per cent per capita. Members of the Committee have repeatedly stressed that such prospects are intolerable and of major concern to the international community.

The Africa Study will present an analysis of internal and external factors inhibiting more rapid growth in sub-Saharan Africa and suggest programs of action to accelerate growth. The study will be issued in the next few months; it may be possible to distribute a brief summary of the principal points for the information of the Committee. A full review and discussion will be scheduled for the September meeting of the Committee.

- Ministers may wish to note the urgency of dealing with the development problem in sub-Saharan Africa, the importance they attach to appropriate programs of action, and indicate their intention to consider such programs in detail at the September meeting.

Item 7: Future Work Program

The Committee will consider at its future sessions those matters now before it or on which work is in progress in the Bank, the Fund or the two Task Forces. These include a regular review of the flow of real resources to the developing countries and the financial needs of these countries; review of issues arising from the Group of 24 Program of Immediate Action, including the SDR link; the problem of indebtedness; the lending program of the World Bank and IDA and the means of financing it; review of developmental issues arising from the Brandt Commission report; and stabilization of export earnings. In addition, it is proposed that the following items be added to the work program:

- IDA VII
- the soft loan facilities of the other multilateral development banks.

Item 8: Other Business

a. Review of the Committee

b. Press Communiqué

c. Date of next meeting in 1981

13/9/4

CONFIDENTIAL

9/4/81.

1. MISS BAKER
2. MR HAWTIN
3. MR BARRATT
4. CHANCELLOR

cc Mr St Clair
Mr Slater
Mr McIntyre

Copies attached for:

Chief Secretary

Financial Secretary

Sir K Couzens

Mr Barratt

Mr Mountfield

Mrs Hedley-Miller

VISIT BY MEXICAN MINISTER OF FINANCE, 11.00 AM FRIDAY 10 APRIL

You have agreed to see Senor Ibarra who is in this country on a private visit. He will be accompanied by Senor Romero (Director General of the Banco de Mexico) and Senor Phillips (Deputy Director of International Affairs, Banco de Mexico).

2. Senor Ibarra wishes to discuss matters of bilateral and multilateral interest particularly in the context of the forthcoming meeting of the Development Committee (of which he is Chairman) in Gabon, but we have no details. The briefing which follows covers subjects which he might raise. You may like to refer to your meeting with Senor Ibarra in September 1979.

Development Committee

3. Senor Ibarra is the new Chairman of the Development Committee. It is due to meet at Libreville on 22 May. A draft agenda has been circulated (copy attached Annex 2) and, like last time, the underlined passages are probably intended as suggestions for a communique. The draft is due to be discussed by the Executive Boards of the World Bank and of the IMF, and we will be pressing for a number of changes, notably:

(a) a rewrite of the passage on the energy affiliate which goes much too far at present;

(b) an attempt to keep more general the wording on the proposed new Task Force on Concessional Flows.

4. Senor Ibarra may well want to use this occasion to press you to agree that the UK should be represented on the proposed Task Force. So far you have simply said that there is no objection on our part to the setting up of such a body. (A copy of your letter is attached Annex 2)

5. We have still to make recommendations to you about UK participation. There is an obvious danger that the Task Force will be used by the proponents of more aid to criticise the aid performance of certain countries (eg US, UK) and call for bigger aid programmes. (The second part of the proposed wording in the draft agenda is not satisfactory from this point of view.) The American position is not yet known: if they decided not to participate, that would influence us in the same direction. And even if we do in the end decide to participate and try to influence the outcome from within, there is no need to be hurried. We suggest that, at this stage, you should not give a direct answer to Senor Ibarra if he asks for British participation, but should raise a number of questions with him.

Line to take

6. The Development Committee performs a useful role and allows practical discussion of difficult questions without too much theorising. The report of the Task Force on Non-Concessional Flows which has some interesting ideas on encouraging further co-financing is a good example of this.

7. We are broadly satisfied with the proposed draft agenda for Libreville. However we will be proposing changes on some items, notably the degree of commitment to the energy affiliate.

8. As to the proposed new Task Force on Concessional Flows, what does Ibarra expect it to achieve?

9. There are indeed questions it could usefully look at eg the quality of aid and the uses which recipient countries make of aid. But it would do nothing but harm if it turned into a forum for criticising the aid performance of selected donors. How does Ibarra plan to avoid this? What terms of reference does he envisage?

10. Who would be the chairman? [One name mentioned is a Dutchman, Jacob Everts, who has a great deal of experience and is given good marks for commonsense and co-operativeness.] We would be strongly opposed to appointing a political figure or to commissioning anything on the lines of a new Brandt Report.

Other items

11. Notes on the other items on the agenda are attached as a reminder. (See Annex 2.)

Energy

12. Oil is a subject of mutual UK/Mexican interest both as major non-OPEC producers and as consumers. A separate brief is attached covering UK oil issues and Mexican energy policy at Annex 3, but there are some points which we would like you to raise in the discussions.

Points to make

13. In view of the recent cut in the price of Mexican Mayan crude what are Senor Ibarra's expectations for the oil market in the rest of 1981.

14. What does Senor Ibarra think the prospects are for the OPEC meeting in Geneva on 25 May especially as regards prices.

15. What have been the effects of oil resources and revenue on the Mexican economy, and exchange rate and other areas. You could say that North Sea oil production raises UK national income and improves our balance of payments. The net benefit to the current account in 1980 was about £4 billion. The real exchange rate can be expected to rise as a result of this. The structure of the economy in the long term will tend to shift in favour of non trade goods.

Mexican economy

16. It seems likely that Senor Ibarra will want to discuss developments in the economy. A full brief on Mexican economic policy and recent economic developments is attached as Annex 4. Some important points are:

(a) Mexico faces unemployment amounting to 40 per cent.

(b) The inflation rate remains stable at 28 per cent.

(c) The economy grew 7.5 per cent in real terms in 1980. The Government's Global Development Plan for 1980-82 aims to maintain growth at about 8 per cent.

(d) The Government are concerned to prevent overdependence on the oil sector as it does not create much employment.

(e) Control of the money supply is not seen as a vital part of present policies.

(f) The Mexican peso has a high exchange rate due to its oil. However the authorities are reluctant to speed up the slow rate of devaluation. This is

probably because they wish to keep down the cost of imports. (There was a 61 per cent rise in imports in 1980.)

General background

17. I attach the following as background papers:

Annex 1 Personality Notes

Annex 2 Development Committee

Annex 3 Oil issues

Annex 4 Mexican Economic Policy and Economic Developments (BOE)

Annex 5 Mexican politics, Anglo Mexican Relations and Trade (FCO)

Annex 6 North/South - factual paper.

S E Burton

MISS S E BURTON

9 April 1981

The National Archives

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Annex 2

Development Committee

9/4/81.

WORLD BANK ISSUES

There are a number of current World Bank issues on the agenda for the Development Committee meeting at Libreville in May. There is no harm in that providing that the Committee does not attempt to prejudge decisions that should properly be taken by the Executive Board (such as the level of lending in fiscal year 1982) or build up expectations about an Energy Affiliate (which the Americans are not prepared to support "at this time").

Sixth Replenishment of IDA(IDA6)

Implementation of the $12 billion IDA6 Agreement has been held up because of the lack of an American commitment. The Reagan Administration now proposes to seek Congressional authorisation for the full $3.24 billion US contribution but to postpone commitments into the second and third years of the replenishment period. Providing that Congress approves the proposals, this should not result in more than a minor hiccup in IDA's lending to the least developed countries.

In the meantime other donor countries have been contributing to a "bridging operation" to allow IDA to continue making loans. Most other countries have advanced their full first year's contribution (one-third of the whole) for this purpose. The UK and France have given only half of our first tranche and we may come under pressure to put in the other half, if all other donors (including the Arabs) do so.

The UK contribution to IDA6 is £555 million ($1.2 billion) or just over 10% of the whole. By contrast, Mexico as one of the richer ldc.s has pledged only a token $20 million and has not so far joined the bridging.

Energy Affiliate

The proposal to set up a new Energy Affiliate as a means of gearing up World Bank lending for energy development in the ldc.s was mentioned in last year's Venice Summit communiqué. The idea would be to mobilise additional (mainly OPEC) funds which would not otherwise have been available. The UK has been sceptical about the proposal (although officials have taken part in some preliminary discussions) because it would involve establishing a new international institution and (probably) more multilateral expenditure on capital subscriptions. Much depends on the American attitude and the new Administration have said that it cannot support the idea "at this time" (probably for expenditure reasons). This may well kill the proposal.

World Bank Lending Programme

Earlier this year the IBRD Executive Board had an inconclusive discussion on Mr McNamara's ambitious plans for expanding the IBRD/IDA lending programme to a staggering $124 billion over the 5 years from July 1981. These plans are clearly unrealistic, although a modest increase above present levels may be possible, if Congress approves the full US subscription to the IBRD's general capital increase (now supported by Reagan). Decisions on the lending programme for individual years are best left to the Executive Board.

Private Sector Involvement

In view of the present budgetary constraints on most donor countries, we believe that the best way forward for the World Bank is to concentrate on stretching out its existing resources by seeking greater involvement of private sector capital by way of various forms of "co-financing" and, where appropriate, some relaxation of its conservative financial policies. This applies equally to the Regional Development Banks, such as the Inter-American Development Bank and the Asian Development Bank, which may also suffer from American public expenditure cuts. The report of the Development Committee's Task Force on non-concessional flows (chaired by Mr Alfredo Phillips of the Bank of Mexico) may produce a useful impetus in this direction. The incoming President of the World Bank, Mr A W (Tom) Clausen, is also known to favour these ideas.

WORLD BANK: General Capital Increase (GCI) and Valuation of Capital Stock

The Dutch have asked for this item to be added to the draft agenda for the Development Committee. The object would be two-fold:

(i) to urge member countries to take up at least part of their GCI shares as soon as subscriptions open in October 1981; and

(ii) to press for an early decision on the valuation of the capital stock and related maintenance of value provisions.

The UK has supported the GCI which (if fully subscribed) will approximately double the IBRD's capital base to about $80 billion. No decision has yet been taken about the level or timing of our subscription (which, if taken up in full, would cost the aid programme about £100m over 5 years).

Some countries have said that they will be unable to subscribe to the GCI until agreement is reached on a new basis for valuing the capital stock. Shares are at present valued in terms of obsolete gold-based dollars. Most countries would prefer to see this changed to the SDR (as in the IMF) but the Americans have so far been unable to accept.

Annex 3

Oil - Background

9/4/81.

UK OIL ISSUES

PRICES:

Government does not set official prices for North Sea crudes. Price of UK oil is set by the market and reflects prices of comparable African crudes. BNOC is obliged to follow the market and does not lead. Last increase was 1 January 1981: $3 increase to $39.25 per barrel, following Bali conference. Government continues to urge restraint in timing and size of any price movements by OPEC producers.

NORTH SEA FISCAL REGIME Budget announcements - New tax, Supplementary Petroleum Duty, 20% on gross revenues from UK oil and gas production. Legislation will be effective from January 1981 to June 1982; in the meantime, further study and consultations with oil companies before permanent arrangements are made. Special reliefs for Petroleum Revenue Tax also restricted. Measures will yield £1b 1981-82. Increases in real price of oil brought substantial benefits to oil companies which now face very different economic prospects from when the earlier tax regime was introduced (1975).

PRODUCTION 1980: Britain for the first time had a balance of trade surplus in oil. UK North Sea production 1.6-1.9 mbd in 1981, rising to approx 1.8-2.4 mbd by 1984. UK Continental Shelf receiverable oil reserves now estimated at about 16-32 bn barrels.

DEPLETION POLICY Secretary of State for Energy announced Government review of oil depletion on 23 July 1980. Government will honour Varley assurances made in 1974, but will consider flexible policy including delays in the development of fields discovered since 1975, supervision of oil and gas recovery of existing fields, tighter gas flaring controls and ban on oil production above approved levels except in exceptional circumstances. On strategic and security of supply grounds, it is in the national interest to extend oil supplies towards the end of the century. Not possible to set out rigid plan in view of uncertainties.

ECONOMIC BENEFITS North Sea oil and gas production raise UK national income and improve balance of payments. The net benefit to current account in 1980 was about £4bn. Part of the gain to income is represented by tax revenues from the North Sea. The real exchange rate can be expected to rise as a result of these factors, the structure of the economy in the long term will tend to shift in favour of non-traded goods.

MEXICAN ENERGY POLICY

Mexican oil production is currently estimated at 2.3 mb/d and is projected to rise to 3.5 mb/d by 1985. Exports are currently 1.3 mb/d, half of which is supplied to the United States. Mexico's proven oil reserves of 40bn barrels are the fifth largest in the world. Mexico has proven gas reserves of 58 trillion cubic feet, not including two major new discoveries made last year. Production is controlled by PEMEX (Petroleos Mexicanos), the State oil company established on nationalisation in 1938.

2. Mexico has the capacity to be one of the world's largest oil producers. However, a recent statement by President Lopez Portillo shows that the government is adopting a cautious attitude to expansion of production. A production "platform" of 2.75 mb/d has been set for 1981. The cautious depletion strategy is designed to avoid overheating the economy by too rapid a rise in oil revenues which could also have damaging effects on non-oil sectors of the economy. But domestic demand for oil may rise quickly and Mexico has the traditional features of a high absorber. A recent Department of Energy assessment suggests that Mexican production might reach the target of 3.5 mb/d by 1985, and then remain in the range 3.5 mb/d - 4.0 mb/d in the period 1985/2000.

3. Another element in Mexican depletion policy is their desire to assert their independence from the United States and show that use of their resources will be determined by Mexican not US needs. Mexico has jealously guarded her independent status and has not joined OPEC. On prices though she has tended to follow OPEC. The 1973/4 round of price increases led to a rapid rise in Mexican production. The industry has previously suffered from the government's policy of holding down domestic prices. Isthmus (34°) crude is currently priced at 38.50/barrel, and the price of the heavier Mayan crude has recently been cut by \$2.50/barrel to \$32 because of increasing world supply. All oil is sold on contract and Mexico has not sold oil on the Spot market.

WORLD OIL SITUATION

Following their last conference, at Bali in December, the OPEC States have raised their official prices to an average of about $35 a barrel. Average world prices are now about 170% higher than they were in 1978 Q4, before the Iranian revolution. But there is a wide range, from Saudi Arabia's light crude at $32 a barrel to Libya's (higher quality) crude at $41.

2. At the moment the supply/demand situation is easier than for much of the last year. If there is no new interruption, supply should balance or slightly exceed demand for the rest of 1981. On the supply side, a key factor has been the willingness of the Saudis to increase production to make up for some of the output lost as a result of the Gulf War. Demand, meanwhile, has fallen considerably - by 5% in 1980 and could well fall further this year.

3. OPEC are to hold their next regular price-fixing conference in Geneva on 25 May. It is doubtful whether present market conditions will permit any significant price rise though the Saudis may increase their relatively low prices in a move towards price re-unification in OPEC. They may also trim production a little.

Annex 4

MEXICO

9/4/81.

Economic policy

The Mexican authorities face four main structural economic/social problems: un- and under-employment amounting to some 40%; a particularly inequitable distribution of income; a high degree of agricultural inefficiency; and an inadequate infrastructure. The rapid development of Mexico's oil reserves (which are currently put at 67.8 bn barrels, proven) have raised hopes of a quicker solution to these problems by substantially raising the economy's growth rate. The rate at which oil wealth should be deployed is, however, the subject of active debate in Mexico. The government is adhering broadly to its "cautious" 1980-82 "Global Development Plan" which aims to keep oil production to no more than 2.7 mn bpd (with exports of 1.5 mn bpd) and real economic growth to about 8%. Its main concerns are to avoid very high rates of inflation and to prevent over-dependence on the oil sector which, given the capital-intensive nature of this sector, would exacerbate the country's unemployment problems.

The main tool of demand management is public sector finances. A rapid increase in investment in oil and large oil revenues has given them their inflationary influence despite a notable improvement in tax collection. Monetary policy is geared to manipulating interest rates in order to control capital flight. This is due to the importance in the Mexican monetary system of the US dollar against which there are no exchange controls and with which the peso has a very stable rate of exchange.

External trading policy remains traditionally cautious. There is a wide range of import controls to protect domestic manufacturing industry and employment; Mexico last year decided against joining GATT for the time being. A more outward approach is beginning to be adopted towards foreign capital as the requirement for foreign savings continues to rise. Mexico is using its new-found strength in the international capital markets to concentrate on a wider (and cheaper) range of borrowing methods - eg, bankers' acceptances, US commercial paper and fixed rate instruments. There are also

plans to allow foreign participation in the Mexican Stock Market.

Recent Economic Developments

The economy grew 7.5% in real terms in 1980. Industrial growth however fell below target to 6% largely on account of bottlenecks caused by Mexico's poor infrastructure. The additional pressure of demand caused inflation to rise to 30% though it has since fallen back to 28% pa. The 1981 budget aims to maintain growth at around 8% pa.

The balance of payments current deficit increased markedly last year to $6.6 bn from $4.2 bn in 1979. In part this was due to the declining competitiveness of the manufacturing export sector and to oil production difficulties (though oil earnings still rose to $9.4 bn - over 60% of total exports). The main factor, however, was a 61% rise in imports resulting from the large growth in aggregate demand.

Mexico has had no difficulty in meeting the larger financing requirement on very favourable terms. One recent example is the $1 bn six-year euro-dollar loan which the public sector recently managed to obtain at ½% over LIBOR. At end June 1980 gross claims on Mexico of banks reporting to the BIS (G10 banks) totalled $37 bn; consolidated claims of UK-registered banks and their branches worldwide at that date amounted to $4.3 bn. The external debt of the Mexican public sector reached $34 bn by end 1980; private sector debt was put at $10-12 bn; the total debt service ratio was about 70%.

Mexico has been actively seeking to improve the profile and cost structure of its external debt. Of a planned $1 bn in fixed rate instruments this year, PEMEX (the State oil company) hopes to raise some $165 mn in the form of a sterling "bulldog" bond issued in the UK.

Prospects

With the current account expected to widen further this year, the public sector gross borrowing target has risen to $13 bn. Total (public and private) debt is expected to rise by up to $10 bn. In view of Mexico's oil wealth there will be no difficulty in

meeting such a requirement. However, some balance of payments adjustment will be necessary to be certain of avoiding debt problems in the longer term. Given the reluctance of the authorities to speed up a very slow rate of devaluation or to check the rate of economic growth, there may have to be a large increase in oil production and there is a solid body of opinion in Mexico in favour of this approach. However, in the short term this may be technically impossible and in the long term could give rise to severe inflationary pressures.

8 April 1981

ANNEX 5

CONFIDENTIAL 9/4/81

CALL BY THE MEXICAN MINISTER OF FINANCE SR DAVID IBARRA ON THE CHANCELLOR OF THE EXCHEQUER

MEXICO

1. Mexico is one of the four leading Latin American countries on which British policy towards Latin America is concentrated. Mexico has an area of just under two million square kilometres and its population of 67 million could double in 25 years. Recent discoveries of large oil reserves have given a substantial boost to Mexico's international importance and influence. Mexico is also a leading producer of silver and sulpher and holds significant deposits of 20 or so strategic materials including uranium.

INTERNAL POLITICAL SYSTEM

2. Although a Federal Democratic Parliamentary state, the President is the dominant decision-maker and the ruling Institutional Revolutionary Party (PRI) has for 50 years swept all elections to the 100 seat Senate and the 400 seat of Chamber of Deputies. The PRI is more an institutional system of Government; it is not a political party with an easily identifiable ideological basis. The PRI draws its strength from an ability to tolerate and adjust to dissenting opinion within its membership, and from the principle that the President may not be re-elected once his six year term of office is finished.

3. Recent political reform measures, including the allocation of 100 of the 400 Chamber of Deputies seats to the Opposition on a proportional representation basis have given opposition parties greater participation in the political fora.

FOREIGN POLICY

4. Mexico pursues an active and independent foreign policy orientated towards the Third World. She is a member of the Group of 77, has observer status at the Non-Aligned Movement and has a seat on the UN Security Council. Mexico is a champion of the UN and has taken a leading part in such questions as disarmament, law of the sea, UNCTAD and the North/South Dialogue. She is hosting a North/South Summit meeting to be held in Cancun in October 1981 in which the UK will participate.

5. Relations with the US have traditionally been difficult. She rejected US appeals for support over the Olympics, the Tehran hostage issue, and to take Cuban refugees. The attitude of the Mexican public of suspicion towards the US does not preclude an all-

pervasive US influence on Mexican life. Mexico's President Lopex Portillo met President Reagan at the US/Mexican border in January. Although little of substance was discussed, a further meeting is to take place soon. While President Reagan is keen to improve US/Mexican relations, US policy in Central America is likely to further disagreement.

6. Mexico is keen to diversify its economic links away from the US and is eager to conclude economic agreements with Japan and European countries who wish to buy Mexican oil. It makes no secret of its pursuit of 'oil diplomacy' to secure technological collaboration and investment on terms favourable to Mexico.

7. Mexico has rejected the idea of joinging GATT, and is not a member of OPEC.

8. Mexico has agreed with Venezuela to supply oil to certain countries within Central America and the Carribbean in an imaginative scheme in which 30% of the oil cost is returned to the customer in the form of soft loans.

BRITISH/MEXICAN RELATIONS

9. Current UK/Mexican relations are good. A fairly constant flow of visitors is maintained. Visitors to Mexico in 1979 and 1980 included the Minister of State, Mr Ridley, Minister of State for Trade, Mr Parkinson, Secretary of State for Industry, Sir Keith Joseph, the Foreign and Commonwealth Secretary, Lord Carrington, Secretary of State for Energy, Mr Howell and the PUSS for MAFF, Mr J Wiggins. Visitors from Mexico in 1980 included the Mexican Minister of Finance, David Ibarra, the President's wife Sra Carmende Lopez Portillo and his sister Dona Margarite Lopez Portillo Minister for Planning, Miguel do la Madrid, and Industry Minsiter Miguel Barbarena.

10. This year the Foreign Minister, Jorge Castaneda visited the UK in March. An outward visit is being made by the Secretary of State for Education, Mr Carlisle at Easter and the Secretary of State for Agriculture, Mr Walker in August.

UK/MEXICAN TRADE

11. In 1980 Mexico was our second largest market in Latin American (after Brazil, and a short head in front of Argentina). It was our 41st export market.

12. In 1980 our exports to Mexico amount to £188 m compared with £135 m in 1979. This has enabled us to maintain our 2.5% share of the market where two thirds of trade in both directions is with the USA. (Although the Mexicans wish to diversify, the figures do not show the US market share to be declining). In 1979 Japan had 6.6% of the market, Germany 6.4%, France 3.2% and Italy 2.0%.

13. Our principal exports in 1980 were machinery and transport equipment, chemicals, whisky and (a new trade) milk powder.

14. In 1980 our imports from Mexico amounted to £111.6m, though nearly half (£62m) related to sales of silver bullion, and a further quarter (£28m) to oil for France (TOTAL). The principal remaining items were honey, textiles and a range of vegetables and chemicals.

15. The Mexicans have complained about the trade imbalances and have said that we buy too little from them. We in turn have said that it is up to them to sell their goods and that (unlike Mexico) the UK is on the whole an open market with only a few restrictions limited to agricultural products and to textiles under the GATT multi-fibre arrangement (MFA).

16. In December 1980 we signed a Memorandum of Understanding providing for the establishment of a Committee on Industrial Projects. We intend to use this committee as appropriate in support of capital projects in Mexico. The Mexicans view it as a joint Committee to encourage UK investment in Mexico. The next main project opportunity probably lies in the extension of the SIEARTSA steel works at Lazaro Cardenas.

Annex 6

9/4/81

NORTH/SOUTH ISSUES

1. Mexico has played a prominent part in North/South matters. Within the G77 she regards herself as having a semi-independent role by virtue of being an oil exporter which is not a member of OPEC. She has adopted radical positions on occasions.

Mexico Summit

2. The Mexico Summit has been postponed to late October to accommodate President Reagan. The latter has still not said publicly that he will attend. The four main areas expected to be covered are food and agriculture; trade and industrialisation; energy, and international co-operation in this field; finance and monetary questions.

Global Negotiations (GNs)

3. Preparations for these are currently on ice, while the US Administration reviews its position. Until this is known, progress on agreeing procedures and agenda is unlikely. We have no clear idea of Mexican views on the prospects for Global Negotiations.

4. It seems very unlikely that there will any significant developments before the Mexico Summit in the autumn, or that the GNs will open before January next year.

TELEX.

9/4/81.

TASK FORCE ON NON-CONCESSIONAL FLOWS

REPORT ON SELECTED ISSUES

Introduction

1. The Task Force on non-concessional flows has held a number of meeting to consider the economic context of future commercial bank lending to developing countries. In the course of this work it has also consulted representativs of international commercial banks.

2. The Task Force considers that a degree of additionality in non-concessional flows could be achieved by multilateral development institution actions to broaden the range and improve the attractiveness of financial instruments available for lending to developing countries. Such actions are reviewed in part I of this report.

3. The Task Force has also discussed the main issues relating to the external indebtedness of developing countries, and held a preliminary discussion of proposals designed to increase the lending ability of MIDS. These topics are discussed respectively in parts II and III of this report.

4. The Task Force looks for guidance from ministers on the course of action to be adopted on the proposals set out in this report.

Part I colon cooperation between multilateral development institutions and financial institutions. Section I Colon scope and range of the proposals.

5. Ins discussing cooperation between MIDS and financial institucions the Task Force had before it a paper, prepared

by the World Bank staff, which analyzed various initiatives towards these ends. The Task Force commends the innovativeness of these proposals and bases its recommendations on the contents of the staff study. The staff report dealt only with the procedures and practices of the World Bank. The Task Force however, considers that in appropiate cases the analysis colud be extended to other MIDS.

6. The detailed recommendations of the Task Force are set out below and cover the following issues colon.

(1) The widening of cofinancing arrangements between MIDS and commercial lenders .

(11) The sale of porfolio and Loan participations by MIDS.

(111) The use of MDI guarantees.

(IV) The issue and placement of pass-through loan certificates. by MIDS.

7. Each set of proposals aims either to improve existing practices (cofinancing, participation sales) or to create mew methods of financial intermediation (complementary financing, partially-guaranteed loan pass-thorugh certificates) by the World Bank and other MIDS. The proposals are therefore complementary to one another rather than mutually exclusive. It is noted that the proposals set our below may involve changes in the lending programs and priorities of MIDS.

8. While individual financial institutions may wisht to participate in more than one scheme, each of the proposals is principally aimed at a particular category of lenders Colon.

i. A widening of cofinancing arrangements will appeal to

major financial institutions that may wish to extend their future lending to developing countries. Improved corss-default clauses, the more systematic treatment of cofinancing flows and the setting of country-specific objetives are aimed at this goal.

ii. Complementary financing and resumed participation sales are designed to attract banks whose traditional lending policies have been less explicitly oriented towards developing countries. The thecnical and administrative assistance that they would receive by participating in MDI loans could encourage them to accept a larger proportion of developing country risks in their loan portfolios.

iii. Parially-guaranteed loan pass-through certificates are particularly designed to be attractive to commercial banks whose involvement in developing country lending has hitherto been minimal. This proposal also enveavors to break new ground by providing a financial vehicle that would enable non-bank lender and private investors to diversify their portfolio to include loans to developing countries.

9. The Task Force recommends to the development committee that the IBRD and other MDIS discuss, as speedily as possible, the proposals made in this report with banks and other financial institutions in all major financial centers. These discussions would assess the reactions of financial institutions to these proposals, and thus provide an estimate of their potential in facilitating the flow of non-concessional resources to developing countries.

10. The benefits of the proposals, in terms of additional flows of resources to developing countries, of of improved terms for commercial loans available to them, are difficult to quantify. Some increase in flows or improvement in terms of loans may be achieved semi Colon it is also possible that they will serve to maintain the existing level of flows which could otherwise be impaired by a deterioration, whether actual or perceived, of the creditworthiness of developing countries.

11. The Task Force concluded that the proposals discussed here could be seen as complementary to other proposals that would be discussed such as an increase in the lending authority of these MIDS, and indeed might partly overlap with them.

12. Several commercial lenders have emphasized their preference for early direct contacts with developing country borrowers. This fact notwithstanding, since a number of these proposals aim at attracting the interest of potential lenders and borrowers who have hitherto not been engaged in this type of lending, they provide for MID assistance in loan negotiations. This assistance is aimed at involving such lenders with developing countries.

Section 2 Colon cofinancing.

13. The Task Force believes that a significant increase in cofinancing by the MIDS and financial institutions is desirable if it leads to additional transfers of non-concessional resources. This additionality could take the form of an increased volume of loans, of a widening of the circle of developing

countries with acces to commercial onas or of increasing the number of market sources willing to lend to them. An increase in cofinancing that was merely a substitute for other capital flows would not be considered satisfactory.

14. The Task Force accordingly consulted a group of commercial bankers to discover what changes in present MDI cofinancing practices would make cofinancing more attractive to them. The bankers suggested the following colon.

i. A greater participation for the banks in the discussions with the potential borrowers.

ii. A streamlining of procedures.

iii. More quote commercial unquote terms and conditions of loans.

iv. improving corss-default cluses.

15. The Task Force agrees that there is some merit in (i) and (ii) above and recommends that MDIS be requested to explore ways with financial institutions and borrowers to implement them. Some members of the Task Force also believe that (iii) would be an acceptable price to pay, if significant additionality can be secured.

16. The Task Force discussed various ways of improving corss-default clauses. In principle, such impovements could range form relatively modest change in the present optional arrangement to a far-reaching midification, making the acceleration of loan repayments mandatory. The more modest changes might consist of (i) modification of the executive board of the MDI concerned of significant defaults or delays in payment

on the colenders'loan semicolon or, if that failed to restore normal banking relations, (ii) agreement by the MDI that it would consult with colenders and participate in the effort to negotiate remedies with the borrower concerned. The strongest form of cross-default clause (a quote mandatory unquote clause)would require, (iii) the MDI to seek accelerated repayment of its loans if the colenders decided to do likewise semicolon it might be possible to incorporate some safeguards for borrowers in such a clause to ensure that it would be implemented only as a last resort when other attempts to find a solution satisfactory to colenders and the borrowers had failed.

17. The Task Force agrees taht such changes to cross-default clauses could only be justified if they promise worth-while additionality and that the amount of modification to be introduced should be the minimum needed to achieve that end. It oalse agrees that there is no accurate way of estimating in advance how much additionality might be expected from each of the theree steps discussed above. Some members of the Task Force therefore favor some modification of cross-default clauses, perhaps in an exploratory way, starting with minimum changes in order to test their acceptability to both colenders and borrowers.

18. However, such changes, particularly quote mandatory unquote corss-default clauses, raise some fundamental issues. In the view of other members of the Task Force, these are sufficiently serious to make the introduction of mandatory clauses by

MDIS unacceptable, regardless of the expected amount of additionality.

19. These fundamental issues include the following colon

(i) Mandatory loan acceleration would make it more difficult or impossible for and MDI to exercise its justified.

(ii) By threatening the excellent service record of MDI loans, such a clause could impair the credit standing of the MDIS and so increae the cost of their financing. This would increase the cost of their lending to all borrowers and thus be detrimental to their interests.

(iii) Mandatory corss-default cluses could undermine the interests of borrowing countries, as lenders might require such cluses as a minimum requirement in all future loans.

20. The Task Force recognized the seriousness of these issues byt was unable to agree to what extent the promise of additionality would justify subordinating them in the interests of enlarged capital flows. It therefore, urges MDIS to seek an acceptable balance between risk and protection in their future discussions with potential colenders and borrowers.

21. Whereas cofinancing involves a direct loan agreement between the borrower and the colender(s), the purchase of a participation in an MDI loan involves no separate loan agreement. Participation sales by MDIS have been of two main types colon

i Participations as such, negotiated between an MDI and private lenders after the terms of the loan have been determined but before disbursement to the borrower has commenced.

ii. Porfolio sales form existing loans, after completion of loan disbursement to the borrower. The world Bani discontinued

this practice in 1977.

In either case, the sale is made on a quote no recourse unquote basis and is negotiated for standerd fixed-rate loans. The task force notes that such sales could be assimilated to quote expost unquote cofinancing.

(i) a new framework for commercial lender participations in MDI loans.

22. The Task Force recommends that, where applicable, MDIS should consider increasing their loan participation programs by adopting a framework that would take account of international finnacial markets as sources of medium-term floating rate funds.

23. This new framework is designated quote complementary financing unquote. (the IDB and IFC already have a program of complementary financing, broadly similar to that set out here). It differs from existing practices chiefly by adopting a dual loan structure. When complementary financing is resorted to, the extension of credit by an MDI would involve two loans, designated as quote a unquote and quote B unquote. The quote A unquote loan would be funded solely by an MDI and be structure in accordance with its current practice. The quote B unquote loan would also be negotiated between that MDI, in consultation with the commercial lenders and the borrower. As distinct from the quote A unquote loan, the quote B unquote loan would include the participants' contributions. It would be

structered to meet tge requirements of commercial lenders, that is, be at floating rates and have maturities acceptable to them. The precise therms and conditions of quote B unquote loans would evolve in line with market practices.

24. It can be expected that income-generating industrial projects will be favoured by financial institutions attracted by complementary financing. For such projects, each MDI would seek the borrower's authorization to solicit BIDS for the quote B unquote Loan. The MDI would evaluate such offers and transmit them to the borrower with appropiate recommendations. Assuming borrower approval, the terms of the quote B unquote loan would be finalized. These terms might include some of the fetarues recommended in the context of traditional cofinancing.

25. Where apprpriate, participants could organize as a syndicate and appoint a lead-bank to deal with the MDI on loan documentation, disbursements etc. Participations in the quote B unquote loan would be sold by that MDI to financial institutions on a quote best effrots unquote basis, that is without any underwriting commitment on its part. Funds obtained in this fashion would be made available to a borrower as, if, and when received by the MDI from the participants. If private lenders'participations were to fall short of the targeted amount of the quote B unquote loan, this shorfall would have to be net by the borrower, either from domestic or international sources.

26. The Task Force noted that sales on a quote best effort unquote basis could entail certain risks for borrowers, insofar as a shortfall of funds could affect the completion of projects

financed in this manner. The Task Force also noted that MDIS might become involved in loan syndicationin connection with quote B unquote loans and raised the question whether this might entail certain underwriting commitments on their part.

27. The Task Force considers that the principal issue of the quote B unquote loan for their own account. In the absence of such retention, this formula would offer lenders roughly the same protection as cofinancing, albeit in a framework where MDIS could possibly attract substantial commercial funds. Conversely, where retention of a portion of a quote B unquote loan is adopted by an MDI, its preferred creditor status would be extended to commercial participants in that loan. However, giving a preferred creditor status to participating commercial lenders could adversely affect the borrowers, by reducing their flexibility in dealing with serious debt management problems. It might also dealing with serious debt management problems. It might also raise objections from other -non-preferred- commercial lenders to a country which was affected by these difficulties.

28. A further implication of MDI participation in a quote B unquote loan is that the MDI concerned would become engaged in floating rate lending.

29. The Task Force recommends that MDIS review the proposals outlined above and consider the advantages and disadvantages of adopting such a framework. The issue of MDI participation in quote B unquote loans should be scrutinized with particular care and legal advice sought on this point.

(II) Increased sales by mdis from their existing loan portfolios.

30. The Task Force believes that mdis could mobilize additional commercial funds for developing countries by promoting sales from their existing loan portfolios.

31. In order to ensure that portfolio sales do not become a costly alternative to direct borrowing by mdis and to safeguard the objective of additionality in non-concessional flows, the Task Force recommends that portfolio sales be based on the following principles colon

(I) Interest rate differentials not be reimbused to borrowing countries but accrue instead to the mdi concerned.

(II) Portfolio sales be marketed not merely on the attractiveness of particular currencies, but rather on the attractiveness of selected borrowers, credit positions. This would help familiarize commercial lenders with particular country borrowers, and pave the way for their future direct market access.

(III) Portfolio sales be built into a regular program, commensurate with the operating scale of each mdi, and that future sales be deducted from the projection of disbursed loans used to determine the permissible level of quote steady state unquoted lending.

32. The Task Force wishes to emphasize that whereas the contribution of cofinancing and complementary financing to increasing resource flows would be direct — even if difficult to forecast accurately — that of portfolio sales is likely to be indirect. If participations purchased from an mdi are added to the finantial markets, aggregate lending to developing countries, such funds will, in the first instance, accrue to that mdi. Strictly speaking, non-concessional resource flows will only increase when these funds are on-lent by the mdi to developing countries.

33. The Task Force believes that portfolio sales could appeal to smaller banks and other fixed rate lenders that might see this instrument as less risky than the purchase of a participation in a syndicated commercial bank loan. From a marketing viewpoint, portfolio sales should thus be regarded as parallel to complementary financing, the principal distinction

being that the former concerns existing loans and the latter new financings.

SECTION 4 COLON THE USE OF MDI GUARANTEES.

34. The Task Force noted that two separate issues should be considered under this heading, namely the use of mdi guarantees, on the one hand, and the development of new multilateral guarantee frameworks, on the other.

35. As regard the latter, the Task Force has received proposals from the Dutch, French and Mexican Delegations, each of which sets out a tentative institutional framework for multilateral guarantee. These proposals will be discussed in detail by the Task Force at its next meeting.

36. With regard to mdi guarantees, the Task Force considers that full mdi guaranttes of commercial loans to developing countries are unattractive for several reasons colon

(1) Fully-guarantted loans are unlikely to be an effective means of familiarizing commercial lenders with the borrower concerned since the underlying country-risk would not need to be investigated.

(II) Fully-guaranteed loans raised by a country might create a precedent and jeopardize the success of future unguaranteed borrowings by the same country.

(III) There are no obvious cost advantages for the borrowers since the mdi guarantee fee would absorb the larger part of any interest rate reduction resulting from the guarantee.

37. Partial guarantees, on the contrary, lend themselves to selective use (for example, they could cover later maturities of a given loan, or be restricted to princial or to interest payments) which makes them a possible tool to stimulate non-concessional resource flows. Furthermore insofar as the guarantee fee would be restricted to that portion of a loan which is covered by such partial guaranttes, the cost impact on borrowers would be limited.

38. So far, partial guarantees have not been provided by the IBRD or other mdis, possibly because conditions in international capital markets in recent years have favored borrowers. The Task Force considers that the

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international financial climate of the 1980s may elicit a greater demand for partial guarantees and recommends that mdis introduce the necessary procedures to offer such partial guarantees to financial institutions.

39 The Task Force noted that one operational drawback arising from the use of guarantees is that they reduce an mdi's lending authority in the same way as loans disbursed and outstanding. In other words, the lending authority is diminished from the moment guarantees are issued, that is, regardless of the actual drawdown of guaranteed loan facilities.

40. The Task Force therefore recommends that mdis be asked to examine procedures necessary to ensure that guarantees be treated pari passu with loans and that they impair their lending authority only after guaranteed loans have been disbursed.

41, The Task Force also recommends that mdis and their member governments should examine the implications of direct quote guarantee leverage unquote, that is, of procedures wereby the lending authority is courtailed by less than the amount of the guarantee. This recommendation is based on the hypothesis that only a small proportion of guarantees is ever likely to be effectively called upon by guaranteed lenders. The introduction of such measures would be tantamount to increasing any mdi's combined loan and guarantee ceiling beyond current gearing limits.

42. The Task Force noted that, to introduce the changes in guarantee procedures recommended for examination, the statutes and slash or articles of agreement of mdis may have to be modified.

SECTION 5 COLON LOAN PASS-THROUGH CERTIFICATES.

43. The Task Force proposes that mdis should examine the possibility of issuing partially-guaranteed quote pass-through unquoted loan certificates, based on a pool comprising a cross-section of disbursed loans. The certificates would be partially guaranteed by the mdi concerned up to a fixed amount, to provide an uninterrupted income stream for certificate holders. Irrespective of possible payments by the borrowers whose loans have been pooled. Each loan certificate would represent a fractional undivided interest in each of the loans contained in that pool.

44. The governing principle of the pass-through program would be risk diversification through the multiplicity of loans and borrowers included in each quote pool unquote of loans. The partial guarantee would be structured so as to apply equally to defaults on or late payments of interest and slash or principal of certificates outstanding.

45. At the outset, all loan pools (and the attendant pass-through certificates) would be denominated in single currencies. The currency of a given pool would be determined in the light of market preferences at the time each pool was set up and subject to the dual constraint of (1) availability in an mdi's portfolio of sufficient loans or loan maturities in that currency semicolon and (11) the mdi's earned yield on loans in that currency.

46. Bearing in mind investors' preferences for liquid financial assets, the Task Force considers that a secondary market for loan pass-through certificates would have to be organized by each mdi in cooperation with the investment bank(s) acting as selling agent in the placement of such certificates. In this connection, the Task Force wishes to stress the potential financial implications for mdis of organizing a secondary market.

47. Furthermore, the implementation of a loan pass-through program would entail certain additional tasks for mdis, such as collecting and paying agency services on the certificate holders' behalf. The Task Force recommended that the legal and cost implications of such services be examined.

48. The principal attraction of the proposed loan pass-through program is that it would result in the creation of a new type of negotiable international financial asset, distinct from traditional loan or portfolio participations. Such certificates might prove particularly attractive to a category of private investors - as distinct from commercial banks - who have hitherto been unable to partake in existing forms of developing country finance. The Task Force also believes that this formula could appeal to smaller or regional commercial banks whose lending policies do not normally include developing country risks and whose risk perceptions could be influenced by the negotiability of the proposed instruments.

If this belief is correct, a degree of indirect additionality would be attained, since the certificate holders'contributions would increase each mdi's subsequent lending potential.

49. The Task Force therefore concluded that, provided the interest rate structure of international money - and capital markets becomes favorable and can accommodate the yield ceilings mentioned in paragraph 45 (II) above, loan pass-through programs could satisfy the objective of additionality in a manner similar to portfolio sales. Furthermore, by attracting new lenders, such programs could raise the financial markets'aggregate lending ceilings for developing country borrowers. Part III colon external indebtedness of developing countries.

50. The Task Force has discussed some of the main issues relating to the external indebtedness of developing countries. For this purpose, it had before it a comprehensive set of papers prepared by the Fund staff describing and analyzing the principal aspects of this question. These papers were discussed on January 26, 1981 by the Executive Directors of the Fund who approved the staff proposals regarding the Fund's role in the context of the newly adopted UNCTAD resolution on debt and development problems of developing countries (Resolution 222-XXI). The Task Force commends the Fund staff for these papers and welcomes the decision of the Executive Board to publish them.

51. The Task Force emphasizes that developments regarding external debt must be viewed in the broader context of the world economic situation. It recognizes the serious debt situations facing a number of developing countries. It notes that several factors, both domestic and exogenous, have brought the debt issue to the forefront of problems facing these countries including the rapid rise of external debt in the recent past, changes in its composition and the consequent hardening in the average terms of debt, and the rise in the level of debt service burden resulting from these developments. The Task Force believes that both short-and longer-term aspects of the debt question must be kept under constant vigilance.

52. The Task Force has examined the implication of these factors for the economic development of developing countries. A large number of developing countries rely to a considerable extent on external sources of finance to supplement domestic savings. The external debt difficulties facing many countries could have a negative impact on continued inflow of external resources. The Task Force stresses the importance of sound debt management, including borrowing on appropriate terms, in order to avoid debt servicing problems and thus help sustain inflows. At the same time, the Task Force continues to believe that a sustained large capital inflow will be necessary.

53. The Task Force has discussed the question of the debt indicators frequently employed in analyses of debt situations of developing countries. It notes the importance of bearing in mind the purpose for which debt indicators are used and the particular qualities of various indicators semicolon great care must be exercised when utilizing debt indicators. The Task Force emphasizes that debt indicators, taken on their own, are not a substitute for comprehensive reviews of the economic situation and prospects of the countries involved.

54. The Task Force has also discussed the impact of inflation on external debt, including the proposition that anticipated inflation leads to a more rapid amortization of a given loan since actual interest payments include a component reflecting the erosion of future amortization payments. This question is of increasing importance because private commercial loans extended at variable interest rates, which incorporate inflationary expectations, are becoming the dominant form of finance for many countries. The Task Force is concerned that failure by creditors to take this factor into account may have a negative impact on financial flows. It is particularly important to avoid situations where, by cutting back on new lending, banks may add to balance of payments instability. The Task Force encourages further study of this subject.

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55. The Task Force notes that debt servicing problems have emerged in several countries and that an increasing number of them have sought debt rescheduling. It notes that these problems evolved over a period of years and reflected the accumulated effects of external and internal imbalances attributable to a variety of factors. The Task Force emphasizes that an important objective of debt rescheduling should be to re-establish the creditworthiness of the debtor country, allowing it to honor its commitments, and to promote the restoration of financing flows interrupted by debt problems. Debt rescheduling should be viewed as part of a comprehensive effort to help the debtor countries implement the necessary adjustment policies.

56. The Task Force redgnizes the importance of a multilateral framework which brings together the interested parties to discuss debt matters. It considers that the existing multilateral arrangements for the renegotiation of official debt constitute an effective forum for the rescheduling of public and publicly guaranteed debt. It notes that the Fund and the Bank intend to cooperate in a very informal manner with UNCTAD on debt matters.

57. The Task Force has discussed the restructuring of debts to commercial banks. In view of the increasing proportion of debt owed to these Banks, the Task Force recognizes the contribution that restructuring operations by these institutions can make, if required, in the overall context of the flow of resources to developing countries. It acknowledges, however, that the approach of private banks to debt restructuring is governed by considerations different from those of official institutions. It also recognizes that governments and inter-governmental institutions cannot determine the conditions for private debt restructuing. Nevertheless, the Task Force encourages banks to take constructive approach to debt restructuring and to examine ways in which they can be of further assistance in assuring stable and sustained financial relations with developing countries. It is important that private debt restructuring should be viewed as part of a comprehensive effort to assist the debtor country concerned. The IMF, the World Bank, and the regional development banks might be able to provide

58. In regard to the long-term aspects of the debt problem, the Task Force felt that questions regarding the relationship between different sources of finance for developing countries, especially taking into account the magnitude and nature of their financing requirements, must be kept under review.

Part III. Increase in lending capacity ofmultilateral development institutions (MDIS).

59. The Task Force will be examining several propositions such as a change in the gearing ration of MDIs, the establishment of affiliates in the MDIS, including an energy affiliate of the World Bank, and other ways of increasing flows of funds from the MDIS. For these discussions the Task Force has suggested that a paper be prepared by the staff of the World Bank for consideration by the Task Force no later than July.

60. The Task Force, at its meeting of October 1980 in Puerto Marquez, Mexico, asked representatives of financial institutions to comment on these issues. There was a discussion of the possibility of modifying the quote gearing ration unquote of the World Bank, that is relaxing the satutory lending limit in order to help to increase the flow of resources to developing countries. There was general agreement among the representatives of financial institutions that the international capital markets had the capacity to absorb somewhat larger borrowing programs by MDIS, although there was disagreement wheter modification in the gearing ratio would affect the quality of the bonds issued, or the borrowing standing of these institutions. Many current holders of World Bank bonds are believed to look upon the soundnes of the institution rather than the gearing ratio or the guarantee provided by the callable capital for the purchase of bonds. This would suggest that there would not be a problem in modifying the gearing ratio. Nevertheless other creditors may attach considerable importance to the existing ratio which constitutes a 100 percent backing of bonds by the capital of the World Bank.

It is thus possible that the impact of a change would vary from one group of creditors to another. One possibility is that the ratio might be removed from the articles entirely and replaced, for example, by a bylaw. It was suggested however that even if the ratio were relaxed, the World Bank would need to proceed cautiously in any consequent expansion of its lending program.

61. The Task Force has considered the possibility that the flow of non-concessional capital to developing countries could also be increased through the creation of new institutions, or affiliates of existing institution, that would finance activities of high priority. The Task Force questioned representatives of financial institutions on three specific proposals.

62. Regarding the creation by an MDI of an institution similar to a comercial bank that would take deposits and lend to developing countries at market rates, the bankers pointed out that this proposal had limited possibilities and they tended to doubt whether the creation of this kind of institution could generate additionality of resources. There were some doubts also whether a facility for financing purchases of capital goods by LDCS would necessarily lead to additionality of resources.

63. The bankers suggested that there might be some interest in the possibility of the creation of an affiliate of the World Bank dedicated to the financing of energy projects in LDCS. Overall the representations of the financial community saw merit in further examination of the proposal to establish an energy affiliate of the World Bank.

64. The Task Force understands that the expansion of the World Bank's lending program and ancillary issues will be discussed by the Development Committee.

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir Kenneth Couzens
Mr Mountfield
Mrs Hedley-Miller
Mr Hawtin
Mr St Clair
Mr Slater
Mr McIntyre
Miss Burton

VISIT OF SENOR IBARRA

I attach full briefing for your meeting tomorrow morning with the Mexican Finance Minister.

2. There are essentially three strands to this: the activities of the Development Committee of which Sr Ibarra is now the Chairman; oil and energy issues, since both the UK and Mexico are significant producers; and Mexico itself, a country of increasing importance, both as an export market and in the world generally.

3. I suggest you spend as little time as possible on the Development Committee, on which as you will see from the brief, there is not a great deal to be said. I hope however that you will make some complimentary remarks about the Task Force on Non-Concessional Flows, since Sr Alfredo Phillips, of the Bank of Mexico, who will be accompanying Sr Ibarra, is the Chairman of that Task Force (modesty will no doubt prevent you from mentioning that most of the useful work in that Task Force has in fact been done by Mr Kent of the Bank of England).

4. Having disposed I hope fairly quickly of the Development Committee, you will be able to get onto the subject of Mexico itself, its oil production and reserves and its economic prospects generally. On these I am not sure whether you ever saw the note which I did after a brief visit I paid to Mexico City last summer. I attach a copy, in case you have time to glance at it. I do not think there is anything in the briefing now prepared for you for Sr Ibarra's visit which is inconsistent with the comments which I made last year. The potential, and the problems, of the country are enormous.

F R BARRATT
9 April 1981

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14/4/81.

NOTE OF A CALL BY THE MEXICAN MINISTER OF FINANCE ON THE CHANCELLOR OF THE EXCHEQUER AT 11.00 A.M. ON FRIDAY 10 APRIL 1981 AT NO.11, DOWNING STREET

Present:

Chancellor of the Exchequer (In the Chair)
Mr Barratt
Mr Tolkien

Senor Ibarra, Minister of Finance, Mexico
Senor Romero, Director General, Banco de Mexico
Senor Phillips, Deputy Director of Internationa
Affairs, Banco de Mexico

Senor Ibarra said that, as Chairman of the Development Committee, he had been consulting various countries, including West Germany and France, in preparation for the meeting of the Committee in Gabon. He was seeking a consensus to avoid any confrontation, particularly with the United States, where the administration had not yet declared their policies on relevant issues. At the same time, however, the developing countries were facing difficulties now and would therefore be looking at Gabon for measures which would assist them, though there were different views about what they should be. Three areas in which the developing countries were seeking progress was increasing the lending programme of the IBRD, the IDA replenishment and the proposed energy affiliate to the Bank. He thought that developed countries generally took a more optimistic view than the Americans, whose position was crucial, might take. He had seen the US Treasury Secretary recently, but he had not, at that stage, been prepared to express a view on the issues. IDA replenishment was particularly crucial: without action reserves would be exhausted very soon. A possible solution, with which the French and Germans were in general terms sympathetic, would be for other countries to make advanced payments, allowing the United States to make payments in due course.

/The Chancellor said that

2. The Chancellor said that whilst the IDA should not be allowed to become exhausted, it was important on this issue, and more generally, to avoid over-pressing the United States, since that would be counter-productive. He understood that there had already been one round of bridging payments to IDA and the immediate issue was whether there should be a further round. He understood that the French and the Germans had not yet committed themselves. Mr Barratt explained that at the recent meeting of IDA deputies the general view was to wait and see what the Americans would say. They, in turn, were hoping for a decision from the Congress by June and there could be a further meeting of deputies then. The Mexicans said that their bilateral talks at Assistant Secretary level suggested that the Americans did not expect a decision before October.

3. On the energy affiliate, the Chancellor said that the draft agenda for Libreville was over-precise. Whilst he supported in principle developing a facility of this sort, he doubted whether establishing a new institution represented the best way of proceeding. Rather, he favoured developing existing institutions. Mr Barratt added that the UK had participated in the initial discussions about the affiliate in order to see what it would involve. The attitude of the United States would be crucial.

4. Senor Ibarra said that the Development Committee had considered several ways of assisting the position of developing countries - the energy affiliate, increasing the gearing ratio of the IBRD and increasing its allocation, and issuing additional SDRs. The developing countries thought the emphasis had to be on increasing the total amount of resources available to them, rather than re-ordering priorities within an existing provision. In reply, the Chancellor said that these aspirations had to be considered against the background of a very difficult world economic situation.

/The economies of the

The economies of the developed world were experiencing low or negative growth and seeking to cut domestic public expenditure. This was bound to have implications for total aid flows. At the same time the emphasis was being moved from multi-lateral to bilateral assistance. Against this background, the emphasis should be on improving the working of existing institutions, developing links between those bodies and private institutions and increased use of non-concessional flows.

5. Senor Ibarra agreed that progress should be made in these areas, but thought that, political and economic considerations, as well as the likelihood that the commercial banks would not be as successful at recycling funds as they had been after 1973, were strong reasons for increasing multi-lateral aid flows.

6. Senor Phillips outlined the work which the Task Force on non-concessional flows, of which Mr Kent of the Bank of England was the UK representative, had undertaken and explained that it would be submitting a report to the Development Committee to be considered at Libreville. (He handed to the Chancellor a copy of the report.) The Chancellor said he would ask his officials to consider the report closely.

7. In reply to a question from the Chancellor, Senor Ibarra said that he envisaged the initial work of the proposed new task force on concessional flows as being to describe and assess existing flows, rather than to highlight points for decision. The Chancellor thought it important to avoid establishing a body which would simply highlight differences of view. It was particularly important to assess the effectiveness of concessional aid flows. Senor Ibarra said that soundings so far suggested a Dutch or Scandinavian official should be the Chairman of the Task Force. He added that membership was developing fast and terms of reference were being worked out.

/Clarifying the UK's

Clarifying the UK's position, Mr Barratt said that the UK expressed no objection to the task force but had not yet said whether it would want to be a member.

8. Senor Ibarra said that the study on sub-Saharan Africa was not yet ready; it would probably be an item on the agenda at Libreville as a courtesy to African countries.

9. Senor Ibarra said that the overriding issue at Libreville would be how to increase aid flows; without an understanding on this the meeting would be a failure. The Chancellor again stressed the need to avoid raising expectations unduly or over-pressing the Americans early in the life of the new administration. Senor Ibarra said that the Executive Board of the IBRD would be meeting on 14/15 April to revise the agenda. The Chancellor said that the UK was happy with the agenda as it stood.

10. Senor Ibarra asked the Chancellor whether, at the forthcoming meeting of the G5, he would be prepared to advocate the proposition that other countries should push ahead with IDA replenishment and the energy affiliate, allowing the United States to catch up once they had defined their position. In reply, the Chancellor said he had not yet discussed these issues with the United States and would be hesitant to pursue the approach which Senor Ibarra was suggesting. He judged that Gabon would provide the first occasion on which it would be right to seek a view from the United States on these issues.

11. On the Mexico Summit, Senor Ibarra thought that the main business would be simply to exchange views. The Chancellor agreed, adding that it was important not to raise expectations unduly, if disappointment was to be avoided.

/Senor Ibarra said that

12. Senor Ibarra said that the Mexican economy was going well. With employment growing at 5-6 per cent per year, which was a good deal more than population growth, unemployment was falling. There was however a shortage of skilled labour and inflation was deteriorating. They had recently introduced VAT. The Chancellor noted that, being an ad valorem tax, its yield rose with inflation, thus avoiding the need for unpopular discretionary changes in taxation.

R.I.T.

R I TOLKIEN

14 April 1981

Circulation:

Chief Secretary
Financial Secretary
Sir K Couzens
Mr Barratt
Mr Mountfield
Mrs Hedley Miller
Mr Hawtin

PS/Foreign & Commonwealth Secretary
PS/Governor of the Bank of England