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PART A

Part. A

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Begins: 6/9/84
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PART A

Chancellor's (Lawson) Papers:

BRIEFING FOR THE 1984 INTERNATIONAL MONETARY FUND AND INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT MEETINGS

Disposal Directions 25 Years

[signature]
21/7/95.

PO -CH /NL/0064
PART A

FAB(84)2 ADMIN
6 September 1984

COPY NO.

HM TREASURY

BRIEFING FOR THE 1984 ANNUAL MEETINGS OF

THE IMF, IBRD AND COMMONWEALTH FINANCE MINISTERS

A revised list of the briefs for these meetings is attached, together with the first batch of briefs. The remainder of the briefs will be circulated next week.

HM TREASURY
September 1984

P C DIGGLE
A B MILLIGAN

196/1a

BRIEFS FOR CFM, IMF AND IBRD ANNUAL MEETINGS

Brief no FAB(84)		TITLE AND COVERAGE
A.	**Procedural**	
	1	IMF/IBRD procedural issues: Interim Committee Chairmanship Future meetings Election of Executive Directors Joint Procedures Committee Observers
B.	**General Issues**	
	2	World Economic Outlook
	3	Debt: recent development and prospects multi annual rescheduling export credit rate capping mortgage-style relief
	4	International monetary reform: G10 studies
C.	**IMF**	
	5	SDR Allocation
	6	Access to IMF resources: including CFF
	7	IMF liquidity: including borrowing requirements/GAB
D.	**World Bank**	
	8	Spring meeting of Development Committee
	9	World Bank: including capital requirements and lending levels lending for adjustment
	10	Linkage between trade and the promotion of development: protectionism, Newly Industralising Countries, UNCTAD
	11	Development Committee Progress Reports: IDA 7 IFC capital increase
	12	Sub-Saharan Africa (including Fund for Africa)
	13	IBRD: World Development Report
	14	International Centre for the Settlement of Investment Disputes

196/1a

BRIEFS FOR CFM, IMF AND IBRD ANNUAL MEETINGS

Brief no FAB(84)		TITLE AND COVERAGE
E.	**CFM**	
	15	Commonwealth countries relations with IMF: Australia, Belize, Dominica, Gambia Ghana, Guyana, Jamaica, India, Kenya Malawi, Mauritius, Nigeria, St Kitts and Nevis, Sierra Leone, Sri Lanka, Tanzania, Uganda, W. Samoa, Zambia, Zimbabwe
	16	Commonwealth Functional Cooperation (CFTC)
	17	Commonwealth Consultative Group
	18	Commonwealth Experts (Lever) Group
F.	**Background**	
	19	US economy
	20	Canadian economy
	21	UK economy - aide memoire
	22	UK aid programme
	23	IMF relations with UK
	24	IMF current business, including conditionality, surveillance and recent developments
	25	Problem countries: Argentia Brazil Mexico Nigeria Philippines Poland Yugoslavia
	26	International Trade (including GATT)

196/2

FAB(84)1 PROCEDURE

B(84)1 Copy no

September 1984

HER MAJESTY'S TREASURY
IMF/IBRD ANNUAL MEETINGS 1984
COMMONWEALTH FINANCE MINISTERS' MEETING 1984

IMF/IBRD Procedural Issues

This is a background brief, covering points which may be raised in the margins of the Fund and Bank meetings.

Interim Committee Chairmanship

2. De Clercq is expected to relinquish the Chairmanship of the Interim Committee before the Spring 1985 meeting. Informal consultations are in progress among the G10 to find a successor. Ruding has expressed interest in the post.

Spring 1985 Meetings

3. The spring meetings of the Interim and Development Committees are usually held consecutively in Washington in April. In 1985 there will probably be a break with tradition.

4. Special meetings of both Interim and Development Committees are likely to be needed, probably in late January or early February (see briefs B4 and D8). The regular meeting of the Interim Committee, and perhaps also the Development Committee, might take place in Paris in April near an OECD ministerial. All details are unclear and will need to be discussed informally before the Development Committee.

Forthcoming Annual Meetings

5. The 1985 Annual Meetings will be held in Seoul from 8 to 11 October. There is an informal understanding that the Chairmanship rotates around the main geographical areas, and in 1985 it is the turn of the francophone African Governors to fill the post. The Governors Tour of Senegal and Daouda of Cameroon have been nominated. Informal consultations in progress among francophone IMF/IBRD Executive Directors have not resolved in favour of a single candidate. Consultation will continue at the franc zone meeting in Paris on 17-18 September and if necessary among the francophone constituency in Washington on 20 September.

6. The 1986 and 1987 Annual Meetings will be held in Washington. The IMF and IBRD Governors [have voted to accept] the German invitation to hold the 1988 Annual Meetings in West Berlin.

New Members

7. St Christopher-Nevis (St Kitts) joined the IMF and IBRD on 4 April.

8. Mozambique applied to join the IMF last April, in the hope of finalising membership by the time of the Annual Meetings. Procedures have been accelerated. But Mozambique has been arguing for a quota higher than that recommended by the appointed Committee of IMF Executive Directors. If Mozambique decides to accept the Committee's recommendation, the application to join the Fund could be placed on the Annual Meetings Agenda for a vote by the Governors. We should support. The votes of the UK may be cast by the Governor for the IMF, an Alternate Governor or a temporary Alternate Governor.

9. Other prospective members are:

(a) Kiribati (pronounced Kiribasse), formally the Gilbert Islands until independence in 1979 and now a Commonwealth member. It is expected to join both Fund and Bank in 1985.

(b) Switzerland, where the government has taken a decision in principle and is hesitating over whether to proceed without a referendum. Switzerland became a full member of the GAB earlier this year (see brief C7).

(c) Poland

Regular Election of Executive Directors

10. The biennial election of IMF/IBRD Executive Directors is scheduled to take place on Tuesday, 25 September, in plenary session. The UK, which appoints a Director in both institutions, is not directly involved.

11. Under the IMF Articles, the five countries with the largest quotas (USA, UK, Germany, France, Japan) each appoint a Director. Saudi Arabia, as one of the two largest creditors of the Fund in the two years preceding the Election, will also appoint a Director (as it has since 1978). The Regulations governing the 1984 election provide for sixteen additional Directors to be elected, the same as in 1982. There is a theoretical possibility that the small francophone African consitituency could get squeezed out. This seems unlikely because of the long-standing tradition that the number of nominees should not exceed the number of seats. In any case, the Regulations allow the Governors to elect an additional Director, ex post, in order to maintain the existing geographical balance in the Executive Board.

12. Five members of the IBRD Executive Board are appointed by the five countries with the largest shares (USA, Japan, Germany, France, UK). The 1984 Election Rules also provide for the election of a further 16 Directors. Governors have agreed to take special note of the risk that certain geographical areas might be under-represented on the Executive Board, and to take whatever steps are necessary to avoid this eventuality. These arrangements should ensure the preservation of existing constituencies.

Joint Procedures Committee

13. The JPC is established each year at the Annual Meetings to serve until the close of the next Annual Meetings. The JPC established last year has 22 members, viz Governors from Australia, Brazil, Cyprus, Dominica, Egypt, France, Germany, Ghana, Japan, Morocco, Netherlands, Peru, Saudi Arabia, Solomon Islands, Sudan, Sweden, Thailand, United Kingdom, United States, Venezuela, Zaire and Zimbabwe. The G5 are permanent members. Other members are nominated annually by the IMF/IBRD Secretaries' Departments.

14. The Chairman of the Boards of Governors (Noboru Takeshita of Japan in 1983-84) is ex-officio Chairman of the JPC. The two Vice Chairmen of the Boards of Governors (the Governors of Ghana and the Netherlands) are also Vice Chairmen of the JPC.

15. The JPC is scheduled to meet at 5.30pm on Wednesday, 26 September. The UK may be represented by its Governor for the IMF or IBRD, or an Alternate Governor, or a temporary Alternate Governor.

16. The JPC is an informal, advisory body available for consultation at the discretion of the Chairman. For example, the JPC, away from the publicity of plenary session, has been asked on occasion to consider contentious matters placed on the Annual Meetings

genda at short notice. The JPC does not vote nor take formal decisions. It acts normally as a steering committee to process the formal business of the Annual Meetings for submission to the full Boards of Governors. It takes note of the standard items on the Annual Meetings agenda, such as the IMF/IBRD Annual Reports and administrative budgets, and makes recommendations on the Chairmanship and other Officers for the period up and including the 1985 Annual Meetings. The reports and recommendations of the JPC on these items are presented to the plenary at the closing session by the reporting member (Australia this year).

Observers

17. The BIS has asked to be admitted as the Observer to the Annual Meetings. In July, however, the Japanese Chairman proposed to follow the example of his predecessors by not inviting any observers except Switzerland. The IMF and IBRD Executive Boards have concurred. We should have been content to admit the BIS (already an Observer at Interim Committee meetings) to the plenary sessions.

18. The Gulf Cooperation Council (GCC) has asked to be admitted as an observer to the Interim Committee. [Informal consultations on the matter are in progress among IMF Executive Directors. We are unenthusiastic but should not hold out against a consensus which favoured the admission of the GCC.]

19. It is possible, though unlikely, that the question of observer status for the PLO may be resurrected. In 1981 the JPC was asked to consider the matter after it had been placed on the Annual Meetings Agenda by the Arab Governors. The JPC agreed to a procedural solution referring two draft Resolutions, put forward by the Arabs and the United States respectively, to the IMF and IBRD Executive Boards "for their consideration as appropriate". Since then, there has been no further discussion in the Executive Boards.

UKdel IMF/IBRD Washington

September 1984

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HM TREASURY

IMF/IBRD ANNUAL MEETINGS AND

COMMONWEALTH FINANCE MINISTERS MEETINGS 1984

World Economic Outlook

Line to Take

(a) Economic recovery in industrial countries particularly the US proving stronger than expected. Recovery in world trade has allowed some pick up in output in developing countries. Important for growth in Japan and Europe to be sustained next year, especially if US growth weakens.

(b) Financial position of many developing countries improved over the last year. Firm adjustment efforts and recovery in world trade have both contributed.

(c) But difficulties still remain and upward trend in US interest rates this year is a cause for concern to both industrial countries and LDC's.

(d) Economic policies should consolidate and extend progress achieved on growth and inflation. This calls for firm monetary policies to keep inflationary pressures in check and further reductions in underlying budgets deficits especially in the US.

(e) Greater efforts are needed to overcome structural rigidities and promote flexibility, especially in Europe. This extends to external as well as domestic markets. Risk that protectionist pressure could hamper developing countries' export efforts. Further capital market liberalisation desireable to improve working of international financial system.

(f) Stability of international system depends on major countries, especially reserve currency countries, pursuing coherent policies. Important to take account of effects of domestic policies on other countries. US fiscal policy notably out of line. Convincing programme to cut the Federal deficit would reduce risks of higher interest rates and allow orderly adjustment of the dollar.

Recent Developments and Prospects

1. Activity in the industrial countries rose by 2½ per cent last year with strong growth in the US and Japan compared to a more modest recovery in Europe. US GNP rose by almost 9 per cent (annual rate) in the first half of this year. Industrial production has

continued to rise strongly in Japan, but has remained weak in Europe. Output in Germany has recently been affected by industrial disputes while in France and Italy it remains sluggish.

7. Most expect US growth to slow later this year and then again more sharply into 1985 though recent indicators suggest growth may not decline as much as first expected. The Japanese recovery could start to slow next year while in Europe activity could pick up a little to around 2-2½ per cent.

GDP growth (per cent per annum)*

	1983	1984	1985
US	3¾	7¼	4
Japan	3	5	4
Germany	1¼	2¾	2½
France	¾	1¼	1¾
Italy	-1¼	2½	2½
Canada	3¼	4½	3
UK	3¼	2½	2½
G7	2¾	5¼	3½
Europe	1¼	2¼	2½
Industrial	2½	5	3½

8. Unemployment in the industrial countries has flattened out largely reflecting the sharp fall in the US where the rate has fallen by 3½ points since the end of 1982 to 7½ per cent. In Europe it has continued to rise reaching almost 11 per cent now. Employment experience has varied with a 6¾ m increase in the US since 1982 but stagnation in Europe. Growth projections suggest US unemployment could decline a little further but most European countries are not expected to make significant inroads into the number of jobless.

Unemployment rates (per cent)

	1983	1984	1985
US	9½	7½	6¾
Japan	2¾	2½	2¼
Germany	8¼	8¼	8
France	9	10	11
Italy	9¾	10	10
Canada	12	11¼	11
UK	12¼	12¼	12
G7	8¼	7½	7¼

* All table from IMF sources unless otherwise shown.

9. Inflation in the major countries has fallen from 12 per cent in 1980 to about 5 per cent now helped by lower earnings growth now at just under 6 per cent. The fall in inflation since 1980 has been most marked in the US and the UK but in France and Italy where adjustment started later progress has been more limited. The Fund are forecasting no further progress on inflation with the rate stabilising at around 4-5 per cent.

10. Among the major European economies inflation could decline further although the German metalworkers' agreement could increase unit labour costs and affect negotiations elsewhere. US inflation may pick up slightly next year and wage pressures could intensify if the autoworkers achieve a favourable result from their autumn negotiations. Any significant fall in the dollar would also worsen US inflation prospects.

Consumer price inflation (per cent per annum)

	1983	1984	1985
US	3¼	4½	5
Japan	1¾	2¼	2¼
Germany	3	3	3
France	9½	7½	5½
Italy	15	11½	11¼
Canada	5¾	5	4¾
UK	4½	5¼	5
G7	4½	4½	4¾
Europe	7¼	6¼	5¾
Industrial	5	5	5

11. The strong growth in private credit demands in the US and the Federal government's borrowing needs have helped increase US interest rates by 2-2½ points since the start of the year. With inflation flat this has led to higher real interest rates. The Summer bond rally halted temporarily this upward trend and rates on 10 year bonds fell by 1 point from their peaks in July to 12¾ per cent by end August but short rates fell less to stand at 11½ per cent. Rates started to edge up again in early September.

12. Interest rates in continental European countries have not followed the increase in US interest rates this year. Widening interest differentials may explain much of the weakness of the EMS currencies against the dollar. The prospect of further increases in US interest rates has pushed the dollar to further highs against the European currencies in early September. Its effective rate is currently over 4 per cent above its previous January peak and 45 per cent above its 1980 level. The yen has also fallen against the dollar recently after being firm for most of the year.

Effective Exchange Rates (1975 = 100)

	1980	1983	1984 Q1	1984 Q2	5.9.84
US	93.8	124.9	129.0	130.2	138.7
Japan	126.2	148.5	157.2	158.7	155.2
Germany	129.0	127.4	125.6	125.8	122.6
France	93.9	69.5	66.3	66.4	64.7
Italy	67.2	51.1	48.6	48.4	47.4
Canada	86.9	91.5	84.0	88.6	90.1
UK	96.1	83.3	81.7	79.8	77.6

SOURCE: BANK OF ENGLAND

13. World trade has been growing faster than anticipated so far this year. The IMF have revised up by their forecast of trade growth in 1984 by 3 points to 8-9 per cent but still see it slowing next year to 5-6 per cent. Industrial countries' imports have been the major factor behind this expected growth and are now some 20 per cent higher than at the end of 1982. This is reflected in the sharp recovery in non-oil developing countries' exports which in turn has allowed some recovery in their import volumes. The staff see their imports growing by 6 per cent this year and next.

Import volumes (percent change)

	1982	1983	1984	1985
Industrial	-½	4½	12	6½
Non-oil dev	-8	-2	6	6
OPEC	6	-11	-2½	1½
World trade	-2½	2	8½	5½

14. Rapid domestic growth and the strong dollar have increased the US current account deficit to more than $40 billion in the first half of the year. It is expected to reach $90 billion for the year as a whole with a further increase of $115 billion next year. The Japanese surplus is expected to average $35-40 billion this year and next. After improving during 1983 both French and Italian current accounts have slipped back into deficit this year.

Short Term Interest Rates (per cent)

	1983		1984		
	Q3	Q4	Q1	Q2	3.9.84
US	9.6	9.4	9.6	11.0	11.5
Japan	6.6	6.4	6.4	6.3	6.3
Germany	5.7	6.3	6.0	6.0	5.9
France	12.4	12.4	12.4	12.4	11.3
Italy	17.7	17.9	17.8	17.2	16.8
Canada	9.3	9.5	9.9	11.2	12.2
UK	9.8	9.4	9.3	9.2	10.8

SOURCE: BANK OF ENGLAND

15. Non-oil developing countries' adjustment has helped cut import volumes sharply. Their current account deficit has more than halved since 1981 to some $53 billion last year (excluding official transfers). IMF see their exports growing by 9 per cent this year and 6 per cent next while non-oil commodity prices could increase by around 3-5 per cent a year in 1984-85. As a result deficits would fall slightly further this year but higher import growth limits any improvement thereafter. The Fund's medium term analysis of developing countries debt prospects suggests that a reduction in debt burdens could be combined with some growth in per capita incomes. The staff acknowledge that any sharp cyclical downswing in the industrial countries would jeopardise this improvement. Moreover their assumption of 3¼ per cent growth in 1985-90 in the industrial countries looks optimistic and there must be some considerable doubt whether the banks will be ready to refinance the 'hump' of debt repayments in 1985-87.

16. World recovery will also help OPEC's export earnings but continued weak oil demand many reduce real oil prices further so that OPEC countries will need to continue to restrain import growth.

Current Accounts ($ billion)

	1983	1984	1985
US	-42	-90	-115
Japan	21	35	40
Germany	4	5	6
France	-4	-2	0
UK	4	2	2
Italy	1	0	-2
Canada	1	0	0
G7	-14	-51	-69
Industrial	-19	-51	-67
Non-oil dev	-65	-58	-59
OPEC	-18	-8	-9

Policies

18. Government of the major economies are agreed over the importance of pursuing prudent counter-inflationary macro-economic policies and promoting more flexible working of goods, labour and capital markets. This broad strategy was reaffirmed by OECD Ministers in May and at the London Economic Summit in June. The IMF's latest WEO also supports this strategy.

19. Monetary growth in the largest economies slowed from an annual rate of 10 per cent in the first half of last year to 7 per cent in the second. Targets were generally met though France was an exception. Compared with last year targets for 1984 have been lowered in the US, Germany, France and the UK and this should be consistent with achieving faster real growth whilst containing inflation. In the US both narrow aggregates are within target but M3 and particularly the Fed's broad credit aggregate have grown rapidly this year and remain outside their targets.

20. Partly due to the effects of the recovery, budget deficits in the major economies are expected to fall this year - the first time since 1979. Progress in reducing structural deficits has been mixed. In recent years structural deficits in Japan and most European countries have been reduced whilst in the US deficits have continued to rise. These trends are likely to continue. OECD estimate that in the two years to 1985 the structural deficit in the US will rise by 2 per cent of GDP while they should fall by 1½ per cent in the other major six countries.

Monetary Growth (annual rates)

	82		83		84	Latest		Target
	H1	H2	H1	H2	H1			
US (M1)	6.5	8.9	14.5	7.5	7.3	5.6	(22.8.84)	(4-8)
UK (MO)	0	3.2	7.0	5.8	5.2	4.4	(August)	(4-8)
FR (M2R)	n/a	n/a	8.6	9.0	n/a	9.4	(April)	(5½-6½)
WG (CBM	5.1	6.0	8.6	6.1	4.1	4¼	(July)	(4-6)
IT (M1)	12.5	16.9	14.5	15.5	n/a			
JP (M2 + CD's)	7.9	8.3	7.0	7.8	7.7			
CAN (M1)	2.1	0.7	15.7	9.2	3.2			
G7 (M1)	6.0	8.7	12.1	7.4	6.9			

SOURCE: BANK OF ENGLAND, TREASURY.

21. The need to foster structural adjustment has been a consistent theme of recent international meetings. To help improve employment prospects further progress is needed to reduce distortions and improve competition particularly in labour markets and promote profitable investment. The need for increased competition also applies to capital markets. The impact of the recent moves to liberalise domestic capital markets

196/3

in Japan and internationalise the yen remains to be seen. But other countries, such as France and Italy who still impose exchange controls as well as domestic restrictions should follow the example.

General Government Financial Deficits (per cent of GDP)

	1983	1984	1985
US	4	3	3¾
Japan	3	2¼	1½
Germany	2¾	1½	½
France	3¼	3½	3½
Italy	11¾	12½	13
Canada	6	5¼	4½
UK	3¾	2¾	2½
G7	4	3½	3½

SOURCE: OECD

22. The US Administration has recently announced that a long term plan to cut the Federal deficit will be introduced in 1986. This should be seen against the failure to deliver the full $150 bn or so downpayment at least so far and the President's difficulties with his tax pledges. Any assessment will have to wait on the precise measures proposed but introducing a tough package at a time of a cyclical downturn will prove difficult (see Brief 19).

7 SEPTEMBER 1984

HM Treasury

FAB(84)B3 COPY NO

HER MAJESTY'S TREASURY
IMF/IBRD ANNUAL MEETINGS AND COMMONWEALTH FINANCE MINISTERS MEETINGS 1984

International Debt

Line to take

(a) Prospects
Firm adjustment by some debtor countries and emerging recovery in industrial countries have helped contain debt strains. Rising exports now allowing some modest recovery in domestic growth, imports and reserves. But position still fragile, and dependent on continued world recovery, interest rates and successful adjustment. Some loss of momentum recently in debtors reaching agreement with Fund on adjustment programmes.

(b) Strategy
(i) As agreed at London Summit, adjustment by debtors remains centrepiece.Must increase exports and restrain imports so that debts can be serviced and balance of payments put on a sustainable basis. Must adjust domestic economy to restore conditions for renewed growth, including reduced inflation and lower budget deficits.

(ii) Developed countries must similarly pursue policies designed to keep interest rates down (particularly US), create the conditions for sustainable growth, and resist protectionist pressures.

(iii) Role of bank lending, especially short term, in development finance must be reduced in favour of more stable forms. In particular:

(i) debtors should encourage direct investments by reducing barriers and creating favourable climate;

(ii) lenders should explore forms of portfolio finance (eg equity).

(iv) Increased marketability of debt should be thoroughly explored. Practical difficulties concerning existing debt; but new debt should take the form of negotiable instruments where possible.

(v) Role of World Bank should be enhanced, and co-operation with Fund increased further (see D8)

(vi) Where adjustment satisfactorily underway, a multi-year rescheduling agreement may allow a debtor to plan his adjustment programme ahead with confidence. But not for recalcitrant debtors.

(vii) Resumption of Export Credit after Rescheduling HMG persuaded of advantages in export credit agencies resuming cover a little earlier than in past. But only where satisfactory adjustment underway under IMF auspices. Details must be discussed with other creditors, who must offer similar support.

(viii) Interest Rate Capping Some interesting ideas, particularly mortgage-style interest deferral arrangements. But interest subsidies and new IMF facility unacceptable. Real solution is reduction of US Budget deficit.

Background

Prospects

1. Non-oil developing countries (NODCs) have reduced their current account deficit (excluding official transfers) from \$108 billion in 1981 to \$53 billion last year. This turnaround reflected a sharp cutback in imports, which fell by about 10 per cent in volume between early 1981 and 1983. NODCs' exports, however, began to rise strongly during last year, and this has allowed renewed growth in imports and a rise in reserves. The IMF estimates that reserves may have risen from 16½ per cent of imports in 1981 to over 20½ per cent now.

2. More immediate concerns over positions of some debtors have eased now that some 35 countries are running IMF programmes. Where countries have made sufficient progress, they have been able to negotiate better borrowing terms. (For example, Mexico: see F25.) Elsewhere the improvement has been less and problems with individual debtors (eg Argentina, Philippines, Nigeria) persist.

3. Improvements in NODCs' position have sometimes involved difficult decisions. The IMF estimates that living standards in NODCs last year may have been 3-4 per cent below their 1980 level. The IMF expects that in aggregate GDP may rise by 4 per cent both this year and next, which should be sufficient to prevent any further fall in living standards. But in many countries growth will be lower.

4. The IMF considers that debt burdens could be manageable, on the assumption of continuing LDC adjustment and around 3 per cent growth a year in developed countries. For NODCs as a whole, this would mean markedly lower ratios of debt and interest payments to exports. Current account deficits would remain at their present relatively low levels of 8-9 per cent of exports throughout the 1980s. But debt and interest payments in a number of countries would remain high.

5. The Fund paints a fairly hopeful picture of the immediate future, expecting GDP in the industrialised countries to rise by 5 per cent this year and 3½ per cent next, with NODCs' export volumes rising by 9 per cent and nearly 6 per cent respectively, and imports by around 6 per cent each year. As a result, unless lower commodity prices lead to worse terms of trade, the NODCs' current account deficit may fall to $45 billion this year and next.

6. But there are considerable downside risks, as the Fund's assumptions look somewhat sanguine:

(i) 1 per cent lower growth in industrialised countries

worsens the NODCs' current balance by about $10 billion.

(ii) a 1 per cent rise in interest rates worsens it by $2 billion.

Successful adjustment by some debtors could encourage others. But the strains could prove heavy enough to tempt some to cease repayments or default. And private capital flows to NODCs' seem likely to remain modest in the short-run, with the growth of net new bank lending expected by the IMF to remain at last year's rate of about 5-7 per cent. But this implies - perhaps unrealistically - that gross lending will have to rise appreciably if, as the IMF assume, banks refinance the hump of debt repayments in 1986-88.

<u>Strategy</u>

7. The following paragraphs discuss the main elements of the strategy as so far developed. The comprise:

(i) adjustment
(ii) developed country policies
(iii) forms of finance
(iv) marketability
(v) IMF and World Bank
(vi) multi-year rescheduling
(vii) resumption of export credit cover
(viii) responses to higher interest rates.

Proposals for a dialogue with certain debtors are discussed in brief D8.

<u>Adjustment</u>

8. It is important to stress the continued need for economic <u>adjustment</u> by debtors, as reaffirmed at the Summit. This need reflects a number of economic imbalances in debtor countries:

(i) NODCs' external debt has risen from below $200 billion in 1973 to a projected $700 billion this year. This is almost 1½ times their total exports of goods and services.

(ii) Over that period, debt service rose from 15 to 25 per cent of exports.

(iii) The average rate of inflation in NODCs last year was over 40 per cent (but this figure is distorted by a few countries with hyperinflation; the median was 11 per cent).

(iv) Budget deficits have been persistently large.

(v) Real exchange rates have often been uncompetitively high.

9. The IMF must continue to play a key role. It is important that IMF credit should be maintained for countries whose adjustment will be protracted - cf UK access proposals (brief C6).

Developed country policies

10. Developed countries should work to implement the commitment at the Summit to policies which will achieve and maintain low inflation and interest rates (particularly the US - see brief F19). Real interest rates have risen from around zero in the mid-1970s to around 5 per cent now. And resist protectionist pressures (D10 and F26).

Forms of Finance

11. The share of bank borrowing in total developing country finance rose from around 30 per cent in 1973 to 70 per cent in 1979-80. New lending over the past two years, since the crisis broke, has been small, and largely unspontaneous. At last year's IMF/IBRD meeting, the Chancellor suggested a larger role for non-bank forms of finance, such as direct investment. This was endorsed by Summit partners in June. But there has been little sign of debtor countries actively encouraging direct investment, with the exception of Mexico and a few less important cases. Many remain hostile to it and maintain barriers, not always overtly. And in the short term, adjustment policies and economic uncertainty deter investors. There has been

negligible success so far in persuading debtors to sell national assets for foreign currency in order to repay or service debts.

12. The shift to alternative forms of finance is bound to take time. Most debtors' financial position is still so precarious that most new money will continue to be unspontaneous for the immediate future. It will be important for the banks to guard against a rapid resumption of lending when circumstances become more propitious. It is similarly important for governments not to yield to pressures to bail out the banks, for example by a guarantee scheme, possibly involving a new government-sponsored institution, as proposed by Lord Lever (brief E18). This would only reduce the discipline on both debtors and banks.

13. The OECD is beginning a study of direct investment in debtor countries, and we hope it will encourage debtors to be more receptive. The IMF is taking more account of barriers to direct investment in the course of surveillance. We should maintain the pressure on debtors to be more welcoming, while not expecting any immediate panacea. Similarly, banks and other financial institutions should explore ways of developing <u>portfolio investment</u> in debtor countries. This would help avoid a concentration of debt in the banks, and could be easier for debtors to service. Until adjustment is secure, portfolio investment may not generally be very attractive. But this could change as credit-worthiness improves; another reason for persevering with adjustment.

<u>Marketability of debt</u>

14. Financial institutions should work with creditor and debtor governments to improve the marketability of bank debt. This would have the following attractions:

(i) redistribution of risk among creditors, reducing vulnerability and allowing smaller banks to opt out of syndicated loans.

(ii) risks could be spread more widely, possibly to non-banks.

(iii) negotiability of claims would facilitate raising of new money by debtors.

(iv) a more appropriate valuation of debts in banks' accounts.

15. The secondary market in LDC sovereign debt is currently small, consisting largely of swaps at par for portfolio management purposes. There is no evidence of non-bank interest. Often the original creditor carries a continuing liability even after transfer. The main reasons for this are:

(i) the repercussions for banks' balance sheets of low valuations of marketed debt;

(ii) risk of non-payment;

(iii) reluctance of debtors to agree to conversion of debt into equity (despite a substantial Brazilian scheme in the 1970s);

(iv) risk of over-concentration of debt in a small number of highly-exposed banks;

(v) risk that large discounts on marketed debt would increase the cost of new money;

(vi) unacceptability to developed country governments of official guarantees or debt purchases.

16. Nonetheless, whatever possibilities may exist should be explored. New forms of finance (see previous section) should be marketable wherever possible.

<u>Fund and World Bank</u>

17. The Summit countries said that the Fund should work even more closely with the <u>World Bank</u> in debt matters. But the US in particular opposes a greater role for the World Bank's non-

project role (see D9).

Multi year rescheduling

18. Following the Chancellor's IMF speech last September, Summit countries said they would welcome multi-year rescheduling agreements (MYRA), where debtors were making successful efforts to improve their position. Such agreements would cover several years' maturities at once. The aim would be to produce a debt service profile which is realistic and attainable by a debtor country which is taking the necessary action to adjust its own economy. Where appropriate, governments and government agencies should stand ready to negotiate similarly on debts owing to them.

19. Since then, the UK has taken the lead, by circulating detailed proposals round the G5 and Paris Club. [Agreement was reached in Paris Club on 13 September on an outline model agreement. This involves 'staged rescheduling' of a number of years' maturities. Each annual stage would be activated by an indication from the IMF that the debtor country's adjustment programme was proceeding satisfactorily. The exact form of IMF documentation is still unclear but it will probably reflect and elaborated Article IV consultation.]

20. The banks are at present negotiating a MYRA for Mexico (details to be supplied when Bank of England report is available - see brief F25). Other candidates are currently few; Brazil, Yugoslavia and Ivory Coast and perhaps Venezuela are the main possibilities. MYRA is definitely not for the 'basket cases', who need permanent ODA support (although a few have had MYRAs on grounds of administrative convenience); nor for those countries whose commitment to the adjustment process is in doubt.

Resumption of Export Credit after rescheduling

21. Hitherto, when a country has run into payments problems many creditor governments have withdrawn export credit cover on grounds of caution and prudence, and have been very slow to resume again after rescheduling. But there is an increasing recognition that new credit, on a modest scale, has a part to

play in the recovery phase, along with new private investment and new money from banks. A recent report by the IMF staff on this point has helped convince the UK government to adopt a slightly more flexible attitude on the resumption of ECGD cover for rescheduling countries in suitable cases in future. This more liberal policy will be considered only for debtor countries making strenuous efforts to effect an economic recovery under a strong IMF stabilisation programme, which offers a reasonable prospect that the new debt service commitments will be honoured and current payments are being made. The shift in policy should remove an obstacle on the part of debtors to agreeing multi-year rescheduling with the Paris Club. It will be important to keep in line with other creditors so far as possible, by ensuring that other governments are committed to offer similar support on an acceptable burden sharing basis. Our view is that the OECD Export Credit Group is the appropriate forum for co-ordination of policies, as the Paris Club should concentrate on debt issues. The French prefer the Paris Club. Other countries' views are not yet clear.

Responses to higher interest rates

22. Although the London Summit recognised the burden of the present level of world interest rates for debtor countries, the Communique carefully avoided any commitment to interest rate relief. The Cartagena Conference 'Consensus' said that in negotiations about debt rescheduling and new loans banks ought to use reference interest rates that in no case exceed the true cost of raising funds in the market and should not be based on administered rates. (See Annex on Cartagena.)

23. Despite some tentative discussions at the FRBNY Seminar in May, and at the OECD Ministerial, there has been no substantive talk among creditors on this issue. But - faced with increasing intransigence of Latin American debtors in bilateral contracts since Cartagena - the UK has proposed closer consultation in the Paris Club about the rate of interest on rescheduled debt, and a 'common line' that the rate for restructuring export credits (as distinct from aid) should not fall below the cost of funds to governments (or in cases where refinance is provided by banks

under official guarantees, a margin to cover banks' costs) plus a mark-up to cover costs of export credit agencies. The Paris Club decided on 13 September ...

24. There are many 'rate-capping' ideas in circulation, but they fall into three groups:

a. Those involving a permanent waiver of some part of interest charge. This imposes a squeeze, and in some cases a loss, on the export credit agencies or banks involved

b. those involving deferral of interest: capitalisation, 'building society' rollovers, fixed annual payments (like a recent small World Bank Loan to Paraguay) etc. These involve large gaps for creditors between returns on loans to LDCs and the cost of raising current funds

c. 'special facilities' - usually a new 'window' at the IMF to lend temporary finance to help meet increased interest bills. This would involve potentially large sums - up to $3 billion a year for each percentage point by which interest rates exceeded an agreed limit.

The UK is firmly opposed to (a) and (c). It recognises the possible need for some interest deferral in a few particularly difficult cases, but without going so far as automatic variation in response to subsequent interest rate movements.

25. International practice pre-1984 was patchy. In general, banks lent 'new money' to help meet interest charges, but did not abate the rate. Spreads have, however, recently been shaved for a number of countries. Governments in the Paris Club have occasionally agreed to the principle of concessional rates (Zaire 1983); but the current formula is 'the appropriate market rate' - left to bilateral negotiation.

26. The Cartagena formula was seen at the time as a triumph for the moderates (because there was no agreement on a debtors' cartel insisting on subsidised interest rates). But since then,

Brazil has taken the lead in trying to force the spread down. This led to the UK proposal at the Paris Club.

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September 1984

ANNEX : THE CARTAGENA CONSENSUS

A group of 11 heavily indebted Latin American countries met on 21-22 June at Cartagena in Colombia to share their experience of coping with debt and consider the scope for a concerted approach. Despite strong efforts by radicals led by Argentina, the communique which emerged was on the whole moderate in tone, though demanding generous treatment from creditors.

2. A further meeting to take stock of developments and concert an approach for the IMF/IBRD meetings is planned for 13-14 September at Mar del Plata in Argentina.

3. A checklist of the consensus proposals, with the UK response, follows.

Proposals	UK line to take
Interest rates	
(A) Industrial countries should adopt economic policies to reduce nominal and real interest rates.	Support, eg through multilateral surveillance (see B2)
(B) Banks' interest rates should not exceed the cost of raising finance.	Perhaps acceptable in appropriate cases, but not generally.
(C) Finer margins, fees and terms	For negotiation, especially for convalescent debtors
No penalties on arrears	No: essential to maintain discipline
(D) Temporary mitigation schemes for high interest rates:	Dangerous to relax commercial practices to give automatic relief.
- IMF compensation scheme	IMF scheme too costly for Fund's limited resources
- Official concessionary loans - Longer repayment terms	Only in very limited circumstances (basket cases)

Debt Service

(E) Treat each country according to its needs	Support case by case approach
Better terms	For negotiation
Easy multi-year rescheduling	No: only for recovery cases
(F) In extremely severe cases, automatic deferment of repayment	No. Dangerous to relax commercial discipline
(G) Ceiling on ratio of debt service to exports	Conditional adjustment programmes in the IMF already temper rigour with realism
(H) Debtors should not be obliged to guarantee private sector debt in rescheduling	For negotiation, but not unreasonable for creditors to take on commercial risk

Lending practices

(I) Easier regulatory environment in creditor countries	Generally no: important to maintain and improve banks' capital ratios
(J) Easier trade credit	Support in appropriate cases of adjustment with good prospects of timely debt service

International Financial Institutions

(K) More resources, especially for the IMF, IBRD and IDB	Support general principle of improving flows IMF: resources adequate at present (see C7) IBRD: support GCI (see D9) IDB: bilateral loans probably better
(L) SDR allocation	Oppose: See C5
Longer IMF adjustment programmes	Accept as pragmatic
Higher access limits	UK emphasis on bigger cumulative access limits though annual limits may have to fall: See C6

(M) Soften IMF conditionality to give priority to growth	Dangerous to relax discipline. Recognise importance of combining growth and adjustment policies: see F24
(N) Faster disbursement of IBRD and IDB loans with less stringent conditions	Limited sympathy. Important to improve conditionality of non-project loans, by using more tranches if necessary

Creditor governments

(O) More generous rescheduling of official debt. Quicker resumption of cover on preferential terms	Direct subsidies out on fiscal grounds. Prepared in principle to reopen limited cover in cases of genuine efforts to adjust and service debt.
(P) Action to stabilise commodity prices	Growth best prospect. Dangerous to tamper with market discipline.
(Q) Elimination of tariff and non tariff barriers in developed countries	Support efforts to roll back protectionism: see D10 and F26

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IMF/IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

International Monetary Reform : G10 Studies

FAB(84)4 G10 STUDIES

Line to take

(a) Right to reassess operation of international monetary system. Much changed since demise of Committee of 20.

(b) Choice of areas of detailed study has proved apt. Useful insights emerging on operation of mixed exchange rate system, supply and demand for global liquidity, possibilities of strengthened IMF surveillance.

(c) See case for provision of medium term framework for enhanced surveillance of major industrial countries.

(d) Useful to develop further co-operation between IMF and OECD especially in work on interactions of economies.

(e) May be useful to revise IMF Executive Board guidelines (on surveillance and exchange rate management) at end of exercise.

(f) Confirm London Summit proposal that studies be completed in first half of 1985 for discussion at early meeting of IMF Interim Committee

Background

Reform studies were originally proposed at the Williamsburg Summit and have been carried forward over the past year by G10 Deputies.

2. An interim report was considered by G10 Ministers in Rome on 19 May. The London Summit proposed completion of the work in the first half of 1985: and consideration by an early meeting of the Interim Committee.

3. The Deputies' work programme covers four areas: exchange rate arrangements, IMF surveillance, liquidity and the role of the IMF. Some useful background papers in these areas have been produced by the BIS, OECD and IMF, together with policy papers by Deputies themselves.

4. We have seen the exercise as mainly educational - an up to date reappraisal of the operation of the system - rather than likely to lead to radical change eg in the exchange rate regime or the system of settlements that might go with it.

5. Discussion so far bears this out. A strengthening of IMF surveillance arrangements (and fuller understanding of the supply and demand for global liquidity) may well emerge. A bonus might be an improved critical framework for judging US economic policies. But no major recasting of the system is in view.

6. The Deputies aim largely to complete their consideration of IMF surveillance at a meeting on 26 September. The role of the IMF more generally (and co-operation between the IMF and IBRD) is scheduled for discussion in November. Drafting of the sections of the report dealing with the functioning of the exchange rate system and liquidity, on which there has already been considerable discussion, will follow at the turn of the year.

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September 1984

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IMF AND IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

SDR Allocation

Line to take

(a) Do not believe that a case can be made out for a SDR allocation on grounds of required precondition - ie global reserves inadequacy. Measured against growth of world trade, global reserves close to average level of 1970s. Structural changes - notably floating exchange rates among major countries - may have lowered demand for reserves over last decade. Agree that quality of reserves has been damaged.

(b) Accept that some developing countries' reserves are low, though import compression has meant that in relation to trade, their average level is only a little below that of 1970s. Their main problem is creditworthiness. Conditional Fund finance with appropriate adjustment policies better response to that.

(c) Important to assess overall supply of international liquidity in broad terms; not just reserves, but also swap lines with other central banks, IMF credit and bank lending.

(d) As in the past, demand for international liquidity is likely to grow roughly in line with trade. Prospects depend on macro-economic policies in major countries, particularly the US.

(e) Recognise that US policy mix could constrain industrial countries' monetary policies and restrict liquidity supply through high interest rates. No evidence of such a trend emerging: reserves up 8½ per cent over year to May despite high real interest rates.

(f) Admit that composition of reserves shows growing reliance on borrowed resources. But SDR allocation not necessarily improvement: SDRs resemble borrowed reserves because using them involves liability to IMF charges.

FAB(84) C5 SDRs

(g) (If US and Germany support allocation) Despite doubts, do not wholly rule out modest SDR allocation if clear consensus develops. But any allocations should be kept small.

(h) Desirable that any SDR allocation should not be accommodated in monetary stance of in developed countries, so preventing potential inflationary effects of creating international liquidity.

(i) Do not support making any SDR allocation conditional. IMF not short of resources. Also reluctant to undermine status of SDR as reserve asset by putting primarily at use of less creditworthy Fund members. French scheme would amount to aid and so would count as public expenditure.

Background

Definitions

1. The SDR is a composite currency unit defined in terms of five international currencies (dollar, DM, yen, franc and sterling). So far SDR 21.4 bn has been issued. The IMF's accounts are also maintained in SDR units. Private use of the SDR as a unit has not taken off after a modest start in 1981.

2. SDR issues took place during 1970-72 (SDR 3 bn a year); and 1979-81 (4 bn a year). Issues are in proportion to IMF quotas. On the present distribution, 65 per cent of any new allocation would go to developed countries, 10 per cent to OPEC and 26 per cent to developing countries.

3. SDRs are not money. They are a potential overdraft facility. Their value derives from their convertibility to foreign exchange. Countries able to show balance of payments need can ask countries in relatively strong balance of payents positions to exchange SDRs. At present there are 26 countries (including the UK) designated to receive SDRs in this way.

4. Countries holding more SDRs than their cumulative allocation are paid net interest on any SDRs they hold above their allocation. They get a market related rate (broadly equivalent to the rate earned on Treasury bills). Countries holding less than their cumulative allocation pay the same rate of interest on the shortfall.

Criteria for Allocation

5. The IMF's Articles of Agreement require (Article XVIII) that "allocation ... of SDRs ... shall seek to meet the long-term global need, as and when it arises, to supplement existing reserves in such a manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world". Additionally, Articles VIII and XXII commit the IMF to making the SDR the principal reserve asset in the international monetary system. These provisions have an increasingly dated appearance. The Article XXII commitment was already something of a pious hope at best when it was written as gold was being demonetised. As most of the subsequent argument has in practice been led by the appetite of the developing countries for potential additions to unconditional credit.

6. Assessment of long-term global need for reserves must be partly judgemental. Measured against imports or trade imbalances, the present level of reserves is close to the 1970's average (Table 1). Measured against external debt, however, reserves may have declined a little over the 1980's (earlier date is not available).

Table 1: reserves adequacy

		ratio per cent, at end year			
	Average 1970s	**1980**	**1981**	**1982**	**1983**
Reserves: imports					
all countries	22.3	20.9	19.7	20.2	20.9
industrials	18.3	17.2	16.0	16.7	17.0
oil producers	70.1	61.5	50.0	44.8	50.3
non-oil LDCs	23.0	19.9	18.6	19.4	20.9
Reserves: trade imbalances					
all countries	132.4	104.5	109.1	109.8	109.1
industrials	164.8	156.9	162.1	131.8	125.2
oil producers	80.7	50.7	57.0	88.0	128.1
non-oil LDCs	102.4	92.8	93.7	79.5	65.1
Reserves: external bank debt					
all countries			18	15	16
non-oil LDCs			12	10	11

7. These figures suggest that, while not ample, present levels of reserves are not grossly inadequate. It is certainly true that a significant number of developing and debtor countries have very low reseves and their access to borrowed reserves via the capital markets is restricted by limited creditworthiness. Proponents of SDR allocations

urge the needs of these countries as a justification. But these needs are not for greater world liquidity; they are for adjustment of domestic economice and for aid.

Table 2: International liquidity

SDR bn

	Reserves	Non gold reserves	Central bank credit lines	Potential IMF access	Commercial bank loans	International bond issues
1963	67	27	4	15	-	-
1968	86	39	26	18	-	-
1973	213	118	32	38	175	8
1978	427	247	46	57	407	24
1983	708	364	79	338-421	1036	56

8. With the growth in international bank lending, reserve adequacy must be judged very broadly against other developments in international liquidity. Table 2 characterises its main elements over the last 2 decades. The figures need to be treated with some caution: for example gold reserves could not all be mobilised without damage to their present market values; central bank swap arrangements and IMF access could not all be drawn down simultaneously since the arrangements are for mutual support. Moreover, the last two columns show flows while the others represent stocks. Overall, the figures do illustrate how reserves have been greatly supplemented by sources of credit.

Economic Effects

9. Creation and distribution of SDRs as such has no economic effects. It simply increases IMF members' reserves. But when SDRs are exchanged for foreign currency and used, eg in intervention or to purchase imports, some slight increase in the world money supply is possible:

(a) if the main industrial economies stick to their monetary targets, interest rates will be slightly higher, developed countries' consumers save a little more, leaving room for a transfer of resources to developing countries;

(b) if industrial countries accommodate the injection of liquidity, inflation rises, developed countries' domestic consumption falls and releases resources for developing countries;

(c) if industrial economies are not fully employed, resources may be transferred to developing countries by boosting output with little effect on inflation;

(d) if SDRs are (in effect) used to service developing countries' debt, its cost structure will be improved. World interest rates will tend to fall.

10. All these effects are small but not insignificant. For example, if industrial countries were exposed to a fully monetised SDR 5 bn a year allocation (an extreme assumption), the injection of international liquidity would be equivalent to about 0.9 percent of the aggregate reserve bases of industrial countries. Though small, this would be a significant fraction of the average 5 per cent annual growth rate in their monetary bases. In practice it is unlikely that all of a SDR alloction would be monetised in the first year after its issue. Allowing for mobilisation of most of developing countries' 26 per cent share of any allocation, the monetary effect would more likely be equivalent to about ¼ per cent additional growth in industrial countries' monetary bases.

11. The potential economic effects of an SDR allocation on developing countries are probably better measured by comparison with other possible sources of credit. An aggregate allocation of SDR 5 bn a year would be equivalent to 5½ per cent of quota, allowing a little ease in adjustment alongside typical IMF programmes of 50 or 60 per cent of quota a year. An allocation of this magnitude would thus not solve debtors' difficulties though the extra finance could help contribute to a solution.

Conditional Allocations

12. It is sometimes suggested that the benefit of an SDR allocation to developing countries should be increased by skewing the distribution to their favour. Direct redistribution would require amendment of the IMF's Articles, a contentious process. Other devices could be used instead.

13. Conditionalising SDR allocations is one of these. The basic idea is that industrial countries would lend some or all of their allocations to developing countries alongside Fund programmes. There are two main variants: a Belgian scheme, under which strong currency countries would lend their SDRs back to the IMF; and a French scheme under which the loans would be bilateral, the IMF simply acting as agent. The French version, which resembles aid, is a non-starter because it would count as public expenditure.

14. The main attraction of a conditional SDR allocation would be its potential use as a supplement to IMF resources. There is no need for such a supplement at present (see brief C7) so the main plank of the case falls. Proponents also argue that it would supply liquidity to meet demand more efficiently than a regular (proportional) SDR allocation.

But making a formal link between SDR issues and development finance would tend to undermine even the modest role the SDR plays as a reserve asset.

Options

15. SDR allocations have so far taken place in basic periods normally of 5 years. The two phases of allocation have each lasted 3 years. The present basic period, the 4th, ends in 1986. So the natural format of any decision on allocation would apply to 1985 and 1986 only.

16. It would, however, be possible to decide on a one-off allocation for 1985, perhaps with an option on 1986. The present basic period could also be extended by a year or more, as suggested by the Dutch. Or 1985 could mark the start of a new 5-year basic period.

17. Proponents of large allocations sometimes suggest revival of reconstitution as a way of helping limit the initial economic impact of potential SDR use. Until 1981 this practice required IMF members to maintain a minimum working level of SDRs as a proportion of their allocation. This restricted the SDR's liquidity, further limiting its usefulness as a reserve asset.

Others' views

18. Developing countries, with France, are in favour of a large SDR allocation: SDR 15 bn a year for at least the remainder of the present basic period. France would couple this with a bilateral lending arrangement (para 13), bolstered by reconstitution (para 17). The developing countries have shown little enthusiasm for these devices.

19. Smaller developed countries favour a more modest allocation, of the same order as previous ones: perhaps SDR 5 bn a year.

20. The Fund staff favour an SDR 10 bn a year allocation for 1985 and 1986.

21. The US is still against resuming allocations, believing that recovery makes them unnecessary. Nevertheless, a basic precaution has been taken by way of informing Congress of the possibility that the IMF may decide on allocations of up to SDR 15 bn a year at the Annual Meeting. Japan, Germany, and Australia have also recently restated their objections to an allocation on the grounds that adjustment is a better way for countries short of liquidity to acquire the necessary finance for development.

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22. The UK line in IMF Board meetings has been sympathetic to LDCs' liquidity problems but sceptical whether a SDR allocation would solve them.

Potential effect on the UK

23. At present the UK's low holdings of SDRs (35 per cent of cumulative allocation) mean that, despite our low reserves, we are designated to receive [22] per cent of the SDRs which other countries want to exchange for hard currencies. If this pattern were repeated with an SDR 5bn a year allocation, of which some SDR 1½bn a year might be used, we might be required to exchange a further SDR 0.3bn or so annually. Though our total reserves would be rising at about the same rate (the UK share of an SDR 5 bn allocation would be SDR 0.35bn), this would put an unwelcome strain on our liquid foreign currency reserves. In keeping with experience, however, we could expect to be able to dispose of unwanted SDRs by sales to developing countries (via the IMF). Many of them choose to service their Fund debts in SDRs.

HM Treasury

August 1984

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IMF AND IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

Access to IMF Resources

Line to take

(a) Believe new access limits have worked well during limited experience so far in 1984. Commend staff efforts to respect spirit of Interim Committee and Executive Board instructions to avoid treating limits as targets, and to restrict Fund credit to amounts client countries can service, bearing in mind their other commitments.

(b) Concerned that countries in balance of payment difficulty and willing to adopt appropriate adjustment policies should be able to obtain adequate Fund credit while need for support persists. Recognise that debt crisis, coupled with less buoyancy in international commercial credit, means that many countries' adjustment processes will have to take place over the medium term.

(c) Important to allow debtors scope for drawing on Fund over longer periods than formerly. Therefore priority for 1985 access limits must be to get cumulative limit right. So perhaps time to break habit of last few years and set it at more than four times annual limit.

(d) Upper tier of access, established for first time in 1984, seems to be redundant: it has not been used. Suggest scrapping it because always scope for access beyond nominated limits in cases of severe need.

(e) As further signal of determination to return eventually to quota-based Fund, believe should continue to wind down annual limit, though at modest pace recognising probable emergence of some individual cases of heavy need. Bearing in mind Fund's projections of declining future demand, suggest annual limits of, say, [100/95/90]. Cumulative limit should decline less fast - say [425/410/400].

(f) Attach low priority to compensatory finance, especially as conditional element lower now. Note most recent drawings have been near limit, ie undertaken by countries

FAB(84)6 ACCESS

with conditional programmes. Believe better to grant conditional finance in programmes themselves. So favour continuing to wind CFF limit down, and preferably at a differentially faster rate - say to [70/60] per cent; with threshold for evidence of co-operation at say [35/30] per cent.

Background

Genesis of Present Limits

1. The current limits on access to IMF resources date only from the beginning of this year, when the 8th quota increase took effect. The limits are lower proportions of quota than their predecessors but allow lending up to about the same cash level for most countries. The figures are summarised in Table 1.

Table 1: access limits pre and post 1984

		1984 as % of new quota		1981-83	
		Normal	Severe need and strong adjustment	as % of old quota	equivalent % of new quota (average)
Programmes:	annual	102	125	150	102
	cumulative	408	500	600	407
CFF:	export shortfall limit	83		100	68
	threshold for co-operation	50		50	34

1984 experience

2. Only 18 conditional programmes have been awarded under the new limits so far. Access granted has ranged from 25 to 87 per cent of quota a year, clustered around 50-60 per cent of quota a year, ie perhaps on average a third or a quarter less in cash terms than previously. It is dangerous to read too much into this trend. A number of big programmes have slipped or not been agreed at all (eg Argentina, Nigeria and the Philippines). The remainder of the year could well see not only more, but bigger, programmes.

3. Tighter access has been combined with tougher conditionality, reflecting the Interim Committee's guidance. (see brief F24).

4. Use of the compensatory financing facility (CFF - making good losses from export shortfalls) though lighter than previously, has still accounted for about a third of commitments so far during 1984, and nearly 40 per cent of disbursements. Each of the

seven cases took access to or very near the CFF limit. All therefore required evidence of cooperation with the IMF - in practice a conditional programme - to justify the drawings. Several were technically questionable.

Decisions

5. Previously access limits stood without a fixed time limit. But the controversial 1984 access limits decisions provided for an annual review, due in time for new limits to take effect for 1985. There is no pressing need for decisions at the Annual Meeting: they could be remitted to the Executive Board, where some preliminary work has already taken place. But it may be difficult to reach consensus in the Board without guidance from the Interim Committee even if detailed decisions are not reached there.

6. Formally, the Board's decisions on 1984 access limits lapse at the end of the year. They will not continue into 1985 unless there is an explicit decision to do so. If the enlarged access policy were not endorsed by establishing new access limits, access would automatically drop back to the mid 1970's levels: in 65 per cent annually, 165 per cent cumulative.

Attitudes

7. The IMF Managing Director has pitched simply for continuation of the present limits and policies. Developing countries, with France and most smaller OECD countries, support this line. Despite the relatively easy liquidity situation (see brief C7) no one has yet argued for raising the limits.

8. The US, Germany, Japan, Canada, Australia and the Netherlands all want lower access limits in 1985. We have indicated general support in the IMF Board, without quantifiction.

9. The US and Germany both want a 20 per cent reduction in the annual access limit, to 80 per cent of quota a year. The US has indicated privately that the cumulative limit should drop faster, to 300 per cent of quota. It is not clear how far these are negotiating positions. It is quite possible that neither country has thought through the consequences (cf paras 23 and 25).

10. Japan and the Netherlands want a medium term path for reducing access limits. Japan favours 90 per cent/350 per cent (annual/cumulative) for 1985, again with a disproportionate reduction for the cumulative limit.

11. Only Canada has so far picked up our emphasis on the cumulative limit (see para below), favouring maintaining the 500 per cent cumulative limit. The Canadians would also abandon the upper tier.

12. Several countries, including the US, have explicitly pointed to the scope for countries in dire need to draw more than the given access limits. The Dutch have proposed a "grandfather clause" protecting the position of countries (such as those in table 3 below) whch might otherwise lose access. It is not clear how this would work. There could be difficulties of conflict with the Fund's principle of impartial treatment for all its membership. And experience suggests that in practice the US might be unreceptive to special treatment for countries other than big debtors. The Managing Director has already condemned the suggestion as a recipe for ar bitrariness.

13. There is a risk that entrenched attitudes on either side may push the other to extremes. The CFF could be a particularly sensitive area: developing countries will resent efforts to curtail what they see as their own overdraft facility.

Prospects for demand

14. The main purpose of access limits is to guide the IMF staff on the size of programmes which should be awarded to countries in balance of payments difficulty. Modest changes in the limits would have very little, if any, effect on the sizes of Fund programmes awarded. And there has always been flexibility to exceed the guidelines in cases of extreme need and severe adjustment. Decisions on new limits should therefore take account of expected demand for balance of payment support, but discounting potential crises.

15. Assessing future demand for Fund support is difficult. The Fund staff have projected a sharply declining profile of commitments under conditional programmes, assuming retention of the present access limits:

Table 2: Commitments under programmes, SDR bn

1983	1984	1985	1986
10.6	5.8	5.1	3.2

16. Such a rapid reduction, while possible, looks optimistic. It reflects the IMF staff's expectation of continuing world economic recovery, with renewed confidence in sovereign lending on the part of commercial banks. Many developing countries and debtors will continue to need Fund programmes as tokens of credit worthiness in

negotiating rescheduling and new loans with their creditors, official as well as commercial. They might manage with fairly small injections of Fund credit, but the now hesitant growth in international bank lending suggests that demands for Fund credit may not tail off very quickly.

17. The Fund's projections of demand (table 2) are fairly insensitive to the access limits chosen. Removing the upper tier, and even reducing the lower annual limit to - say - 90 per cent of quota, would make relatively little difference, though further reductions would probably restrict the sizes of programmes awarded. A less sanguine view of developing countries' ability to manage without the Fund could, however, increase projected commitments considerably. For instance, were Argentina and Nigeria both to agree 3 year (EFF) programmes with the Fund later in 1984, the SDR 3½ bn commitments projected for the remainder of the year could jump by SDR 22½ bn. And the Fund anticipates commitments in 1985 will subside to only 15 per cent of non-oil--developing countries' forecast current account deficits, close to the historical average, 14 per cent. Something closer to the 18 per cent of 1983, ie at least SDR ½bn more commitments, might be more realistic.

Annual Limit

18. As programmes negotiated recently or in the pipeline all involve 90 per cent or less of quota a year, there would be scope for dropping the upper limit (125 per cent of a quota a year) and shading down the lower one from 102 per cent of quota a year. A modest reduction, to end up with a limit in the range 90-100 per cent of quota a year, would be little more than a political gesture, though perhaps valuable as a signal. Some, including the IMF Managing Director, argue it would be the wrong signal - indicating the IMF's diminishing capacity to support debtors. This seems an extreme view.

19. It is worth noting that any reduction in the lower limit would mean that the existing EFF programmes for Brazil and Mexico, at respectively 102 per cent and 103 per cent of quota a year, would exceed the new annual limits. This would not necessarily be a problem even though both programmes will continue through 1985. It would simply recognise the exceptional nature of their need for Fund support and their importance for the stability of the international monetary system.

Cumulative limit

20. Reducing the cumulative limit will be more difficult. Choosing the right level is partly a matter of judgement. Since repayments of Fund credit usually begin 3¼ years after the start of a programme, setting it at about 4 times the annual limit would allow

chronic Fund clients to receive programmes near the annual limit for 4 years, with rollover of repayments thereafter; or (more likely) rather smaller programmes than the annual limit for 4 years, with a combination of rollover and new credit therafter. But in practice few countries actually negotiate consecutive programmes for as long as 4 years. And the differential quota increase, coupled with the change in access limits earlier this year, means that there is no way to deduce the right absolute relationship between the annual and cumulative limits. There is no substitute for examining the countries likely to be affected.

21. There are 10 countries whose present or prospective programmes will take their use of Fund resources above 300 per cent of quota (see table 3). Virtually all are chronic Fund clients. With the probable exception of Mexico, all will need at least one more Fund programme to continue or complete the adjustment process after the end of their present one. Since all will be repaying previous loans, there is scope for rolling over Fund credit. So all would be able to get 1-year follow-on programmes in the range 50-60 per cent of quota (ie the present average) provided the cumulative limit did not fall below about 375 per cent of quota. For many this would represent very little new credit, but the banks should be prepared to accept any significant programme as evidence of Fund sanction (eg the present Yugoslav programme, involving only 26 per cent of quota in new money net of principal repayments, reassured commercial banks into rescheduling in 1984.)

Table 3: heaviest users of IMF credit

Country	Present or expected Programme expires	use of IMF credit at end (% quota)	Repayments to IMF during following year (% quota)	Max follow-on programme for 1 year with 408% limit (% quota)
Jamaica	June 85	376	55	87
Morocco	March 85	353	58	113
Malawi	Sept 86	340	62	130
Turkey	April 85	336	62	134
Yugoslavia	April 85	326	58	140
Ivory Coast	Aug 85	321	52	139
Sudan	June 85	315	70	163
Mexico	Dec 85	310	8	106
Brazil	Feb 86	307	7	108
Uganda	[Nov 85]	[305]	[70]	[170]

22. It is worth in particular considering the positions of the major debtors. Argentina has no present Fund programme and little outstanding borrowing from the Fund. Mexico should not need another programme after the end of its EFF late next year, but if the need arose could get further support at about the same rate as at present (about 100 per cent of quota a year) for 1986 provided that the cumulative limit were at least 400 per cent. Brazil, which will almost certainly need further IMF support after the end of its EFF in early 1986, would be similarly placed. After 1986, however, Brazil could only hope to rollover its debt to the IMF (ie programmes of about $0.6bn or 40 per cent of quota a year) unless the cumulative limit were set appreciably above 400 per cent.

23. Reducing the cumulative limit disproportionately heavily, as the US and Germany suggest, would place all the 10 countries in table 3 in difficulty. By virtue of the size of their debt, several might be able to justify exceptional access beyond the normal limit. Turkey, Yugoslavia, Brazil and (if the need arose) Mexico might manage in this way, but only if they were prepared to accept stronger programmes than seems likely - or appropriate - at this stage in their adjustment. Dropping the strong adjustment criterion would reduce the exceptional access provisions to mere ar bitrariness. And there would be a strong risk that the smaller countries would be virtually excluded from further IMF support. Morocco, for instance, could get a follow-on programme of no more 5 per cent of quota (300 - 408 + 113 from table 3). Jamaica would have to wait until repayments of some 21 per cent of quota (SDR 30m) had been made before even a rollover programme could be arranged.

Future propsects

24. Within the next couple of years another dozen or more countries are likely to find themselves in a similar position to the countries in table 3. Table 4 shows countries whose present programmes will take their use of Fund credit to the range 200-300 per cent of quota. Of these, all but Korea and Panama will continue to need Fund support. Their cumulative use of Fund credit could well approach 400 percent by the end of another year or two of Fund support.

25. If a cumulative limit of 300 per cent of quota were adopted for 1985, all the countries in table 4 would be seriously constrained in negotiating follow-on programmes. Countries whose programmes expire this year - Kenya, Liberia and Senegal - would all be quite close to a 300 percent limit by the end of a follow on programme, ie toward the end of 1985.

26. There are several other countries whose present use of Fund credit is rather less, but which are likely to have substantial and perhaps sustained, future need for example Argentina, Chile, Peru, Sri Lanka, and Zimbabwe.

Table 4: heavy users of Fund credit

	Present Programme	
Country	**expires (or present position)**	**use of IMF credit at end (% quota)**
Korea	March 1985	255
Uruguay	April 1985	250
Mauritius	-	249
Dominica	June 1985	242
Kenya	Sept 1984	240
Haiti	Sept 1985	238
Madagascar	Feb 1985	232
Liberia	Sept 1984	225
Zambia	April 1986	221
Panama	Dec 1984	213
Ghana	Dec 1985	205
Senegal	Sept 1984	205

27. The substantial number of Fund members whose use of resources will approach 400 per cent of quota over the next year or two argues for caution in lowering the cumulative limit. While figures in the range 375-400 per cent of quota might be tolerable, they would leave a number-probably a growing number - of countries in a tight position. 425 per cent looks safer. 300 per cent would be dangerous and possibly unsustainable.

HM Treasury

September 1984

197/3

FAB(84)C7 Copy No

HM TREASURY
IMF AND IBRD ANNUAL MEETINGS 1984
COMMONWEALTH FINANCE MINISTERS' MEETINGS 1984

IMF Liquidity

Line to take

(a) Substantial influx of resources into IMF, with reduction in profile of expected demand, means no immediate need to consider further borrowing by the Fund. Content to leave decisions until 1985 or perhaps even 1986.

(b) Prepared in principle to consider any feasible means of financing the Fund, including activating the GAB and market borrowing. Hope that, if any further borrowing is needed, it can be drawn from a wide range of creditors to spread the load fairly. Interested in developing new instruments to facilitate this.

Background

Recent developments

1. The past year has seen a substantial improvement in the resources available to the IMF:

(i) quotas were increased by nearly half to SDR 90 bn at the very beginning of 1984. Of the SDR 30 bn addition, some SDR 25 bn is in usable currencies;

(ii) borrowing of SDR 6 bn was agreed in March 1984, SDR 3 bn from Saudi Arabia and SDR 3 bn from the BIS covered by 17 OECD central banks, including the Bank of England (but not the US Fed), together with Japan and Belgium bilaterally;

(iii) the General Arrangements to Borrow were nearly trebled. A parallel arrangement with Saudi Arabia began. In addition to the long standing use of this facility for industrial countries, part of the GAB is now also to be available for the Fund's general use if there is a serious risk to the stability of the international monetary system.

FAB(84)7 LIQUIDITY

2. A number of other factors have also contributed to making the Fund's resource position more comfortable than might have been expected:

(iv) demand for Fund resources has contracted with the economic recovery. Coupled with the tighter rules on access (see brief C6), commitments for conditional programmes during 1984 are likely to be scarcely more than a half of last year's level;

(v) in particular, no existing programmes have been augmented to take advantage of higher quotas;

(vi) negotiations on several large programmes have been unexpectedly protracted - notably Argentina, Nigeria and the Philippines, whose programmes might together have added some SDR 5 billion to commitments during 1984;

(vii) India decided voluntarily to forgo the last EFF drawing of SDR 1.1 billion, and some other large programmes have collapsed with substantial balances undrawn (Argentina, Zimbabwe);

(viii) the economic recovery has meant that the Fund is able to use more of its currency holdings in its lending operations. Virtually all OECD countries' currencies are now usable. Together with the unexpectedly favourable currency distribution of the quota subscriptions, this means that the Fund now has about SDR 10 bn more usable resources (including SDRs) than was expected.

Prospects

3. The Fund's projections of future lending (see annex) suggest with some confidence that the level of resources should continue adequate until at least the end of 1985. After that the Fund estimates, but with far less certainty, adequate or even comfortable resources to end 1988, when the next quota increase is due.

4. The present stock of SDR 36 bn usable resources should be depleted relatively slowly, leaving SDR 25 bn by end 1986 even if no further borrowing is arranged. The Fund guess that borrowed resources might be fully committed by late 1985, but given their usual caution it would not be surprising if the stock of borrowed resources lasted into 1986. In any case, the SDR 2½ to 3 bn over-commitment of borrowed resources projected for end 1986 would not be unmanageably large. So, if it were more convenient, conclusion of new borrowing arrangements could wait until 1987. These projections are of course very tentative.

5. For the medium term, the Fund's projections suggest that, even without further borrowing, there could be sufficient resources to last until payment in early 1989 of the next scheduled quota increase. For example, if the Fund were to rollover repayments of principal of previous lending as they fall due in the late 80s, there would be some SDR 15 bn of uncommitted resources left by the end of 1988. If, say, an additional SDR 2 bn a year were lent, resources would be down to a (just) tolerable SDR 10 billion by the time of the next quota increase.

6. However, the projections for the post 1985 period must be treated with some scepticism:

(a) they are implicitly based on the Fund's own World Economic Outlook exercise, whose results may over-state the strength of the recovery (see brief B2);

(b) if world economic growth were to proceed less vigorously, or the downswing came sooner, the picture could look very different. Demand for Fund lending could increase dramatically, while Fund resources as defined might drop substantially as more industrial countries faced balance of payments problems precluding the use of their currencies in Fund lending;

(c) even if the recovery continues, interest rates might be forced higher, adding to the debtors' problems and so intensifying demand for Fund resources;

(d) a dollar collapse, perhaps in 1985 or 1986, might mean that the dollar could not be used in IMF lending (as happened in 1978-79). This would cut the Fund's stock of usable currencies by a third or so, perhaps temporarily;

(e) bank lending might remain depressed, requiring the Fund to help supply the deficiency and to supervise the adjustment policies required to contract developing countries' balance of payments deficits to match the limited commercial finance available;

(f) it may only be possible to refinance the hump of debt service falling due in the mid to late '80s (see debt brief B3) on the back of Fund programmes. The banks may be unwilling to offer generous terms unless the Fund is actively lending too;

(g) even with the best will in the world, adjustment may simply take longer than the Fund expects. Programmes frequently break down, reflecting political difficulties or just sheer failure of nerve.

7. These considerations suggest that the Fund projections are probably on the optimistic side. But it seems clear that there is no immediate need to worry about providing additional finance for the next year or two.

8. Developing countries often press for substantially more generous lending facilities for the IMF. These could run down the stock of resources very quickly. The Lever group, for instance (see brief E18), recommend a compensatory facility for interest rate fluctuations above a threshold. Such a semi-automatic device could be very costly: each 1 per cent point rise in US interest rates, adds some $3bn to developing countries' debt service commitments.

Borrowing

9. . The Fund projects a borrowing requirement of some SDR 3 bn by end 1986. Given the relative ease of the Fund's anticipated resource position, it might seem logical to aim to revert to quota-based finance, avoiding further borrowing. The US, Germany and perhaps Japan may argue for making that an explicit objective. The Fund's own figures would support it.

10. However, given the doubt about their accuracy post 1985 (paragraph 6), it seems premature to jump to that conclusion. By 1985 or 1986 it might look advisable to provide the Fund with more resources by borrowing in order to cope with anticipated greater demands. A decision on further borrowing can and should be left until late 1985 or later. Everyone will be content to agree with that. In the meantime it seems sensible to keep all the borrowing options in play:

(i) the GAB, with Saudi Arabia, realistically capable of providing up to about SDR 10 bn but available only in circumstances of systemic danger. (The theoretical maximum of SDR 18½ bn could never be drawn in full);

(ii) further official borrowing via partial rollover of maturing loans to the Fund - eg 50 per cent rollover of repayments due in 1986 and 1987 would furnish SDR 4 bn;

(iii) market borrowing, still untried and hotly opposed by the US and Germany because of the potential loss of creditor control.

11. If further borrowing is decided on, all the creditors will be anxious to ensure fair sharing of the burden. This will mean strong pressure for a US contribution.

12. So far as the UK's domestic interests are concerned, reverting to quota finance or market borrowing would probably be the best choices. All the methods of financing the Fund necessarily involve actual or potential increases in the money supply of the currencies used, requiring higher interest rates to maintain monetary targets and contain inflation unless the liquidity injection can be taken up by faster growth. They therefore all lead to broadly similar effects on international interest rates and/or inflation for the same transfer of resources to Fund clients. Their main difference is in their effects on official reserves, since Fund lending in currencies other than the dollar is nearly always converted into dollars (at the request of the Fund client) by the central bank of the currency lent. If the Fund obtained finance through quotas only 4½ per cent is likely to be in sterling as against 9 per cent through borrowing via the GAB. Market borrowing, of course, would have no direct reserves effect.

HM Treasury

September 1984

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IMF liquidity

SDR bn

		Aug-Dec 1984	1985	1986
A	Uncommitted usable resources at start	36	31	26
	of which borrowed*	3 ½	2	-1
B	Commitments	4 ½	7	5
	of which conditional programmes	3 ½	5	3
C	Repayments to the Fund (net of Fund repayments to creditors)	-	2	4 ½
D	Uncommitted resources at end = A-B+C	31	26	25
	of which borrowed*	2	-1	-3

* negative borrowed resources denotes overcommitment.

Source: IMF papers EBS/84/170 and 171

201/4

FAB(84)D8 Copy no

HM TREASURY

IMF/IBRD ANNUAL MEETING 1984

COMMONWEALTH FINANCE MINISTERS MEETING 1984

Spring meeting of the Development Committee

Line to take

(a) Note the proposals emerging from both the London Summit and Commonwealth Consultative Group that discussions on international financial issues should be taken forward in the Development Committee.

(b) Points to special meeting of the Development Committee. Support Canadian suggestion of informal format. Avoid commitment to overambitious objectives, eg on communique. Any preparatory machinery should be limited and explicitly temporary.

(c) Go along with a fairly wide-ranging agenda for the discussions. Important to avoid excessive duplication with the regular business of the Interim Committee and other existing institutions. Resist commitments to follow-up, especially in UN context.

(d) Point to advantages for discussions of this sort of manageable size and structure of the Development Committee; small yet representative.

Background

1. Developing countries are pressing for an international monetary conference at every available opportunity. There are two main strands:

   (a) the Commonwealth Consultative Group (see E17), set up to consider how to carry forward the recommendation of the Helleiner Report in favour of a preparatory process aimed at an international conference on monetary reform.

   (b) the Cartagena group of Latin American countries, which has been seeking a dialogue on debt with the G7 (summit) countries.

2. There is a good chance that the pressure from both groups could be satisfied by a special meeting of the Development Committee instead of a full-blown conference. Some may regard it as a step toward such a conference. By allowing them to make their

FAB(84)D8 DEVELOPMENT COMMITTEE

views known at a relatively low key meeting of an existing institution, it may be possible to demonstrate that special procedures are in fact unnecessary or at least to show the weight of views against. G5 governments generally favour this approach.

Recent developments

3. The proximate causes for elevating the Development Committee are:

(i) Canada's proposal, in the CCG, for an extra day to be added to next Spring's meeting. This was echoed in the Summit Communique's remit "to consider the scope for intensified discussion of international financial issues of particular concern to developing countries in the IBRD (sic) Development Committee, an appropriate and broadly representative forum for this purpose";

(i) Mexico's backing for it. This has been an additional factor encouraging summit countries to divert Latin American approaches about a debt summit in that direction.

4. The Chairman of the Development Committee has formally proposed that the future role of the Committee should be discussed at the September meetings and in particular at the dinner on Saturday 22 September immediately before the formal Development Committee meeting the following day. In addition, he has telexed the Summit countries asking them to come prepared to discuss the implications of the London Summit reference at a discussion which he envisages following the dinner.

5. By then, the Cartagena group may have firmed up their own ideas. They are to meet again at Mar del Plata on 13-14 September, ie just before the CFM.

Agenda

6. It is important that the agenda for any special meeting of the Committee should not create expectations of more grandiose subsequent developments such as the Global Negotiations under UN auspices favoured by UNCTAD. So it needs to be framed wider than debt, without encompassing areas likely to be misconstrued as preparing for subsequent international monetary reform discussions.

7. The report of the Commonwealth Consultative Group also considers the agenda for any international discussions (see brief E17). Their proposals are broadly acceptable. It will be important to avoid any excessive duplication with the Interim Committee or other existing institutions but we could support an agenda on the lines proposed in the

Report. Some bias toward aid, debt and trade may be unavoidable given a Cartegena input. Details could be left to be settled by officials later.

Timetable

8. As usual, there is risk of congestion in the spring timetable of international financial meetings. Additional complications this year include the French wish that the Interim Committee be held in Paris and German proposals for an early summit.

8. One possibility would be to have meetings of the G-10 (on the reform report) and the Development Committee in Washington in end-January/early February. The Interim Committee meeting might then take place in Paris in April alongside an OECD meeting brought forward to precede the summit. The various options should be clarified in informal contacts with our EC partners and others before the Development Committee meeting.

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September 1984

98/61

FAB(84)D9 Copy no

HER MAJESTY'S TREASURY

IMF/IBRD ANNUAL MEETINGS, 1984

COMMONWEALTH FINANCE MINISTERS' MEETING, 1984

World Bank

Line to take

(a) Appreciate IBRD role in encouraging economic development in many member countries. Pleased to participate in the $8.4 billion Selective Capital Increase agreed earlier this year.

(b) Welcome innovations in co-financing arrangements with commercial banks, eg World Bank bank.

(c) Await with interest Bank's fundamental review of its role. Particularly concerned to safeguard resources needed to sustain and improve Bank's flows to LDCs. This could include possibility of a General Capital Increase.

Background

1. The International Bank for Reconstruction and Development (IBRD) was established along with the IMF in 1947. It rapidly abandoned finance for post-war reconstruction in Europe because of insufficient funds and now concentrates exclusively on development.

2. It aims to promote economic progress in developing countries, other than the very poorest, by providing financial and technical assistance, mostly for specific projects in both public and private sectors. Loans have been granted to governments (or private enterprises with government guarantee) for projects in a variety of sectors with a concentration on agriculture and basic infrastructure. There has also been some non-project lending, including Structural Adjustment Loans. Total lending in the year to June 1983 was $11.1 bn.

3. Member countries contribute to the capital stock of the IBRD. Shareholdings are generally in line with IMF quota. The authorised capital of the Bank will shortly be $86.5 bn (after approval of the special capital increase), of which the UK share will be 4.76 per cent, down from our former 4.99 per cent. This reduction will allow Japan to assume second place after the US.

FAB(84)9 WORLD BANK

4. The World Bank obtains most of its funds through medium and long-term borrowing against its cash reserves plus callable capital. The Bank's income derives from the paid-in capital on members' shares, its retained earnings and repayments on its loans.

UK policy

5. The UK supports the World Bank's role in long-term economic development in LDCs. We also support the International Development Association which helps the poorest countries. We favour an expansion of the Bank's capital base to sustain lending levels and to prevent decline in net Bank transfers to LDCs over the next several years. While we would not wish to change the essential character of IBRD as a project lender, we would accept more structural adjustment lending, with appropriate conditionality.

6. The Economic Declaration at the London Summit attached "particular importance to ..... encouraging closer cooperation between the IMF and the IBRD, and strengthening the role of the IBRD in fostering development over the medium and long term." Developing countries may expect follow-up initiatives. But there is little prospect of quick progress on a General Capital Increase (GCI) for the Bank, if only because of US opposition.

7. The current review of the IBRD's future role is intended to lay the basis for the next GCI. The Bank's projected lending programme should be consistent with its ability to mobilise funds from the world's financial markets at costs low enough to enable attractive terms for its own borrowers. This should surface at the Spring 1985 Development Committee.

8. A possible package which might command support then might include:

(a) strong conditionality for non-project lending;

(b) a lower paid-in portion of shares under a GCI;

(c) increased co-financing with commercial banks with new ideas for loan design, subject to proper Executive Board scrutiny;

(d) a World Bank Bank to strengthen IBRD's links with the private sector;

(e) improved Fund/Bank cooperation;

(f) a greater IBRD role in aid coordination; and

(g) improved effectiveness of the Executive Board.

ODA

August 1984

FAB(84)D10 Copy no

H M TREASURY

IMF/IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

Linkages between trade and the promotion of development

Line to Take

(a) Believe trading contribution to development is best sustained by an open multilateral trading system to promote competition and efficiency. Repeat Summit commitment to resisting protectionism and encouraging trade liberalisation.

(b) Encourage NICs to improve access to their domestic markets, so enabling preferential treatment for poorest developing countries.

(c) Best hope for world trade lies with sustained, non-inflationary economic growth among developed countries. Developing countries can help restore international stability with resumed growth by adopting sound domestic economic, political and social policies.

Protectionism

1. The developing countries often blame developed country protectionism for their economic difficulties. UK support for resisting protectionism has been frequently repeated: at the Williamsburg and London Summits, in the OECD and at UNCTAD VI. The main regular form are GATT (see brief 26) and UNCTAD.

UK record

2. Superficially our performance in resisting protectionist pressures is good. For instance in 1980 80 per cent of UK imports of manufactured goods were admitted duty-free and only 7 per cent of total imports were subject to none tariff restrictions (4 per cent if agricultural products are excluded). However a large slice of this (about half) was with the EC and we are also seen internationally as heavy users of mixed credits, despite our stated desire to see them phased out.

3. Such protectionism as exists, with the exception of a tightening of the Multi-Fibre Arrangement (MFA), largely predates the recession. We reserve the right to introduce temporary protective measures, in accordance with GATT obligations. These are limited

FAB(84)10 TRADE

to industries seriously affected by changing patterns of increasingly competitive international trade, enabling them to restructure and regain competitiveness.

Newly Industrialised Countries (NICs)

4. UK trade policy attaches importance to greater integration of the NICs (especially in the far east and Latin America) into the open multilateral trading system. It would strengthen the system, reduce market distortion, increase developing countries' influence in multilateral trade negotiations and enable the poorest developing countries to benefit from preferential treatment. Ideas upon ways of achieving graduation of the NICs are still at an exploratory stage, in GATT and OECD. No early progress is expected.

5. In the negotiations the developed countries have little to offer as reciprocal concessions outside the most sensitive sectors (eg MFA), as tariff levels are already low. (Although the areas covered by MFA have considerable export potential for LDCs), it is doubtful whether the EC's Generalised Scheme of Preferences (GSP) could be effectively used to provide a greater incentive to integration, although a major review of the Scheme in 1985 may help. UN discussions on a Global System of Trade Preferences among developing countries have made little progress (the NICs would be the main beneficiaries).

6. Greater access for developing countries' goods in centrally planned economies could also be beneficial. In 1980 only 2½ per cent of developing countries' exports went to CPEs, compared with 57 per cent to the developed market economies.

UNCTAD

7. UNCTAD is a cumbersome and largely ineffective body, but it does provide a relatively harmless opportunity for developing countries to orate. UNCTAD VI in Belgrade in June/July 1983 managed to avoid costly commitments.

8. The US subsequently launched a searching attack on UNCTAD's aims, priorities budget and operations. We are actively cooperating with a group of developed countries to build on this initiative. Apart from the regular machinery in Geneva, an opportunity to consider these ideas further will present at the Trade and Development Board just before the Annual Meetings (10-21 September).

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HM TREASURY

IMF/IBRD ANNUAL MEETINGS, 1984

COMMONWEALTH FINANCE MEETING, 1984

Development Committee Progress Reports

Line to take

(a) IDA 7: regret IDA Management's inability to raise supplementary financing for IDA 7. Reiterate UK willingness to join in supplementary financing on the basis of fair burden sharing and negotiation of satisfactory detailed arrangements. Attach importance to the formal review of the IDA 7 replenishment to be conducted next year.

(b) IFC capital increase: attach important to role of private investment in LDC's. Support GCI. Very willing to consider reallocation of shares with other shareholders.

Background

IDA 7

The IDA 7 replenishment negotiations finally ended in January with agreement on only $9 bn (IDA 6 was $12 bn). Despite strong pressure from other donors, including an EC demarche, the US would contribute no more than 2¼ bn. All other donors would have subscribed to a $12 bn replenishment with a corresponding US contribution. We supported an unsuccessful attempt by IDA management to supplement by up to $3 bn, but Japan and Germany refused to participate. Hope of securing an IDA 7 Supplementary Fund now seems remote.

2. Bank staff have recently suggested instead a special action programme for Sub-Saharan Africa via a dedicated facility (see D12). At its diminished level, IDA 7 will mean a likely share of only about $1 bn a year for the area in the 3 years to 1987. It is now doubtful whether other donors (besides Germany and Japan) will support this initiative.

3. At the end of the IDA 7 negotiations, most donors recognised the inadequacy of the $9 bn supplement. They recommended a review after 18 months, ie in mid 1985. IDA Management should be kept to this.

FOB(84) 11 DEV. COMM. PROGRESS REPORTS

IFC General Capital Increases

4. A General Capital Increase of $650m was recommended by IBRD Executive Board earlier this year. This subsequential increase should provide resources to make a significant contribution to energy exploration, restructuring of existing basically sound firms, expansion in Sub-Saharan Africa and provision of technical assistance for strengthening local financial markets. The Japanese were persuaded not to delay approval of the GCI pending settlement of their claim to a parity shareholding with their new second position in IBRD. We have made clear our willingness to accommodate their wishes by taking less than our share allocation (at less cost to the Aid Programme).

5. The Task Force on Concessional Flows was set up in 1982 by the Development Committee. Neither we nor other major OECD donors welcomed it. The key element of its terms of reference is to study "the problems affecting the volume and quality and effective use of concessional flows, both in the shorter and longer term". Its members comprise the major OECD aid donors and some middle sized ones, some OPEC aid donors and a number of developing countries including China and India. The Chairman is Professor John Lewis, a US academic and former Chairman of the DAC (in OECD). The UK representative is Mr R M Ainscow, of ODA.

6. An interim report by the Task Force was given to the Development Committee last year. The Task Force has commissioned studies in a number of areas including a major one on aid effectiveness. The final consultants' report is due on February 1985.

7. The UK has made a contribution of £10,000 to the fund to help finance the Aid Effectiveness study, which is being carried out largely by UK scholars and consultants. The Task Force Secretariat has estimated that total consultancy costs could reach $½m and may suggest that members contribute further to the fund. No commitment should be given on a further UK contribution.

8. The report of the Task Force Secretariat is likely to go to the Autumn 1985 Meeting of the Development Committee.

FAB(84)D12 Copy no

HER MAJESTY'S TREASURY
IMF/IBRD ANNUAL MEETINGS, 1984
COMMONWEALTH FINANCE MEETINGS 1984

Sub-Saharan Africa (including Fund for Africa)

Line to take

(a) Welcome current focus on Africa. Reiterate UK commitment to helping solve Africa's problems. Shared history and current concern reflected in level of existing financial flows to Africa including UK aid.

(b) World Bank Report a significant further contribution to policy - formulation: merits further study with Bank, donors and African governments. Broadly agree Report's analysis, especially that chief issue is how to make better use of domestic and foreign investments, past as well as future. Also agree that improved co-ordination is desirable, as is effective policy dialogue between donors and recipients. Policy reform frequently necessary both for general economic development and to increase the value of aid-supported activities.

(c) Fund/facility for Africa. Will consider carefully. But greater flexibility, extra support for policy reform, and help for recurrent non-project costs can be met by bilateral aid policy changes in conjunction with contributions from IDA. We remain willing to consider participation in supplementary financing for IDA 7 on satisfactory conditions and if other donors will do so too.

(d) Debt relief. Admit scale of problem. Many African countries find it almost impossible to service debt. Governments and banks have recognised this by rescheduling (sometimes more than once) on generous terms. This is preferable to giving concessional finance with which to service debt.

Background

General Economic

1. The impact of the world recession remained severe on the countries of Sub-Saharan Africa in 1983 and many of them continued to experience low or negative growth. High interest rates and low commodity prices continued to accentuate their debt servicing

FAB(84)12
SUB-SAH AFRICA

difficulties. These problems were compounded in many cases by the continuing drought which curtailed industrial production (eg by interrupting hydro-electricity supplies) and necessitated imports of food.

2. External difficulties have been exacerbated by inappropriate domestic policies: poor use of commercial borrowing, policies penalising farmers, inefficient parastatal monopolies, rapid population growth, and a general dearth of effective management. Many countries have faced falling per capita incomes over the past few years. With extensive black markets, overvalued exchange rates, over-ambitious fiscal policies and poorly judged agricultural support, they have often found it difficult to cope with external shocks.

Debt

3. Their fiscal and external disequilibria have been exacerbated by their debt burdens, which, though not large by global standards, continues to rise in relation to GNP and is a serious drain on scarce foreign exchange for individual countries (with debt service ratios in excess of 40 per cent not uncommon and, in the case of Zambia, as high as 90 per cent before rescheduling). Despite generous official and private reschedulings, debt relief will continue to form part of the adjustment process in the medium term for many countries (including Madagascar, Sudan, Togo, Zaire and Zambia). A further problem has arisen (eg Uganda, Ghana) where the debt is largely debt not eligible, or (eg Zimbabwe) unsuitable, for rescheduling.

4. Consequently an increasing number of African countries have sought help from the IMF and from debt rescheduling: 17 with programmes in 1983 (cf 11 in 1982) and 9 Paris Club reschedulings (cf 5 in 1982).

IMF programmes

5. Adjustment programmes in Africa now make up half of the IMF's clientele. For a number of countries (eg Uganda, Ivory Coast, Zaire) Fund assistance already stretches back over a number of years and will continue to be required in the medium term. In many case, the prospects for achieving a viable balance of payments, even by the end of the decade, are poor and have been worsened by the strains imposed by drought.

6. Programme design for African countries faces a wide range of deep seated endemic problems (paragraph 2), worsened by poor institutions and inadequate data. Following a spate of programme break-downs in the early 1980's, the IMF has adopted a pragmatic stance; eg allowing temporary multiple currency practices in Uganda and Ghana to

achieve substantial phased depreciations. Nevertheless IMF policies in Africa may be criticised. Some programmes fail to take account of the importance of the parallel market (eg Sierra Leone) and place excessive importance on adjustment in the formal sector. Liberalisation of exchange arrangements (as in Zaire) may help in such circumstances. There are also the persistent difficulties of pricing agricultural products in order to give farmers adequate incentives without exacerbating parastatals' deficits or worsening inflation.

7. Nevertheless, in compromising between the politically feasible and economically desirable, the IMF has had some success in reducing domestic consumption and so maintaining the productive export sectors. African governments have achieved major domestic adjustment but have proved less successful in undertaking the supply side measures necessary to restore long term growth. Increasing IMF/IBRD cooperation should help.

8. But longer term financial flows usually depend upon concessional finance and inward direct investment since on the whole African countries do not enjoy access to capital markets. Over the coming years the IMF's role should be primarily catalytic in designing the necessary adjustment with a financing gap that can realistically be closed by a combination of debt relief and donor assistance, so sharing the burden of adjustment between creditors and debtors.

Aid

9. So official aid is vital, justifying a substantial share of the British bilateral budget. In 1983 this amounted to £236 million. The principal aim is to lay a sound foundation for future growth, with particular emphasis on manpower development and agriculture. Assistance is focussed on countries which accept financial disciplines with sound development priorities. Policy reform should generally include agricultural revival, greater export orientation, improved public sector efficiency, effective maintenance of capital resources, and a development-oriented educational system.

IBRD

10. Recently the Bank tried to press the idea of a Fund for Africa to compensate for the shortfall in IDA 7. We are concerned about the risk of breaking up IDA into regional funds. We would only consider participating on the basis of reasonable burden sharing, but participation by all major donors seems unlikely. Available resources are likely to be restricted by our possibly large obligations to the EDF, still to be finalised under Lome III. In any event such a regional grouping already exists in the AFDB group. The

documents do not make specific recommendations for a Fund, but they do speak of a 'Facility' which might turn out to be the same thing. There may be discussion of this in the corridor.

World Bank Report

11. The report "Towards Sustained Development: A Joint Program of Action for Sub-Saharan Africa" is the third in the series. African countries are urged to make sensible changes in their policies and institutions to improve effectiveness of existing investments, provide better incentives and marketing services for farmers, reduce burden of inefficient parastatals on budgets, improve basic human resource programmes and encourage competitive industries and more private investment. All this is welcome, though the Report does not acknowledge how much many countries are already doing.

12. The report envisages donor/recipient agreement promising increased aid in return for substantial policy change. Aim would be to guarantee net capital inflows of $11 billion in 1985-87 (the same as in 1980-82). Without such special action, the Bank envisage only $5 billion. The report is over-ambitious in that:

(a) it assumes generous debt rescheduling by commercial creditors, while failing to recognise increasingly pragmatic and generous approach of the Paris Club;

(b) it probably over-estimates the strength of private flows;

(c) it does not pay sufficient attention to the difficulties of handling the mechanics. It would be more realistic to try to establish a <u>climate</u> in which recipients accept the need for frank high-level discussion of policy and institutional issues.

13. We can, however, endorse two points particularly:

(i) The debt service burden and associated scarcity of foreign exchange is a significant factors throughout Africa. Imported inputs are needed to speed developments, though hesistant capital markets make wider current account deficits unlikely.

(ii) There is a long-term requirement to change the social and political climate in African countries, in order to encourage inward direct investment offering the prospect of real growth.

UK response

14. We cannot endorse the financing programme suggested by the Bank's report because of the increase in aid spending which this would require. Instead we can support the conclusions urging improvement and intensification of aid where we are already ahead of the game. Much of our aid is already of the non-project kind designed to make past investments yield better, and is increasingly allotted to reinforce IMF/IBRD-led structural adjustments (sometimes with explicit conditionality). We are ready to co-finance with IBRD, have played our part in generous Paris Club settlements, and favour increased direct investment. Furthermore we are already champions of better aid coordination.

Possible Special Donors' Meeting

15. Bank management is to consider, in light of Development Committee, possible convening of a special meeting of Donors interested in Africa development issues. Its focus would be on lending and funding, and would thus cover bilateral and regional aid as well as possibility of additional Africa-specific funding of IDA. If the Development Committee welcomed the idea a paper would be prepared for the meeting. Our response must turn on likely agenda and participation (closed or plus Africans). In general the more private, the less the likely pressure on UK for additionality and the more acceptable the meeting.

FAB(84)D13 Copy no

FAB(84)13 IBRD - World Development Report

HM TREASURY
IMF/IBRD ANNUAL MEETINGS, 1984
COMMONWEALTH FINANCE MEETINGS 1984

IBRD: World Development Report

Line to take

(i) Part I of the Report on medium term world economic outlook is generally sound. In particular:

(a) note the analysis of the factors underlying the deterioration in industrial countries' economic performance since the early 1970s, and how this has affected LDCs. Agree that events have been compounded by oil price increases and the high level of interest rates;

(b) but there are other factors too which have helped to precipitate the debt crisis; eg capital flight, and a loss of confidence by creditors;

(c) we can agree with the importance the Report attaches to the developing countries improving their economic situation by domestic adjustment;

(d) we can agree too with many other points in the Report, including the importance of resisting protectionist measures and the need for co-operation, rather than confrontation to debt problems.

(ii) The specific theme chosen for this year's Report is population. Part II of the Report is an excellent appraisal of the very difficult issues involved, and will serve as a valuable reference work on questions of population development and policies.

Background

1. The Report is not specifically on the agenda for discussion at the September meetings. It is a background document. It begins with a survey of the world economic outlook, but focuses principally on population matters.

2. Part I of the Report puts the main blame for the general increases in unemployment and inflation on labour market rigidities and deficit financed public spending. The oil price increases are held to have compounded rather than originated them. The increase in real interest rates at the end of the 1970s is identified as a major

cause of LDC's debt service problems. It is ascribed to counter-inflationary monetary policy, together with declining real savings reflecting falling OPEC surpluses and crowding out by budget deficits, especially in the US.

3. Although interaction between external and internal factors in creating these problems is recognised, no account is taken in the Report of loss of confidence among creditors and associated capital flight in precipitating debt crises in individual countries. This is the main weakness of the document.

4. In Latin America and Eastern Europe, regional crises have been brought about by loss of confidence on emergence of serious problems in Mexico and Poland respectively. These led at best to a major re-appraisal by commercial creditors of their lending policies towards neighbouring countires or, at worst, to a scramble to withdraw outstanding assets from them. This generated liquidity problems in countries whose economies had previously been relatively sound. Capital flight has also been a very major factor in certain instances.

5. The Report under-estimates the debt crisis in Sub-Saharan Africa. (See brief D12). It is misleading to characterise the debt of low income Africa as relatively low. While the absolute amount is low compared with the larger debtors, African ldcs' outstanding long term debt represents heavy domestic burdens: 28.1 per cent of GNP in 1982, as compared with only 23.4 per cent in Latin America and the Caribbean, and 21.5 per cent in East Asia and the Pacific.

6. The Report goes on to present two scenarios for world economic development up to 1995. The major differences between the two are the size of net lending and export growth. The 'low case' seems to be a central estimate of what would happen if present policies continued. As such, it is not the most pessimistic outcome possible. But it offers a bleak outlook with sustained net transfers of resources to the industrial countries, suggesting that co-operation might not survive any increases in protectionism. The 'high case' illustrates what might happen if a very vaguely formulated policy approach were to have considerable success in reversing recent trends. It is possible that the underlying framework of both analyses may be faulty. Under-recording of national income data in Sub-Saharan African countries may give too gloomy a view of performance and prospects.

7. The Report emphasises the need for developed countries to resist protectionist pressures and improve domestic growth, while recognising LDCs should improve their own policies by raising savings and investment rates and by working to improve trade balances. The political costs of adjustment prompt the need for a co-operative rather than a confrontational approach over debt. Another valuable point, which deserves greater prominence, is that creditors' individual interests may lead them to act contrary to their collective interests.

Population

8. Part II of the Report considers the historical and forecast trends of world population growth and the means available for decelerating rapid growth. Population growth in developing countries has slowed from the peak of 2.4 per cent in 1965 to about 2 per cent today. It is argued that this slowdown will not continue without strengthening policies to reduce fertility. Rapid population growth impedes development by reducing resources available for educating/training each person, complicating economic and social change. And in countries dependent on agriculture, there may not be enough food to go round. The Report shows that appropriate public policies can reduce population growth.

9. Access to family planning services and information could be improved in all countries, eg by reaching rural people. A number of countries have yet to introduce such programmes, particularly the low-income countries of Africa where benefits from family planning could be great. Comparatively small increases in public spending in these countries could be very effective. The same is true of official aid (less than 2 per cent is devoted to population assistance).

FAB(84)D14 **Copy no**

6 September 1984

FAB(84)14 ICSID

HER MAJESTY'S TREASURY

IMF/IBRD ANNUAL MEETING 1984

COMMONWEALTH FINANCE MINISTERS MEETING 1984

The International Centre for the Settlement of Investment Disputes:

Line to Take

(a) Support role of ICSID. Regret that tribunals have been slow to reach decisions. ICSID's very existence, and willingness of some governments to consent to arbitration on equal terms with foreign investors, may contribute to improving climate for international investment.

(b) FY 1985 budget: query the estimated underspend on contractual services in FY 1984. Support proposed revision of the Rules and Regulations and continuation of the Additional Facility.

Background

ICSID Convention

Since 1965 ICSID has encouraged the growth of private foreign investment for economic development. It is the only non-financial member of the World Bank Group.

2. The UK joined ICSID early. There are now 86 member states, mostly developing countries. There are some conspicuous absences: the majority of Arab states, most of Latin America and India.

Role of ICSID

3. ICSID attempts to settle legal disputes about investment between contracting states and nationals of other contracting states. All actions require the prior consent of both parties.

4. The UK has concluded bilateral investment protection agreements providing for conciliation and arbitration by ICSID with the following 18 countries: Egypt, Singapore, Korea, Indonesia, Jordan, Sri Lanka, Bangladesh, Senegal, Philippines, Lesotho, Papua New Guinea, Malaysia, Paraguay, the Yemen Arab Republic, Belize, Cameroon, Costa Rica and St Lucia.

5. Mr R Manning (UKDEL IMF/IBRD Washington) will represent the UK at the meeting.

H M TREASURY

6 September 1984

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B(84)E15 Copy no

HM TREASURY

IMF AND IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

Commonwealth Countries' Relations with IMF

FAB(84)15 COMMONWEALTH + IMF

Background

1. This brief contains background details on the 10 Commonwealth members (out of a total of 49) who currently have Standby Agreements (SBA) and External Financing Facilities (EFF); 8 are in Africa and 2 in the Caribbean. In addition, there are notes on several other members, such as Sri Lanka, currently discussing possible programmes.

2. A number of Commonwealth countries can be classified as chronic Fund clients, whose present or prospective programmes will take their use of Fund resources above 300 per cent of quota: Jamaica 376 per cent, Malawi 340 per cent, Uganda 305 per cent. (see brief C6). Others, including Dominica, Kenya and Zambia, are heavy users of Fund credit and likely to have susbstantial need for support for several years.

3. Nigeria is the only member whose debt remains a major source of concern to the international banks (total at end 1983 some $20 billion; see problem countries brief F25). Other Commonwealth countries have large debts in relation to their GDP, but relatively small when compared to the problem countries eg Jamaica £3½ bn, some 1½ times GDP.

4. The brief also includes a note on Australian ambitions to participate in future economic summits.

HM Treasury

7 September 1984

stralia

Line to take

1. In response to demands to participate in summit: decision on participation a collective one. No country unprepared to see Australia participate but all feel it impossible to draw line at Australia. Widening of participation would destroy intimate character of discussions. As hosts Germans have responsibility for 1985 Summit participation.

Background

2. Australia sought unsuccessfully to be admitted both to the Williamsburg and London Summits. The Australian Prime Minister approached the Prime Minister at CHoGM last autumn. Subsequent discussion among sherpas concluded that Australia should be not be invited.

3. Australia's case is that in GDP terms they are second only to Spain as an OECD member not participating in the Summit process. But in GDP terms other countries such as Brazil and India could also lay claim to participation if Australia were admitted.

Belize

4. Economic activity has weakened considerably recently, due to a substantial deterioration in the terms of trade, coupled with the effects of the Mexican peso devaluation which halted a flourishing transshipment and re-export trade with Mexico. Shortage of domestic and foreign currency has led to accumulation of payments arrears. The authorities are expected to begin negotiations for a SBA shortly.

Dominica

5. Following devastation by hurricanes in 1979-80, Dominica successfully implemented an economic adjustment programme supported by a 3-year EFF. A follow-on one-year SBA for SDR 1.4m approved in July supports the country's efforts to stimulate investment and contain the growth of public sector debt and debt service.

The Gambia

6. After a successful 1 year programme expired early in 1983, there were delays in formulating an acceptable follow-on programme, caused partly by The Gambia's efforts to secure an EFF. A 15 month SBA for SDR 12.83m was eventually approved in May. Despite efforts to diversify the economy, groundnuts (which have been badly hit by the

cent drought) are still the principal export commodity. The external position continues to deteriorate and foreign exchange is in increasingly short supply. The Gambian economy reflects the vulnerability of a micro state subject to variable weather and an over stretched administration.

Ghana

7. A one-year SBA for SDR 238.5m has just been successfully completed. Continued IMF assistance is essential. A new SBA for SDR 180m to run to end-1985 has just been approved. The authorities remain firmly committed to adjustment, but recovery has been slower than expected, partly because the economy was more maladjusted than the IMF first thought, and also because the supply response has been tardy due to drought.

8. Successful implementation of the follow-on programme depends largely on the outcome of the IBRD-sponsored Donor's Conference in December to close the 1985 financing gap. We are prepared to consider increasing our aid and are encouraging other donors to boost their support. With exports low the debt servicing burden will be heavy for the remainder of the decade, even though much external debt is concessional. A rescheduling is unlikely in the near future.

9. Overall, economic prospects remain bleak. Recovery is hampered by shortage of foreign exchange for imports and run-down infrastructure. It is crucial therefore that the authorities, continue with the adjustment process.

Guyana

10. The economic and financial scene in Guyana is dominated by protracted discussions with the IMF about a future programme. There are three main differences between the two sides. Firstly the main export industries, bauxite and sugar, have declined seriously due to inadequate investment and a steady exodus of qualified management. The Guyanese consider therefore that the scope for a significant rise in exports as part of any programme is limited, even if demand strengthens sharply.

11. Secondly Guyana is resisting the demand management policies urged by the Fund because they doubt whether they would achieve the desired objectives. They believe a sustained low volume of imports has already had a severe impact on productive capacity.

12. Lastly, Guyana has been in arrears to the IMF for over a year. Since April, Guyana has been prevented from borrowing from the Fund until the repayments are made. Arrears to the Fund have now risen to SDR 17.1m by end-June.

13. In the absence of a programme, the black market continues to grow, now estimated at over 50 per cent of total transactions. External debt stands at $1.3b. There are now arrears of £7.5m on UK aid loans.

Jamaica

14. An acute economic crisis was eased in June, when an IMF programme was re-instated, paving the way for rescheduling agreements with commercial banks and the Paris Club.

15. Following the second breakdown of a three-year EFF (approved in 1981), the IMF cancelled its programme in October 1983. As part of a package of austerity measures designed to meet the Fund's requirements, the currency was effectively devalued by 43.5 per cent. After 6 months protracted negotiations with the IMF, largely over halving the fiscal deficit this financial year, an SBA for SDR 67.2m and a CFF for SDR 76.3m were eventually approved in June.

16. The recent depreciation of the exchange rate has reduced the attraction of the black market and improved the flow of foreign currency into the banking system. Some improvement can be expected in bauxite exports (some two-thirds of total exports) as the impact of stronger US demand works through. But long term prospects are not favourable; the debt service burden ($3¼bn external debt outstanding) will require further restructuring exercises.

India

17. A 3 year EFF for SDR 5 bn was approved in November 1981, before India's adjustment problems became acute. India made significant progress under the arrangement although the fiscal deficit remained too high and public enterprises too weak. In January it announced that it would forego the final year's drawings of SDR 1.1 bn, principally so as to deflect opposition criticism of the Fund's conditionality. A further IMF programme, perhaps early next year after the election, cannot be ruled out.

18. India has been one of the main proponents of an international monetary conference since the 1982 CFM meeting. UK and India are both represented on the Consultative Group set up at CHoGM to promote consensus on international economic issues (see brief E17).

Kenya

19. An 18 month SBA for SDR 176m was agreed in March 1983 and is continuing successfully. As substantial adjustment, particularly in the public sector, is still required, the Kenyan authorities were hoping for a follow on EFF, to run concurrently with a third IBRD SAL.

20. Since then budgetary and balance of payments problems are re-emerging, largely due to the widespread drought. There is a need for major food aid, and an overall balance of payments deficit is now projected instead of approximate balance this year. Discussions on a one-year IMF programme covering 1985 are to begin shortly; the authorities may continue to lobby for an EFF, despite our serious reservations. Reluctance of the Kenyan authorities to permit any linkage between food aid and adjustment in the agricultural sector makes agreement on a IBRD SAL difficult.

21. The Kenyan authorities have proved sensitive to criticism of their adjustment effort and the UK (unjustifiably) was singled out for comments made when the programme was put in place in March 1983.

Malawi

22. A weak EFF for SDR 100m was agreed last September, the only EFF in Commonwealth Africa since the spate of failures in 1981-82. An IBRD SAL is running in tandem and there has been close IMF/IBRD cooperation in devising an adjustment programme. The first year of the EFF has been successfully completed, and external trade performance has been surprisingly vigorous, although there are doubts for the future. The policy action proposed is barely adequate to deal with Malawi's problems. There is little prospect of a viable balance of payments position at the end of the programme. Malawi has faced severe difficulties in sustaining its trade, because of guerilla activity on the routes through Mozambique and the high costs of alternative transport. Donors including the UK are assisting improvements to the routes through both Tanzania and Mozambique.

23. UK caution over domestic financing and pricing policies at the time of the first review in March produced an (unjustified) adverse reaction from the Malawian authorities.

24. Malawi wishes to avoid a third Paris Club rescheduling in 1984 if possible, in order to encourage the restoration of export credit cover. Cover is not at present available to the public sector but the possibility of restoring some cover to certain countries undertaking rescheduling is being considered.

Mauritius

25. Since 1979 Mauritius has made extensive use of Fund resources under four consecutive SBAs, the last of which has just been completed. Mauritius' cooperation with the Fund has been exemplary. However, despite the progress made, the adjustment process is not yet complete; debt servicing remains a vulnerable area. The authorities are expected to begin negotiations for a follow-on programme later this year, against the background of worsening terms of trade.

Nigeria

26. See problem countries brief F25.

St Kitts and Nevis

27. Following independence in September 1983, St Kitts became the 147th member of the Fund in April 1984. It is not expected to request Fund assistance under present circumstances.

Sierra Leone

28. After protracted negotiations, a heavily back-loaded one-year SBA for SDR 50.2m was approved in February 1984. The programme is patently weak and largely ignores the problem of the widespread black market. Drawings of the penultimate tranche have been delayed by the authorities' reluctance to devalue the leone, although there are signs that a compromise may be reached.

29. Without continuing Fund assistance, Sierra Leone's overall economic and financial situation will become desperate. Corruption has become widely entrenched; an estimated 80 per cent of imports are financed by diamond smuggling; the debt burden is unsustainable. A Paris Club debt rescheduling was concluded in February but it appears unlikely that the Sierra Leoneans will be able to sustain their obligations under the agreement.

Sri Lanka

30. Sri Lanka is faced with growing economic difficulties; large budget deficits, (13 per cent GDP in 1983), inflation of 15-20 per cent, an increasing current account deficit (some $600m pa) and a debt service ratio of 22 per cent. These stem from an over ambitious public investment programme and overvalued currency, compounded by recent drought affecting the major tea exports, and civil disturbances which have reduced tourist receipts.

In the wake of last summer's riots, an 18 month SBA for SDR 100 m was agreed in September. Never well designed, it failed after a few months largely because of government preoccupations with social policy. A package of economic measures is expected shortly, which could pave the way for a fresh IMF programme. Discussions are likely to take place in late September.

32. The UK is Sri Lanka's third largest aid donor (about £50m pa) and has been closely involved with the major Mahaweli River hydropower and irrigation project.

Tanzania

33. The Tanzanian authorities have been unable to agree a Fund programme since the breakdown, after the first drawing, of an SBA in 1980. The major sticking points have been Tanzanian resistance to the market-orientated approach of the Fund, the scale and timing of a devaluation, the appropriate level of producer prices and rejection of a proposed Fund limit on domestic credit expansion. The 1984-85 budget, which included inadequate devaluation, raised producer prices and lowered subsidies appears to project credit growth more than twice that envisaged by the Fund. The IMF has refused to grant a request for a moratorium on arrears of repurchases.

34. The declining economic situation (falling exports and budgetary resources and an increasing black market) has encouraged the Tanzanians to move towards accepting Fund prescriptions. A staff mission is visiting Dar es Salaam in September to hold the Article IV consultation, as a prelude to discussions over a possible programme. An approach for rescheduling would follow the agreement of a programme. Tanzania has substantial arrears, including overdue payments to the Fund of some SDR 12m, and a dsr of 58 per cent in 1983.

35. The UK has deflected repeated approaches from the Tanzanian authorities to lobby the Fund on their behalf for softer conditionality.

Uganda

36. The rehabilitation of the Ugandan economy, underpinned by substantial IMF and donor assistance, has continued in 1983-84. GNP grew at over 7 per cent, albeit from a very low base. Uganda's fourth successive one year standby (of SDR 90 m) broke down in June before the final drawing, because short term public sector external debt was higher than the IMF criterion.

[illegible]. Discussions on a draft letter of intent for a new standby were held up by a disagreement over the size of the projected fiscal deficit. A programme outline has just been agreed, involving no net use of resources. This reflects the Fund's belief that, despite a dsr in excess of 40 per cent and little prospect of any rescheduling (partly due to a debt dispute with Israel) there is no overall balance of payments disequilibrium. The major emphasis of the new programme, unlikely to be in place before mid-November is expected to be control of the fiscal deficit. Continued donor support will be important but may be jeopardised by human rights concerns.

Western Samoa

38. The economy experienced serious difficulties during 1980-82 due to deteriorating terms of trade. IMF support from June 1983 has aimed at remedying the inadequate policy response. The overall financial position of the economy has achieved a dramatic turnaround, all but eliminating the accumulation of external payments arrears. The present one-year SBA for SDR 3.4m, approved in July, is intended to consolidate the gains achieved and further improve the economy through correction of structural weaknesses.

Zambia

39. The Zambian economy is characterised by over-dependence on copper exports, a heavy debt service burden for the rest of the decade and massive arrears on current payment. Capital investment has declined and existing productive assets have deteriorated. Copper provides some 90 per cent of export earnings but has suffered a substantial fall in price over recent years. Suggestions of US protectionism have given rise to fears of further major price cuts. Despite Zambia's significant agricultural potential, the outlook is bleak.

40. A 21 month SBA for SDR 225 m was agreed in July, involving no net use of IMF resources. It required donor assistance (£5.5m from the UK) and exceptionally generous rescheduling in order to close the financing gap and allow the first drawing to take place. The Paris Club terms provided 100 per cent relief on both new maturities and sums due under the previous Paris Club settlement. A Staff mission is in Lusaka to conduct the first review, due by end-September. The continued fall in the copper price means foreign exchange receipts and budgetary revenue will be lower than previously projected, and the Fund are looking for further substantial devaluation. The prospects of the Zambians sustaining the Fund programme and meeting their obligations under the Paris Club agreement appear poor. Balance of payments management will require sustained budgetary restraint and generous debt rescheduling for several years.

●. There is strong UK interest in Zambia. 15,000 UK citizens still work on the Copperbelt; two British banks (Barclays and Standard Chartered) are represented; UK banks, companies and individuals are owed 1/3 - 1/2 of the $600 mn commercial payments arrears stretching back 3½ years; there is well over £200m UK investment.

Zimbabwe

42. The 18-month SDR 300 m SBA approved in March 1983 broke down in March 1984. The proximate cause was announcement of a tightening of exchange controls without prior consultation with the Fund. In addition Zimbabwe breached the criteria relating to domestic finance, following a mini budget in February which raised the projected fiscal deficit to about 11 per cent of GDP. The programme had earlier suffered similar difficulties when the end June 1983 criterion on credit to the government was breached.

43. The recent drought, and associated additional food imports, has worsened an already severe external situation; debt service presents a serious potential problem. Latest reports suggest IMF Staff are less optimistic than before about the prospects for a new programme. Zimbabwe's recent budget, though austere, was out of line with understandings reached during the last mission. Sticking points are likely to be the size of the fiscal deficit and a further devaluation. Discussions are expected in the margins of the Annual Meetings.

BANGLADESH (SUPPLEMENTARY NOTE)

We have now had confirmation that Syeduz-Zaman, Principal Finance Secretary, who will lead the Bangladesh delegation to the CFM meetings and the IMF/IBRD Annual Meetings, will be asking the UK for additional assistance as a result of the recent serious floods. He is likely to ask, in order of priority, for the following:

i. Food aid in the form of wheat for an extended food for work programme.

ii. Financial assistance for the purchase of grains on the world market.

iii. A special grant for the rehabilitation of roads and bridges damaged in the floods.

2. There is one further piece of background information of which the Chancellor will wish to be aware. Last year at the UN General Assembly meetings Bangladesh abstained on a pro-Argentinian resolution in respect of the Falkland Islands. They have now said that they will support us actively by, for example, lobbying other countries. Whilst it is not entirely clear whether this means they will actually vote in support of the UK, it is certainly a positive step in the right direction.

Line to Take

i. Food Aid. Bangladesh is a major recipient of the Community's food aid programme. If the food situation deteriorates rapidly, it will be for the Community to make the first response. We are of course in very close contact with local representatives of the FAO etc.

[Not for use. Food stocks overall in Bangladesh are at reasonably high levels. Our own bilateral food aid programme is already largely committed in Africa this year].

ii. Rehabilitation Assistance. We have already indicated our willingness to look at bridging generally in Bangladesh, and we await a response from the GoB to proposed Terms of Reference, for an appraisal team. We are anxious to move ahead with this with the minimum of delay. In the very short term, we would consider sympathetically any specific request put to us by the GoB.

[Not for use. It would be possible to fund emergency bridging etc from FCO/ODA Disaster Unit funds. This would certainly amount to more than the £150,000 ceiling for any one country which is the limit of delegated authority, and Treasury approval would thus be needed].

Copy no

FAB(84)E16

HER MAJESTY'S TREASURY
IMF/IBRD ANNUAL MEETING 1984
COMMONWEATH FINANCE MINISTERS MEETING 1984

Commonwealth Functional Cooperation: Follow-up
Action on Conclusions Reached at
Finance Ministers' Meetings

FAB(84)16 comm functional co-op.

Line to take

(a) Commonwealtah Programme on Capital Markets: support Secretariat's useful technical assistance and encouragement of contacts between developing countries and financial institutions.

(b) TAG advice on macro-economic policies and financial management: facilities such as the provision of advice on economic policy options and techniques for the management of external debt. Encourage Secretariat to continue close liaison with other IFIs to avoid duplication of effort.

(c) Private foreign direct investment: applaud useful project, consistent with UK commitment to direct investment. It provides development finance, increases employment and introduces new skills. It directly creates growth in the market sector of their developing countries economies, an essential development tool to which aid is not always well-adapted. Encourage efforts to ensure that conditions for investments are conducive to flourishing relationship between investors and host countries.

(d) Commonwealth Fund for technical cooperation: support CFTC's important role in Commonwealth affairs. Value mutuality of the Fund. Welcome use of human resources from throughout the Commonwealth.

(e) CFTC contribution (if other Commonwealth Ministers choose to announce their countries' financial pledges to the CFTC for 1984-85): reiterate UK intention to continue to provide 30 per cent of the total income from contributions.

Background

Commonwealth programme of capital markets

1. The programme assists developing member countries to tap international markets. Under this programme a consultation between major international banks and interested countries is being prepared for November this year in London. A workshop on debt management techniques (in conjunction with the Dag Hammarskjold Foundation and the Swedish National Debt Office) may be held in 1985 (postponed from this year). The Secretariat circulates to governments its regular Capital Markets Review describing general market conditions of interest to developing countries.

TAG advice on macro-economic policies and financial management

2. The Technical Advisory Group offers developing member countries an independent source of policy advice on macro-economic issues. As part of its advisory service on setting up a Debt Recording and Management System, the Group is developing a computer software package which should be available to member countries early in 1985.

Project on private foreign direct investment

3. The UK has signed 22 bilateral Investment Promotion and Protection Agreements (IPPAs) with developing countries, and would welcome more. These agreements provide for the protection of existing and future investments under the law of the host country, for the payment of prompt, adequate and effective compensation in the event of expropriation and for the independent settlement of investment disputes.

4. We also support the work currently being done in the International Finance Corporation on the encouragement of private investment and takes a close interest in the World Bank, on establishing a Multilateral Investment Guarantee Agency.

Commonwealth Fund for Technical Cooperation

5. Our contribution to the CFTC in the current financial year is approximately £6.6 m. Total fund expenditure is expected to amount to approximately £22.7 m.

6. Detailed background information on the CFTC and other various Commonwealth programmes is available from the ODA member of the delegation (Mr K G W Frost).

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HM TREASURY

IMF/IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

Commonwealth Consultative Group

FAB(84)17 Comd. Consultative Group

Line to take

(a) Sorry that, despite comments by Chancellor and others at May meeting, Report devotes relatively little attention to specific current issues;

(b) But agree with what is said on specifics (para 19 of Report) eg on interest rates, resources of agencies and trade questions;

(c) Do not see case for new full scale reform exercise. System itself not unsound;

(d) But agree merit in wide ranging discussion of areas set out in para 11 of Report. Some of these also being looked at by G-10;

(e) Development Committee a good choice cf forum for special meeting. Representative of all interests. Use of existing institution has practical advantages.

(f) Should have open mind at this stage on precise timing of meeting.

Background

Commonwealth work on international monetary reform dates back to the London 1982 meeting of the Commonwealth Finance Ministers, when an expert report under Professor Helleiner was commissioned. It was published in September 1983. It recommended work toward

an international monetary conference. In response CHoGM commissioned further work under two headings: a Commonwealth Consultative Group (CCG) of representative ministers and their deputies; and a Commonwealth Experts' Group (CEG) under Lord Lever.

2. The CCG consists of representatives of 8 countries; Canada, Fiji, India, New Zealand, Tanzania, Trinidad, UK and Zimbabwe. Senior officials, including Mr Littler, met three times, and Ministers once, in London just before the Summit.

3. Through most of its existence, the Group had to contend with Sir Robert Muldoon. Despite UK efforts to get the Group to address a limited list of realisable recommendations, it has been largely preoccupied, with the active encouragement of the Secretariat, with over ambitious ideas on the "process" of international monetary reform. The Group's report discusses how work toward a Committee of 20 style international monetary conference might be engineered. A general list of issues for wider discussion is identified; basically the four areas under discussion by the G10 together with trade and aid (see Annex A). There is a short and uncontroversial section (Section IV) on current issues.

4. We have supported a Canadian initiative to deflect further work into the Development Committee, perhaps by way of a special seminar session in spring 1985 (see brief D8). Other members of the Group have been prepared to go along with this, although they do not see it as a substitute for something more grandiose later on. (It remains to be seen whether New Zealand will join the UK/Canadian line following the change of government.) The case for a special Development Committee session is stengthened by the Latin American bid for a special meeting on debt (see brief D8).

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ANNEX A

Extract from Report of Consultative Group, 8 August 1984

With the above considerations in mind, the Group has agreed to commend the following agenda for further consultations, in the hope of facilitating early consensus on these issues among developed and developing countries:

"Areas for Consideration in the Framework of World Recovery and Development

- The role of the IMF, including balance of payments support, adjustment, conditionality and surveillance, SDRs and international liquidity.
- The role and resource position of the multilateral development institutions, particularly the World Bank and IDA.
- Financial flows including official development assistance and commercial flows and problems of external debt.
- Trade liberalisation, protectionism and structural adjustment.
- Linkages between money and finance, trade and economic development.

HM TREASURY

IMF AND IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

Commonwealth Experts' (Lever) Group Report

Line to take

(a) Welcome thorough analysis of nexus of problems facing debtors and developing countries and methods so far used to deal with them. But cannot accept vastly enlarged role for creditor governments as proposed.

(b) Accept that much depends on developed countries' prospects. Underlines importance of surveillance and multilateral consultation in helping achieve non-inflationary growth and lowering real interest rates to more tolerable levels.

(c) Emphasise complementary need for responsible adjustment policies in developing countries in order to achieve external viability within reasonable timescales. Adjustment need not be incompatible with growth even for heavily indebted developing countries: eg Korea, Uganda, Ghana, Mexico. Indeed it creates conditions conducive to sustainable expansion.

(d) Endorse self-help through opening up channels for direct private investment and other non bank forms of finance (ie bonds).

(e) Support central role for IMF: both lending in its own right and providing reassurance for other creditors. Believe its present resources sufficient for foreseeable needs after recent supplementation by quota increase and borrowing. Dangerous to relax discipline by weakening conditionality, though support greater structural content in adjustment.

(f) Agree in broad terms with the Report's views on the World Bank group, in particular on IBRD and IDA. But do not believe in borrowers' interests to relax IBRD's gearing ratio at this stage.

(g) Willing to study new ways of dealing with existing onerous debt commitments. Believe existing case by case approach sound basis for debt strategy. Support multi year

FAB(84)18 LEVER

rescheduling in appropriate cases where successful adjustment offers hope that sustainable external position may be reached reasonably quickly. Doubt whether this technique should be applied generally.

(g) Mistrust global solutions. Without complacency about gravity of international crisis, believe existing institutions sufficient.

(h) Do not envisage substantially expanded role for industrial countries via increased aid or through bank guarantee arrangements. Substantial cost of recommendations would undermine fiscal strategy of developed countries on which world recovery depends, reduce discipline on banks and debtors, and weaken incentive to adjust.

(i) Acknowledge severe problems of many low income countries, especially those afflicted by drought in sub-Saharan Africa. [Stick by case by case approach.]

Background

1. The Commonwealth Heads of Government Meeting (CHoGM) last November commissioned an independent group of experts to examine the developing countries' debt problem. The 10 member group led by Lord Lever met three times. It is fairly clear that the majority of its analysis was prepared by the Commonwealth Secretariat, while Lord Lever imposed the report's radical recommendations on a not altogether unanimous group.

2. The report follows on the heels of the Helleiner Report published last September in time for the 1983 Commonwealth Finance Ministers' meeting. With basically the same background picture of the origins of the debt crisis (the oil shocks; the build up of indebtedness over the 70s; high interest rates) it too goes for a global initiative of ambitious proportions. The recommendations could, in effect, form the agenda for the international monetary and financial conference recommended by Helleiner. (See brief E17 on the Commonwealth Consultative Group which has been separately studying the scope for an international initiative with inconclusive results).

3. The Lever proposals are deceptively enticing for developing country consumption. They cover virtually every topical idea with Lever's hobby horse, an insurance scheme for bank debt, as the centrepiece. They purport to offer a coherent policy response designed to stabilise the international economic and financial systems and redistribute responsibility while safeguarding the security of the international banks. But relieving the banks of the burden of responsibility for their previous lending decisions while

ghtening debtors' servicing obligations can only be accomplished at industrial countries' expense. The consequences of this strategy are not thought through. In particular, there is no serious attempt to address the inevitable damage these costly policies would do to industrial countries' growth potential and inflation rates. A simple comparison is offered; the flow of $800 billion OECD annual income against the $400 billion stock of developing country debt to banks. The importance of vigorous industrial countries' prosperity for debtors and developing countries is recognised as a final flourish.

4. The following checklist of the report's recommendations suggests responses to the specific points:

Recommendations	UK attitude
A Debt	
Softer loan terms for debtors and LDCs: longer maturities, grace periods.	Longer maturities, (including via rescheduling) yes; subsidies no - fiscal constraints.
Debt service in local currencies.	Creditors at unfair risk of competititve LDC devaluation
Multi-year rescheduling 'norm'	MYRA only for convalescent debtors: see brief B3
Insurance scheme for commercial bank lending	Impractical: too costly for industrial countries governments. Weakens discipline on banks and debtors. Inconsistent with reports' own opposition to bailing banks out.
Interest rate capping	Other techniques to ease loan terms more practicable, even where no subsidy involved. Oppose any Fund scheme
More bilateral lending	Precluded by fiscal constraints: see F22 for UK contribution

More multilateral lending: IMF, IBRD, regional development banks	Support roles of IFIs. IMF resources adequate: see C7 Support GCI for IBRD
Encourage direct investment	Yes: but LDCs must facilitate by lowering own post-colonial barriers: see B3.
Bond financing	Fine if private sector can devise; but no official guarantees.

B Low-income countries

Reactivation of IMF Trust Fund Introduction of low interest rate, low conditionality facility	More appropriate for LDCs to cope with medium term adjustment and development problems through regular Fund facilities. Would require more Fund resources.
IMF lending to have more structural character with IBRD support	Already being implemented: many Fund programmes now in medium term framework: see F24.
More aid and debt write-offs	Most now converted. UK took lead in aid write-off in 1970's.
More generous debt restructuring	Paris Club very flexible -100 per cent over long periods in worst cases.
Prompt restoration of trade credit insurance cover	Prepared to be more flexible -see B3.
Technical assistance in managing debt	Support, eg through IMF and IBRD.

C IFIs

IMF: Softer loans, longer maturities, weaker conditionality, enlarge compensatory financing facility (CFF)	Essential not to damage credibility of IMF programmes in promoting adjustment: see F24
Increase IMF resources	Unnecessary: see C7.
Big SDR allocation	Oppose: see C5

IBRD: raise non-project lending to over 30 per cent	Support some increase with appropriately tight conditionality: see D9.
Further GCI	Support
Big SDR allocation	Oppose: see C5

IBRD: raise non-project lending to over 30 per cent	Support some increase with appropriately tight conditionality: see D9.
Further GCI	Support

Relax gearing ratio	Oppose: market constraints
More IDA lending More cofinancing	Support in principle but await review
More equity investment/ investment in private sector	Attach great importance to role of private investment. Supported recent SCI (see D9) which should facilitate more equity investment.
Greater IBRD role in programme design	Support more supply side adjustment in conjunction with IMF conditionality: see F24.
Greater role for regional development banks	Support, but development of IBRD role itself is the key

D <u>Industrial countries</u>

Growth Lower real interest rates	Support; sound fiscal and monetary policies should help achieve; surveillance should consolidate: see B2.
Less protectionism	Support in principle: see F26

HM TREASURY
August 1984

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HER MAJESTY'S TREASURY
IMF/IBRD ANNUAL MEETING 1984
COMMONWEATH FINANCE MINISTERS MEETING 1984

US Economy

Line to take

(a) Recovery stronger than expected helped by lower inflation. GNP now 7 per cent higher than a year ago. Important this is consolidated into more moderate but sustainable growth. Most forecasts, however, see activity slowing perhaps sharply during next year with inflation picking up.

(b) Strong credit demand and large Federal deficit have pushed US interest rates up by 2 points this year. High interest rates threaten longer-term growth prospects. They put pressure on other industrial countries' rates and aggravate debt burdens.

(c) Combination of budget and external deficits unlikely to prove sustainable. Danger of investors both at home and abroad becoming increasingly reluctant to finance them. If no action implies higher interest rates or downward pressure on the dollar. Latest dollar strength raises anxieties over eventual precipitous fall.

(d) Concerned that Congress not yet finalised full $150 bn down payment deficit cut. Tax measures agreed so far make only limited contribution. Hope Congress will agree on other spending cuts package soon. Expect US Administration to introduce further measures after the election including the President's longer term plans.

(e) Federal Reserve faces more difficult task through fiscal inaction . Volcker right to stick with firm counter-inflation policies whilst recognising dangers from higher interest rates.

(f) Confidence amongst markets from a firm programme to cut the budget deficit would help moderate interest rate pressures and allow orderly dollar adjustment.

Background

1. US output economy grew by 3½ per cent last year after a 2 per cent fall in 1982. GNP rose by an unexpectedly fast 7½ per cent at an annual rate in the second quarter of 1984 and is now estimated to be some 5½ per cent higher than at the end of 1983. The

FAB(84) 19
US Economy

recovery is partly the result of the unexpected success in reducing inflation together with Reagan's personal and corporate income tax cuts, as well as the usual turn-round in the investment and stock cycles. The fall in inflation has allowed lower savings while still maintaining existing real wealth and has created more room for growth within fixed nominal monetary and fiscal objectives. The main impetus has come from consumer's expenditure though the unexpectedly strong business investment recovery has also been a major factor.

2. Recent economic indicators are mixed but suggest growth could soon start to slow. After moderating somewhat industrial production rose again by 1 per cent in June and July. Recently retail sales, however, have been flat and housing starts have weakened. The leading indicators fell again in July for the second consecutive month. Investment plans are also being revised down a little.

3. The US Administration now forecasts growth of 6½ per cent this year as a whole in line with the general consensus. Most see some slowdown later this year and particularly into 1985 and after though views differ on its extent. The US government's 4 per cent projection for both 1985 and 1986 may be optimistic.

4. US employment has risen by over 6½ million since the end of 1982. As a result unemployment has fallen from its peak of almost 11 per cent in late-1982 to 7½ per cent in August. The scope for further significant falls may now be more limited.

5. Annual consumer price inflation has risen from its artificially low rate (because of statistical changes) of 2½ per cent last year to just over 4 per cent now. There are few immediate signs of any further acceleration. Earnings growth remains low but some fear that the autoworkers could negotiate large settlements given improved profitability and this could exacerbate wage pressures elsewhere. Some gradual pick up in inflation is expected next year but any sharp depreciation of the dollar would add a further upward twist. The OECD sees inflation rising to over 5 per cent though private forecasters envisage a faster increase.

6. Strong private credit demands together with the government's borrowing needs have helped force interest rates up. Short-term interest rates rose from under 9½ percent in January to almost 12 per cent in early July - but have since edged back to around 11½ per cent. Ten year bond rates have fallen by rather more, reflecting in part

greater confidence in the longer-term inflation outlook, to stand at 12½ per cent now. Short rates have firmed recently with new Treasury issues and the report of the recent Federal Open Market Committee suggesting no easing of policy.

7. The current account deficit which rose to $41 billion last year is expected to reach $80-100 bn in 1984. The trade deficit rose to a new monthly record of $14 bn in July - this year's cumulative total is $74 bn and US officials put it at $120-130 bn for 1984 as a whole. This partly reflects the US lead in the recovery, depressed export markets and the high dollar. Recovery outside the US should help reduce it but a dollar depreciation coupled with slower relative US growth seems likely to be needed to restore the current account to balance over the medium term.

8. The dollar effective rate weakened earlier this year but recovered sharply and has risen over 10 per cent since March easily exceeding its previous mid-January peak. It is now almost 50 per cent above its 1980 level. Burgeoning external deficits together with some unwinding of those factors which have contributed to the dollar's strength (such as 'safe haven' considerations and the good relative US inflation performance) are expected to result in some depreciation - but as long as US interest rates are expected to remain firm or rise further this adjustment could be delayed.

Monetary and Fiscal Policies

9. Monetary policy has not been consistently firm in recent years. After overshooting in 1982-83 monetary growth slowed in the second half of 1983 when M1 grew at an annual rate of 6 per cent and M3 grew at 9 per cent. Narrow monetary growth picked up earlier this year. M1 has moved erratically recently but remains towards the middle of its 4-8 per cent target range. M2 was within and M3 just above their 6-9 per cent target ranges in July. In the first half the Fed's credit aggregate grew 2 points faster than the top of its 8-11 per cent range.

10. Despite this rather mixed monetary picture which Volcker presented at his mid-year review in July he announced that the current policy stance and targets would not be changed. The continuing problems of LDC debt, domestic banks (including Continental Illinois which has now received a $4½ bn loan by the Federal Deposit Insurance Corporation) as well as election prospects clearly have had some influence. Tighter provisional targets for the narrow aggregates were set for 1985 with the ceilings lowered by 1 and ½ point to give ranges of 4-7 per cent and 6-8½ per cent for M1 and M2 respectively.

11. Volcker argued that some of the excess credit growth was the result of an unusually hectic period of merger activity and 'leveraged buyouts' (substitution of debt for equity) which would have little inflationary potential. But he did note that recent rates of credit growth, in excess of nominal GDP growth, if continued would be inconsistent with the Fed's objectives. Lowering some of next year's targets will have helped calm inflationary fears though by leaving the M3 and credit targets unchanged he may not have gone far enough.

12. On fiscal policy, the US Administration continues to dispute the widely held link between budget deficits and interest rates. Although the economic cycle may obscure any simple relationship most believe that Federal borrowing needs and prospect of rising structural deficits mean interest rates being higher than otherwise (see annex).

13. The President has signed into law the 1984 Deficit Reduction Act which provides for savings of $63 bn, mostly of tax measures, as part of the $150 bn or so downpayment plan to cut the deficit in fiscal years 1985-87. It closes loopholes but contains no major new tax proposals. Spending cuts of $13 bn, mostly on health expenditure are included. But progress on other major expenditure reductions especially defence is proving more difficult. Congress only has until 4 October, when it adjourns, to complete the fiscal 1985 budget process. Failure here would mean that spending will be maintained by continuing resolutions.

14. Difficulties in Congress centre on defence spending. The Senate seeks a 7¾ per cent real increase for fiscal 1985, in line with the President's plans while the House wants a 3½ per cent increase. In June, compromise on a 5 per cent real increase seemed possible but further disagreements especially over the funding of the MX missile, have mudded the waters again. With continuing resolutions defence spending would be left relatively high.

15. The Administration's mid-session review estimated the deficit this fiscal year as $174 bn or 4¾ per cent of GDP (cf $195 bn or 6 per cent last year). Against the January forecast the government now sees deficits slightly lower in 1984-87 but higher in 1988-89. The differences are a result mainly of much stronger growth in 1984 and some policy changes particularly lower planned defence expenditure though in the later years these are offset by larger interest charges on the growing Federal debt as a result of higher though still not entirely plausible, interest rate assumptions. The 4 per cent growth assumed for 1985-89, regarded as over-optimistic has been retained.

16. On more realistic assumptions the Congressional Budget Office's latest forecast sees the deficit rising to $263 billion in 1989 and averaging 4¾ per cent of GDP over the period. Privately held Federal debt could almost double over the rest of the decade. It is this prospect which has led Volcker and others to question the willingness of investors to continue financing the deficits. The recent abolition of withholding tax should stimulate extra foreign interest in US government securities and other plans are being considered.

17. President Reagan has recently announced that a long term plan to cut the deficit would be included in the budget for fiscal 1986 to be released in January 1985. The failure to deliver the full downpayment at least so far together with Reagan's difficulties on taxes cast doubt on his intentions. Almost inevitably taxes would have to be increased to achieve significant deficit reductions. The political problems of introducing such fiscal restraint at a time when US growth might be slowing quite sharply could prove difficult.

13 September 1984
HM Treasury

ANNEX

THE LINK BETWEEN DEFICITS AND INTEREST RATES

Summary

In theory there may be circumstances when higher budget deficits do not affect interest rates - notably if the private sector uses its increased income from the higher deficit wholly to purchase bonds at given interest rates, or if lower taxes lead to higher growth and hence increased savings to finance the deficit. Both are matters for empirical testing. Our own work suggests the former is not usually the case and that supply effects are probably modest.

2. Simple single-equation models can be misleading. The link between deficits and interest rates is complex as spending and saving decisions are affected throughout the economy. Simple relationships are bedevilled by the fact that increases in deficits as a result of cyclical factors are often associated with periods of low interested rates. Notable that when other researchers adjust for these factors they tend to find deficits <u>do</u> affect interest rates.

3. Better generally, however, to consider effects of deficits in the context of overall working of the economy. Large models which attempt to capture main relations, eg in the US those of the Federal Reserve and DRI, all find that higher deficits tend to increase interest rates. Our own model for the UK does likewise.

4. Most convincing argument, however, depends less on models than on high level of US interest rates in both nominal and real terms.

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HM TREASURY

IMF AND IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

Canadian Economy

Strong recovery seen during 1983 seems to have slowed this year. This may reflect natural cyclical slowdown together with the rise in interest rates partly as a result of higher US rates and the weakness of the Canadian dollar.

2. Welcome sharp fall in inflation from 12½ per cent in 1981 to only just over 4 per cent now but there is a risk of some acceleration following recent expiry of 6/5 pay and prices policy.

3. Budget deficit currently about 8 per cent of GDP. Sizeable deficits look set to continue and threaten sustainability of recovery. Important that incoming government takes firm measures to put deficit on a sustainable path.

Background

4. The Conservatives under Brian Mulroney won a large majority over John Turner's Liberals in the election on September 4. The Liberals had been in power for almost all of the previous 21 years.

5. Canada is emerging from a short but unusually severe economic cycle. Output fell sharply by 4½ per cent in 1982 as domestic demand slumped. Recovery last year was unexpectedly swift, helped by strong US growth. Canadian output rose by 6½ per cent through the year although the pace of recovery has slowed so far this year.

6. **Unemployment** which peaked at almost 13 per cent at the end of 1982 fell back to about 11 per cent at the start of this year. Since then unemployment has fluctuated but remains around 11 per cent now.

7. **Inflation** rose to about 13 per cent in mid-1981 but has fallen sharply since to 4¼ per cent which at least partly reflects the success of the government's 6/5 policy. This legislated limits on federal wages and government administered prices of 6 per cent

FAB(84)20 CANADIAN ECONOMY

in the year to mid-1983 and 5 per cent to mid-1984. Recession may also have restrained wage demands.

8. Canadian interest rates have more than matched recent increases in US rates this year. 3 month interest rates rose from 9¾ per cent at the start of the year to over 13 per cent at the end of July before falling back to just over 12 per cent. This partly reflects the weakness of the Canadian dollar which fell back to US$75 cents in July after trading at around $81 cents for much of last year. It has recovered since to around $77 cents.

9. The previous government's forecast of 5 per cent growth this year is only slightly above those from the OECD and IMF. It depends on continued strong growth in consumption and some business investment recovery which has yet to get firmly underway. Inflation is unlikely to fall any further and could rise again if faster activity leads to efforts to recoup recent declines in real earnings particularly following the end of the 6/5 policy. Some further decline is expected in the current account surplus.

Policies

10. Monetary targeting (M1) was abandoned at the end of 1982 due to instability partly as a result of financial innovation. The authorities have not yet found a satisfactory alternative to M1 and attention has been directed at a range of indicators including the exchange rate. This policy has been reasonably successful but with no specific target, there is concern whether the authorities will be able to keep a firm check on inflationary pressures in future.

11. Firm fiscal policies reduced the federal deficit from almost 5 per cent of GDP in 1978-79 to 2½ per cent in 1981-82. It rose sharply in 1982 reflecting both the recession and more expansionary policies.

12. The Special Recovery Program announced in the 1983-84 Budget in April 1983 constituted a further relaxation of policy. Additional capital projects were announced worth $2.2 billion, 70 per cent of which was to be spent by March 1985. Incentives for private investment were increased. These were partly offset by increases in indirect taxes due to come into effect in October this year.

13. The 1984-85 budget left the fiscal stance broadly unchanged. Indexation of pensions and income tax brackets is to be resumed after increases of 6 and 5 per cent

201/5

over the past 2 years in line with the government's 6/5 policy. Collective bargaining in the public sector will recommence although no catchup will be allowed.

14. The previous government expected the Federal deficit to fall only slightly by 1 percentage point to 7 per cent of GDP in fiscal year 1984-85 despite significant growth. The deficit is projected to fall to 4¾ per cent of GDP by 1988 though this depends on the optimistic projection 4 per cent a year growth.

15. The structural Federal deficit is estimated to have risen last fiscal year to 2½-3½ per cent of GDP. It is expected to remain broadly unchanged this fiscal year but decline slightly afterwards. The prospect of such large structural deficits continuing inevitably creates uncertainty over future policies especially on the monetary side. They may pre-empt savings and have adverse implications for private sector activity and longer-term potential growth.

HM TREASURY
September 1984

AB(84)F22 Copy No

HER MAJESTY'S TREASURY
IMF/IBRD ANNUAL MEETING 1984
COMMONWEALTH FINANCE MINISTERS 1984

UK Aid Programme

Line to Take

(i) The gathering economic recovery in OECD countries has helped bring about a modest improvement in the terms of trade of developing countries. With improving export and price performance they have been able to continue to reduce their aggregate current account deficit. However the low-income countries who are net importers of oil - the main recipients of aid - were considerably less successful in this respect. Clearly their difficulties can only be solved by practical and realistic domestic policies, as the UK has consistently advocated.

(ii) The UK believes that industrialised countries can make an important contribution to the economic development of the poorer countries by establishing conditions which help promote sustained growth of the world economy. This requires sound domestic economic manangement and the maintenance of an open and vigorous international trading system. In pursuing these objectives the UK has continued to exercise strict control over public expenditure, including aid.

(iii) Nevertheless the Government continues to maintain a substantial aid programme. The amount available for the current financial year (1984-85) is £1,174 million, representing an increase of just over 7 per cent over estimated expenditure in 1983-84.

(iv) The programme's principal aim continues to be the encouragement of more rapid economic growth and the raising of living standards in the poorest countries. About two-thirds of bilateral aid allocations go to the poorest countries. Since most of this is given as grants rather than loans it is of particular help to countries who have difficulty in attracting commercial financing and therefore have the greatest need for concessional funds.

FAB(84)22
UK AID.

(v) Although official aid has a crucial role to play in the alleviation of the problems now faced by the developing countries, trade, external private investment and lending

are also essential, as are the developing countries' domestic policies. The UK continues to be one of the major sources of private capital flows which totalled over £2.5 billion in 1983.

Background

Volume

1. Net disbursements of official development assistance (oda) in 1983 totalled £1,058 million ($1,605 million), equivalent to 0.35 per cent of GNP. This compared with £1,028 million ($1,800 million) or 0.37 per cent of GNP in 1982, an increase of about 3 per cent in sterling terms and a decrease of about 11 per cent in dollar terms. We accept in principle the 0.7 per cent of GNP aid target set by the United Nations but like previous Governments are not committed to a timetable for acheving it.

2. The net aid budget for 1984-85 has been fixed at £1.1 bn. In addition to this net public expenditure provision, a sum equal to the repayments of capital on past aid loans is available for allocation as net aid. The planned amount for the current financial year is about £75 m. The amount available for spending (the gross aid programme) is therefore expected to total about £1,174 m. This compares with estimated expenditure on the 1983-84 gross aid programme of £1,095 million and represents an increase of about 7 per cent in cash terms. [This is expected to represent a small increase in real terms.]

3. UK private flows to developing countries in 1983 totalled £2,581 m ($3,915 m). Combined official and private flows in 1983 were £3,776 m ($5,728 m), or 1.25 per cent of GNP. This exceeds, as in previous years, the 1 per cent target for combined resource transfers set by UNCTAD in 1968. While this represents a fall from the level of 1.29 per cent of GNP achieved in 1982, due mainly to a decline in banking flows from the levels of 1980-82, the United Kingdom remains one of the larger sources of financial flows to the developing world. (See Annex 1.)

Trends in Aid Policy

4. The basic aim of the aid programme remains to promote economic development, particularly in the poorest countries. An announced in February 1980, we also give due weight in the allocation of our aid to political, industrial and commercial factors alongside the developmental objective. Elements of policy receiving particular attention are the need to help develop indigenous skills and make institutions more effective (especially in Africa: see brief D12), and the value of concentration of the aid effort on

limited number of economic sectors in certain countries. At the same time, with acute balance of payments difficulties facing many countries, the UK responds flexibly to requests for programme aid, often in conjunction with other donors and in support of IMF adjustment programmes. There has also been growing acceptance of the value of donor co-ordination in maximising the impact of aid, and a recognition of the importance of dialogue between donors and recipients on policy questions.

5. The balance of payments and debt problems of developing countries also highlight the importance of attracting flows such as private direct investment. With this aim further efforts are being made to interest British companies, as well as voluntary organisations and other institutions, in the challenges and opportunities of the developing world. Support for voluntary agencies from the official aid programme is being substantially increased.

Allocation

6. In 1983 nearly 57 per cent of our official development assistance (oda) was disbursed as bilateral aid, and of this amount (£645 million) 63 per cent went to the poorest developing countries.

7. Aid is invariably made available on grant terms to all countries with a 1981 GNP per capita of $405 or less. In 1983 about 94 per cent of gross bilateral expenditure was on grant terms.

8. In addition to receiving the bulk of our bilateral aid, the poorest countries, amongst which are many of the Commonwealth countries of sub-Saharan Africa and South Asia, benefit from our contributions to multilateral programmes including the European Development Fund and the International Development Association and those of the United Nations agencies. The aid programme also contributes to the African, Asian and Caribbean Development Banks, each of which provides development assistance to its Commonwealth members. The UK supports a number of Commonwealth programmes, the largest being the Commonwealth Fund for Technical Cooperation (see brief E16). The Commonwealth Development Corporation, which lends to a range of development projects, is partly financed by loans from the UK aid programme. Support is also given to refugee and disaster relief. Annex II gives details of aid spending by major category.

ANNEX I

UK Flows to Developing Countries 1983

	$m	£m	%
Official Development Assistance	1,605	1,058	28
Other Official Flows	208	137	4
Private Export Credits	1,322	871	23
Direct Investment (excluding financial subsidiaries)	1,145	755	20
Banks (foreign currency)	1,365	900	24
Grants by Voluntary agencies	83	55	1
TOTAL FLOWS	5,728	3,776	100
As % of GNP		1.25	

ANNEX II

UK AID PERFORMANCE

A. Net official development assistance

	1981	1982	1983
£ million	1,081	1,028	1,058
% of GNP	0.43	0.37	0.35
(DAC Total)	(0.35)	(0.38)	(0.36)

B. Gross official development assistance

	1981		1982		1983	
	£m	%	£m	%	£m	%
Bilateral	744	64	630	57	645.4	57
Multilateral	427	36	481	43	492.2	43
Total	1,171	100	1,112	100	1.137.6	100

C. 1983 gross ODA

	£m	% of total	% of bilateral
Bilateral aid			
Asia	234	21	36
Africa	216	19	34
Other bilateral aid	111	10	17
Other Regions	84	7	13
	645	57	100
Multilateral aid			**% of multilateral**
World Bank Group	203	18	41
European Community	185	16	38
UN Programmes	54	5	11
Regional Development Banks	32	3	6
Other multilateral aid	18	1	4
	492	43	100
Total gross ODA	1,138	100	100

D. 1983 Bilateral Aid (gross oda)

1. Financial Aid/TC/Administrative totals	£m	%
Financial aid	381	59
Technical co-operation	232	36
Administrative costs	33	5
	645	100

2. Major recipients		% of total allocable gross bilateral oda
India	128	24
Sudan	32	6
Kenya	30	6
Sri Lanka	29	6
Tanzania	29	5
Bangladesh	25	5
Pakistan	17	3
Zimbabwe	15	3
Zambia	14	3
Malawi	12	2
10 largest recipients	330	62

3. Commonwealth share (of which African Commonwealth)	396 (153)	74 (29)

Note: Totals have been rounded in some cases

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HER MAJESTY'S TREASURY
IMF/IBRD ANNUAL MEETING 1983
COMMONWEALTH FINANCE MINISTERS 1983

IMF Relations with UK

(a) **Quota.** In December the UK paid its quota increas of SDR 1,800m, 75 per cent in sterling and 25 per cent in SDRs. The UK quota now stands at SDR 6,914m; 6.7 per cent of total and second in size to the USA. The Eighth Quota Review increased total quotas from SDR 61 billion to SDR 89 billion.

(b) **SDRs.** At end June the UK held some 662 mn SDRs, 34.6 per cent of our net cumulative allocation and just over 4 per cent of total members' holdings of SDRs. It is one of 21 members which currently can be designated to exchange SDRs for hard currencies on request.

(c) **Use of Sterling.** The UK is one of 27 members that have balance of payments and reserve positions currently considered sufficiently strong for their currencies to be used for net lending by the Fund. From September 1983 to May 1984 (latest available figures) the IMF has lent sterling to the value of SDR 115 m, some 4½ per cent of the total currency used; the UK's reserve position in the Fund is now SDR 2 bn.

(d) **Borrowing.** The UK has had no outstanding purchases from the Fund since January 1983 when the final repurchase in respect of the Oil Facility was made.

(e) **GAB.** Following G10 Ministerial agreement in January 1983, the Fund's Executive Board finally approved an increase in the GAB in December, from SDR 6.4 bn to SDR 17 bn; the UK's approximate share is 10 per cent. Saudi Arabia has agreed to provide an associated facility of SDR 1.5 bn.

(f) **BIS.** In April final Executive Board agreement was reached on a SDR 6 bn facility for the Fund, half from SAMA and the rest from the BIS, Belgium and Japan. The Bank of England provides exchange and interest rate cover for a share of the BIS facility of SDR 300 million.

FAB(84)23
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(g) The UK Article IV consultation in December was discussed in the Executive Board in February. The staff report commended the medium term approach to policy in the UK, based on the MTFS, leading to notable success in reducing inflation and stimulating recovery. The IMF Board recommended more action on the supply side, particularly in the labour market to improve competitiveness. Directors feared potential balance of payments pressures when the revenue from North Sea oil declined, if manufacturing industry failed to respond. The next Article IV consultation wil again take place in December.

HM Treasury

September 1984

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H M TREASURY

IMF/IBRD ANNUAL MEETING 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

IMF Current business

Line to take

(i) Conditionality: support present mix of policies. Welcome widespread acceptance among debtors and developing countries of need for sound domestic policies in order to achieve adjustment to external viability within reasonable period.

(ii) Prolonged use of Fund resources: accept that one effect of debt crisis is to prolong timescale of adjustment for many countries. If Fund's resources are to be availalbe to revolve among membership, this means that resources devoted annually to chronic clients must be modest. It also blurs distinction between Fund's adjustment role and Bank's longer term development role, making Fund/Bank collaboration more vital than ever.

(iii) IMF's role: endorse central importance of Fund in restoring creditworthiness to sovereign debtors and advising on policies, both through design of conditionality and by surveillance. While distrusting blanket solutions for debt crisis, believe there is scope for developing existing techniques. Encouraged by signs of willingness on part of official and commercial agencies to resume lending on strength of Fund's judgement.

Background

Conditionality

During the past couple of years the IMF has been lending under conditional arrangements to typically 35-40 countries. The clientele is now almost exclusively developing countries, comprising much of Latin America, most of Africa, with some in Eastern Europe and relatively few in the far east. The annexed list of current programmes shows that most, but not all, problem countries are now subject to Fund programmes. There are a few worrying omissions, notably Argentina, Nigeria and the Philippines, in all of

FAB(84)24 IMF

which negotiations have been protracted. (See problem countries brief F25). The swing away from three year extended arrangements (EFFs) has continued, with standby arrangements (SBAs) being preferred as more flexible.

2. The conditionality now associated with Fund programmes has returned to the (stricter) historical standards. The balance of conditionality and finance has moved toward firmer adjustment with more restrictive conditions for lending, as directed by the Executive Board in December 1983. Monitoring arrangements have been tightened, with more frequent reviews in some instances. Developing country resentment has grown more strident under this harsher approach. Despite stirrings such as the recent Cartagena conference, however, there seems little disposition to rebel against the Fund's discipline in practice.

3. Adjustment programmes have often been very harsh - eg the 8 per cent real drop in private sector consumption in Mexico during 1983. Sometimes they have proved too painful - eg the Dominican Republic's EFF broke down in April when bloody riots followed the reduction of food subsidies. Some of the Fund's potential clients have balked at the necessary steps - eg Nigeria's unwillingness to devalue and Argentina's reluctance to accept lower real wages. On the whole, however, (sometimes temporary) breakdowns in programmes have been no more frequent than usual, and indeed last autumn was unusually quiet in this respect. This would seem to suggest that the Fund staff's judgement in compromising on adjustment measures continues to push toward the limits of political tolerability. The Executive Board acts as a check on this vital aspect and normally functions effectively though obliquely, most directors offering objective economic advice on programme design. The US' schizophrenia in favouring their own clients (eg Sudan, Turkey and most of Latin America) while condemning sometimes unintentional lapses elsewhere (eg Jamaica, Zimbabwe) often jars. Similar French partiality (mostly toward Francophone African countries, eg Madagascar) is if anything more strident though less successful than American lobbying, which is usually conducted behind the scenes.

4. It is perhaps worth noting that Fund programmes are not automatically incompatible with growth. The Managing Director, M de Larosiere, has recently made several speeches identifying significant correlation between adjustment and prosperity, and citing a range of success stories including Bangladesh, Korea and Uganda.

5. Design of some programmes has posed formidable problems over the year, despite long experience in prescribing adjustment. In Brazil, the combination of hyperinflation

and indexation has proved particularly intractable: very regular fiscal and monetary monitoring has helped keep track of rapidly changing economic conditions. In Africa drought has exacerbated the economic maladjustment of much of the Sub-Sahara region. (See brief D12.) In addition the prevalence of parallel economies and corruption makes African programmes difficult to construct and evaluate but even in such unmanageable economies as Zaire and Sierra Leone the attempt is being made. And of course all Fund programmes have to be designed to cope with nervous and relatively thin international banking markets, in some cases forcing even harsher adjustment.

6. Over the last couple of years there has been or growing realisation that the Fund will need to keep on supervising a relatively large group of clients over sustained periods, much longer than the traditional short sharp shock of adjustment over a year or two, followed by repayment of Fund credit even 5 years or so. In this cycle the recovery has hardly altered the number of countries needing IMF assistance, though it may have diminished the scale of their problems. The debt crisis has both increased the degree of adjustment of adjustment needed and reduced other lenders' willingness to continue financing sovereign risk. High real world interest rates, reflecting the US' inconsistent domestic mix of fiscal and monetary policies, have also intensified debtors' problems: eg each 1 per cent added to real interest rates increases developing countries' net debt repayment commitments by some $3 bn.

7. Clearly the IMF will need to continue to assume a pivotal catalytic role for some time. At present, most debtors use negotiation of a Fund programme as a sign of credibility in negotiating rescheduling of their official and commercial debts (the former in the Paris Club). Most aid (certainly most UK bilaterial aid) is tied to Fund programmes too. Sometimes rescheduling is associated with guarded resumption of lending (eg Mexico), often of an unspontaneous nature engineered by the IMF Managing Director. Multi-year rescheduling and limited reopening of officially guaranteed trade credit are now also being considered for convalescent debtors such as Mexico. (see debt brief B3). These new techniques, applying to periods much longer than traditional Fund programmes, may need new indicators of creditworthiness. The IMF may be able to supply these via its surveillance function - eg commercial banks recently began discussions on Venezuelan rescheduling on the strength of an informal understanding that the Fund endorsed Venezuela's domestic policies. And provisional agreement has been reached that successive tranches of Mexico's proposed multi-year rescheduling of bank debt should be activated on the strength of a special semi-annual Article IV with an

explicit medium term character (see brief F25 for more detail of this). Another possible technique is the adoption of precautionary standbys (sometimes in the form of shadow programmes) involving no use of Fund resources.

Other developments in the past year

IMF resources

8. 1984 began with a substantial increase in the resources available to the IMF, with the quota increase in December 1983. BIS and Saudi loan agreements were concluded in April. Further details are in the liquidity brief C7. The GAB was also enlarged, and Switzerland became a full participant in it, though still not an IMF member.

9. Because of difficulties with legislation in Congress, US participation in the quota increase was in doubt until mid December, a mere fortnight before the deadline. In the end all but 1 per cent of the membership accepted the quota increase, only a few countries (Iran, Singapore, UAE) failing to take up their shares. But uncertainty about the US legislation delayed finalisation of the loan agreements, throwing doubt on the Fund's future flow of income. With borrowed resources already overcommitted, the Managing Director suspended negotiations on new loans other than those in the pipeline for 6 weeks in the autumn of 1983. In practice the hiatus cast a longer shadow. Only 2 programmes were actually agreed during Q1 1984 even through the moratorium had been lifted by then.

10. The US' failure to participate in the BIS loan rankled with some countries which did. In the hope of ensuring a US contribution to any future lending to the Fund, the German chairman of the G10 Central Bank Governors Poehl, sent a declaratory side letter to the IMF Managing Director conveying his expectation that lending under the BIS facility would be taken into account in the pattern of any future lending under the GAB. The Saudis sent their own side letter in much the same vein, thus neutralising part of the effect of the Poehl letter. The Managing Director, somewhat irritated, merely took note.

IMF lending

11. All conditional lending agreements concluded during the last year have been within and mostly well short of the lower access limit, 102 per cent of quota per year. None has fallen in the higher zone up to 125 per cent a year. Nor has it been necessary for any

country's cumulative use of Fund resources to exceed the lower limit, 408 per cent of quota. In contrast to previous quota increases, no existing programmes have been augmented mid-stream, though Mexico did put out some unsuccessful feelers.

12. An unfortunate side effect of the tougher approach has been to increase the incentive for developing countries to draw on the compensatory financing facility which subsidises shortfalls in export income. There have been several questionable cases, including Brazil, Malawi and Peru.

Other financial business

13. In return for increasing its lending to the Fund, Saudi Arabia sought to increase its leverage over the Fund. Ths was dressed up as concern about the Fund's creditworthiness. Eventually a new routine was developed for dealing with countries with overdue payments owing to the Fund. So far Guyana, Nicaragua and Vietnam have been formally excluded from further borrowing from the Fund until they have made good the amounts outstanding. Similar treatment may shortly be meted out to a number of others, including Chad and Tanzania. A Board review of policy toward countries misreporting their performance also helped reassure Saudi doubts about Fund creditworthiness.

14. As part of negotiations in the Executive Board on the details of the new access limits (see C6), the US insisted on increasing the rate of remuneration - ie the interest rate on creditor countries' normal lending to the Fund. Since 1981 it has been set at 85 per cent of the SDR interest rate, but is now to rise on a sliding scale, reaching at least 95 per cent of the SDR interest rate by May 1986 and perhaps 100 per cent of the SDR rate by May 1987 if interest rates generally do not rise too fast. The US' intransigence was strongly resisted and resented by the developing countries.

15. The US' attitude reflected reluctance to absorb Fund-related reserve assets and was associated with increasing disenchantment with the SDR. They continued, with the Germans and ourselves, to resist a SDR allocation. They also, with the Germans, prevented some straightforward simplification of SDR transactions which everyone else was prepared to accept.

Regular IMF business

16. A new Deputy Managing Director was appointed at the beginning of May. This post is traditionally held by a US nominee. Bill Dale has been replaced by Dick Erb, formerly the US Executive Director. The US still have no replacement for Erb as ED.

17. The triennial review of the comparative mechanism for determining staff salaries was also badly managed. We opposed the Managing Director's initial recommendation of an average 5.6 per cent on top of an already inflated salary structure but would have been prepared to go along with his subsequent compromise suggestion of 4 per cent for 'core' staff. Insistence on a very low salary increase by some hardliners including the US, Germany and Japan resulted in acceptance of something closer to the original proposal than the MD's, though further tilted toward 'core' staff.

18. As for the review of Executive Directors' salaries, the recommended 4½ per cent increase was voted down by a very slender margin, by the Governors. It is not clear what will happen next. It is possible that the two MDs, Clausen and de Larosiere, may seek agreement on a compromise increase in the margins of the Annual Meeting.

19. The Fund has continued its regular surveillance work. The main activity is the World Economic Outlook. This year's volume, published in the spring, was widely regarded as over sanguine in forecasting falling interest rates and vigorous widespread growth enabling most developing countries to overcome their debt problems by the end of the decade. The WEO is now to be a semi annual publication. (See also brief B2).

20. Surveillance also included the usual annual reviews of exchange restrictions, multiple exchange rate practices and the international capital markets. The bread and butter work consists of annual economic reviews of each Fund member under Article IV. Regular coverage is now almost complete. Only 8 members' consultations are currently overdue. Analysis has been improved by the inclusion of projections of the external account (debt as well as balance of payments) for most relevant countries. This procedure is useful early warning of difficulties ahead and, for the smaller countries at least, offers a valued opportunity to reassess policy stance.

21. A substantial portion of the Fund's research work this year has been devoted to special studies for the G10 work on reform of the international monetary system. (See brief B4). It has mostly been of excellent quality. Some of it has been published. Topics have included the operation of the floating exchange rate system, the effect of exchange

rate variability on trade and international liquidity. A paper on the role of the Fund, including its relationship with the World Bank, is in preparation.

22. There have also been several unrelated one-off studies. Of these, by far the most important was a discussion on chronic debtors in recognition of the increasing frequency with which the Fund's clients now need IMF credit for a sustained period. There were also review papers on the Fund's role in co-ordinating credit with commercial banks (the Mentre Report, since published), direct investment and small tropical islands (most of which seem to be Commonwealth countries). An unfortunate series of mistakes (including some on the UK) in a study from 1983 on international comparisons of Government employment and pay resulted in amendments to the text of the published volume.

23. Co-ordination between staff of the IMF and IBRD continued to improve over the year, with members of each institution frequently participating in missions of the other. This is likely to become increasingly important as Fund clients need longer term relationships with the Bretton Woods institutions, including help with supply side policies.

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ANNEX: CURRENT IMF PROGRAMMES

Country	Loan types	Duration	Expires	Loan amount SDR m
Brazil	EFF	3 yrs	Feb 86	4240
CAR	SBA	1 yr	July 85	15
Chile	SBA	2 yrs	Jan 85	500
Dominica	SBA	1 yr	July 85	1
Dominican Republic	EFF	3 yrs	Jan 86	371
Gambia	SBA	15 months	July 85	13
Ghana	SBA	16 months	July 85	180
Guatemala	SBA	16 months	Dec 84	115
Guinea Bissau	1st credit tranche	–	–	2
Haiti	SBA	2 yrs	Sept 85	60
Hungary	SBA	1 yr	Jan 85	425
Ivory Coast	SBA	9 months	Aug 85	83
Jamaica	SBA	11 months	Jun 85	64
Kenya	SBA	18 months	Sept 84	176
Korea	SBA	9 months	Mar 85	576
Liberia	SBA	1 yr	Sept 84	55
Madagascar	SBA	1 yr	Mar 85	33
Malawi	EFF	3 yrs	Sept 86	100
Mali	SBA	17 months	May 85	40
Mexico	EFF	3 yrs	Dec 85	3410
Morocco	SBA	18 months	Mar 85	300
Niger	SBA	14 months	Dec 84	18
Panama	SBA	18 months	Dec 84	150
Peru	SBA	15 months	July 85	250
Portugal	SBA	16 months	Feb 85	445
Senegal	SBA	1 yr	Sept 84	63
Sierra Leone	SBA	1 yr	Feb 85	50
Sudan	SBA	1 yr	Jun 85	90
Togo	SBA	1 yr	May 85	19
Turkey	SBA	1 yr	Apr 85	225
Uganda	SBA	1 yr	Sept 84	95
Uruguay	SBA	2 yrs	Apr 85	378
Western Samoa	SBA	1 yr	Jul 85	3
Yugoslavia	SBA	1 yr	Apr 85	370
Zaire	SBA	15 months	Mar 85	228
Zambia	SBA	21 months	Apr 86	225
Zimbabwe	SBA	18 months	Sept 84	300

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FAB(84)25 PROBLEM COUNTRIES

HM TREASURY
IMF/IBRD ANNUAL MEETINGS 1984
COMMONWEALTH FINANCE MINISTERS' MEETING 1984

Problem Countries

This background brief supplements the general discussion of the debt crisis in brief B3. It contains material on the main debtor countries whose debt servicing difficulties are sufficiently severe to put pressure on the international financial system. They do not include all of the biggest 12 debtors (see following table) since some are able to cope with their debt servicing commitments: eg South Korea because of strong export-led growth, Israel because most of the debt is highly concessional and Venezuela because of substantial oil revenues.

2. Debt problems are not of course confined to the countries on this list. Many smaller countries owe debt whose service is at least as onerous in domestic terms. Most of Latin America (including Chile, Ecuador, Peru and Uruguay) is in this situation, as is much of Africa: see separate brief on sub Saharan Africa (D12).

Top 12 Major Debtors

$ billions

	Total external debt (End Dec 1983)	British owned banks exposure (End Dec 1983)	ECGD exposure (End March 1983)
Brazil	92	6.1	2.1
Mexico	91	6.3	1.6
Argentina	44	2.5	0.2
Spain	40	2.8	0.3
S Korea	40	2.6	1.0
Venezuela	34	2.4	0.1
Indonesia	31	0.8	1.8
Israel	29	0.6	0.2
Poland	27	0.5	0.9
Philippines	25	1.4	0.3
Nigeria	20	1.3	3.7
Yugoslavia	19	0.9	1.2
Total	492	28.2	13.4

ARGENTINA

3. The Alfonsin government elected last November has so far failed to get to grips with Argentina's economic problems. These centre on hyperinflation (recently touching 600 per cent) and debt. The scope for policy action has been deliberately limited by overambitious political commitments, including in particular to significant real wage increases in 1984. Unpopular measures have been avoided for fear of endangering Argentina's fragile democratic system.

4. Although the government has repeatedly affirmed its intention to honour external debt, there have been continuous delays in negotiations with the banks, primarily caused by failure to negotiate a new IMF programme. Without external finance, the government has been unable to resist pressure from the trade union movement and has failed to halt the slide towards economic chaos.

IMF negotiations

5. The recent IMF Article IV showed that there is very limited common ground between the Argentine government and the Fund staff. Though there is agreement on some basic objectives, such as reducing inflation and improving the trade balance to facilitate debt service, there is little willingness to adopt the necessary adjustment policies. Argentina attitudes are no doubt hardened by (approximate) self-sufficiency in food and oil as well as the enormity of the debt service commitments (amounting to over 100 per cent of export earnings in 1983 and 1984.

6. The main measures needed for a viable IMF programme are:

(a) a more realistic wage policy, particularly deindexation;

(b) elimination of price controls, and exchange and trade restrictions;

(c) a significant devaluation of the peso to enable a stronger balance of payments;

(d) the Fund's usual demand restraint measures, both fiscal and monetary;

(e) most important of all, explicit acceptance that some objectives - eg on growth - may have to wait.

7. The IMF Managing Director has recently reported better progress, with Argentina more realistic on fiscal policy. It is just possible that other differences with the Fund, principally on monetary and exchange rate policy, could be resolved in the margins of the Annual Meetings.

Banks

8. In discussions on the most recent rollover proposal, the IMF declined to give a firm written assurance of good progress in the negotiations - though oral reports gave an impression rather more encouraging than was strictly accurate. Argentina had no choice but to make the loan repayment of $125 m when it fell due on 15 August.

9. The next major deadline for the banks is 14 September, when Argentina is due to repay $750 m from the 1982 $1.1 bn bridging loan. Unlike the August rollover, it seems unlikely that Argentina will have sufficient funds available to cover this payment. Argentina has asked to roll it over. The banks are adopting a cautious attitude in the face of IMF reluctance to give a progress report on the status of the negotiations on a possible programme. The deadline rather awkwardly coincides with the second ministerial-level meeting of the Cartagena group, which Argentina is to host.

10. Another important pair of deadlines occur at the end of September. $100 m is due to be repaid to the working committee (consortium) of banks. This should cause no difficulty as it is secured (like the $125 m repaid in mid August) against deposits with the US Fed. More difficult, however, will be the banks' attitude to provisioning against Argentine loans in making up their quarterly books. It is possible that there may be little change since there was some discounting in the end-June make-up day accounts.

11. Looking further ahead, the US regulatory authorities are to meet on 29 October to discuss provisioning in general. They may want to focus on the substantial volume of Argentine arrears which are over 180 days overdue. If the situation is judged sufficiently serious, Argentina sovereign debt may be judged to be in the value impaired category, requiring higher provisioning.

12. The IMF project Argentina's need for balance of payment finance in 1984 and 1985 at $11 bn. Neither this nor rescheduling is likely to be forthcoming from banks and official creditors without a Fund programme.

Paris Club

13. Argentina has now formally requested rescheduling of official external debt falling due in 1984 and 1985 (as well as arrears from 1983). No progress can be made without an IMF programme. We intend to participate to protect our own interests.

Trade restrictions

14. Negotiations (currently suspended) on normalising relations between UK and Argentina include efforts to remove the current restrictions on UK companies trading in Argentina. The selective import embargos on British goods and the exclusion of British companies from public sector contracts continue. British companies are also denied the automatic right to repatriate profits and dividends (via Bonex, $ denominated bonds); disposal or transfer of their assets may be prevented; government appointed overseers may interfere with regular conduct of business. Though there is evidence of administrative delay in handling UK companies' affairs, it is not clear that it is provably worse than for other foreigners.

BRAZIL

15. The Brazilian economy in 1984 has been dominated by the dramatic improvement in external trade and lack of progress in dealing with inflation.

IMF programme

16. The IMF programme has continued despite two major revisions. Monthly monitoring has been instituted to keep track of the rapidly changing economic scene and to give early warning of emergent problems. The Fund staff have frankly admitted their puzzlement about the intractability of inflation to fiscal and monetary restraint. Further revisions to the programme have recently been agreed by the staff and should be presented to the Board in late October.

17. The relative success of the programme rests on the dramatic turnaround in external trade performance. The $7.2 bn surplus for the first 7 months of 1984 promises substantial overachievement of the $9.1 bn target for 1984 as a whole (cf $6.5 bn actual for 1983). The rapid improvement primarily reflects import contraction (particularly of oil), but also better sales of manufactured and semi-manufactured goods. Despite recent rises in international interest rates, it seems likely that the 1984 current account deficit will be lower than the IMF target of $5.3 bn, perhaps as low as the official forecast of only $3 bn, half the 1983 deficit. Reserves growth in 1984 is likely to be very strong at $5.7 bn, appreciably higher than the $4.3 bn target.

18. The persistence of inflation - still over 200 per cent - is partly caused by the buoyant external account. The improved balance of payments has allowed a $4.3 bn increase in international reserves in 1984 so far, equivalent to an unexpected increase of 60 per cent in the monetary base. This is putting pressure on the monetary aggregates.

Moreover the strong devaluation policy, on which the strong trade surplus depends, has directly pushed up domestic prices. Inflation has also been fuelled by indexation, largely unrestrained by ineffective legislation. The annual rate has now settled at around 220 per cent, much higher than the original (informal) target for 1984 of 135 per cent.

19. The recently agreed revisions to the programme include a substantial increase in the monetary growth target, from 50 per cent to 95 per cent for 1984 as a whole. Given recent growth at an annualised rate of 140 per cent, this will still be difficult to achieve. Banks reserve requirements are to be lifted sharply to that end. Additional fiscal measures will also be needed to achieve the required 0.3 per cent GDP operational budget surplus (ie before allowing for the cost of indexing debt). On 12 September some significant relaxations of the external trade regime were announced, including phasing out the export incentive scheme.

Banks

20. Negotiations on phase III of the debt rescue package are due to start soon. Brazil will probably seek some concessions from the banks, including multi-year rescheduling and a softening of terms. Multi-year rescheduling in the Paris Club is also a possibility.

Political

21. Internationally, despite debt servicing difficulties, Brazil was a force for moderation at the Cartagena Conference, successfully blocking radical proposals.

22. At home, indirect Presidential elections to replace Figureido are due in January. Neither of the two candidates - Paulo Maluf and Tancredo Neves - seems likely to favour a radical departure from the reasonably co-operative approach of the present government. Early indications are that a Tancredo Neves administration would seek a fundamental reappraisal of IMF-backed policies.

MEXICO

23. Mexico was the first Latin American country to announce (August 1982) that it could no longer service its debts. Its adjustment has been conspicuously successful. International credit has largely been restored. Effort seems likely to be rewarded by the first multi-year rescheduling agreement with the banks.

IMF programme

24. Despite substantial costs, the Mexican government is sticking to the terms of the stringent IMF programme. External adjustment has gone particularly well: excellent surplus on trade ($13.7b) and current ($5.5b) accounts were achieved in 1983. For 1984 with exports performing strongly, (in particular non-oil goods up 50 per cent on last year) and imports lower than expected, a healthy trade surplus should be achieved, resulting in a small surplus on current account. It is slightly worrying that this result depends on domestic economic stagnation, reflecting low business confidence: real growth this year will probably not exceed 1 per cent.

25. Inflation is falling more slowly than hoped. The official objective of 40 per cent by end 1984 will be exceeded by at least 10 percent age points; the rate is still 67 per cent. The overshoot reflects continuing adjustment in controlled prices and the size of wage awards. Real wages are to be held broadly unchanged over the year, after a fall of some 25 per cent in 1983. The daily rate of devaluation may have to be increased to maintain competitiveness with the slower fall in inflation.

Banks

26. The Advisory Group of banks have now agreed in principle to reschedule some $43bn which falls due in the period to 1990. Mexico has negotiated fine terms: 14 years restructuring, a fine interest rate based on LIBOR, without restructuring fees. Despite pressure from UK banks, there was no disposition to insist on a Paris Club rescheduling. The IMF Managing Director has agreed in principle (though as yet without formal authority from the Board) to let the banks see the outcome of special souped-up semi-annual Article IV exercises for Mexico after the end of the EFF in early 1986. If agreed by the other commercial banks, this would be the first multi-year rescheduling and the first overtly to include IMF supervision distinct from a conditional programme.

Official Credit

27. In recognition of Mexico's successful adjustment efforts the UK recently agreed an increase in the amount of ECGD cover available for medium term credit. (Cover was never completely withdrawn because the 1983 rescheduling covered private sector debt owed to Paris Club creditors, not public sector guaranteed debt.) Mexico has been reluctant to go to the Paris Club because it feared withdrawal of cover. The banks appear to have withdrawn their insistence on a parallel rescheduling exercise by governments Press reports blaming HMG for blocking a Paris Club operation should be denied.

NIGERIA

Line to take

28. (a) Encourage Nigeria to reach early agreement with the IMF on the basis of a strong adjustment programme. This is a precondition for a multilateral restructuring of insured trade arrears, negotiated with trade credit agencies.

(b) (with other creditors and the Fund) No question of relaxing UK Government insistence eg in response to unilateral Nigerian offers) on multilateral deal, linked to a Fund programmme. However, there appears to be no way in which HMG could legally prevent individual insured creditors accepting such an offer.

Background

29. Faced by the abrupt weakening of world demand for oil, Nigeria experienced substantial current account deficits in the period 1981-3 largely financed by the accumulation of trade arrears and a run down of reserves to a near to irreducible minimum. A further current account deficit is expected this year. External debt and debt servicing requirements have risen sharply since 1980 with total debt now estimated at about $20 bn (including around $5 bn of commercial arrears), and a debt service ratio of some 30 per cent.

IMF talks

30. The military government which seized power in January has recognised the need for adjustment. Efforts have been made to curb public expenditure and stifle coruption. In principle the authorities are prepared to meet the Fund's fiscal objectives and take meaures to resuscitate the neglected agricultural sector. If successfully concluded, IMF support might be worth $2-2½ bn over 3 years.

31. There are three sticking points in the negotiations:

(i) (primarily) devaluation. The Fund want about 60 per cent, perhaps phased, to remedy mispricing in the non oil foreign trade sector. Nigeria sees no need to adjust the naira's value abruptly as some 98 per cent of exports are dollar-priced oil, fearing the effect on domestic price inflation and urban unemployment. They might accept an inadequate phased depreciation;

(ii) tariff reform, which the Fund would implement to bolster the revival of non-oil trade. Nigeria would prefer to maintain quantitative controls to limit imports, despite the further opportunities for corruption (and evasion) they would offer;

(iii) domestic petroleum product prices. The Nigerians are reluctant to raise their prices to world levels.

32. After several rounds of discussions, negotiations are deadlocked. The next move is up to Nigeria. Talks are expected to resume in the margins of the Annual Meeting. A bilateral approach to the UK is very probable.

OPEC

33. Alone of OPEC members, the July OPEC meeting gave Nigeria permission to produce 0.1 mbd over her 1.3 mbd OPEC quota in August and 0.15 mbd over quota in September. Assuming that the extra production can be achieved (not a foregone conclusion), the additional revenue may encourage Nigeria to manage without the IMF. In the currently weak oil market, Nigeria has found difficulty in selling oil.

Arrears

34. Trade credit agencies including ECGD remain insistent that a multilateral restructuring of insured trade arrears is conditional on agreement being reached with the IMF. In view of the stalemate and to avoid continuing discrimination in payment between groups of their suppliers, Nigerians have said they will unilaterally offer individual companies with insured arrears a deal identical to that already agreed on uninsured arrears (see para 33) and thus bypass credit agencies. (This would lessen pressure for an IMF deal.)

35. The offer, if formally made, would place the U.K. apparently alone among creditor countries in a difficult legal position. ECGD's legal advice (which we are examining again) is that under the contract with its policy holders it cannot insist that a Company reject an offer where that offer provides a means of recovering the debt or minimising loss. Nor can it refuse to pay under its guarantee where a company accepts a deal involving deferred payment. (An additional political but non-legal problem is the difficulty of persuading companies not to accept the expected Nigerian offer which would be financially beneficial for most of them). Our expectation therefore is that ECGD would not endorse any Nigerian offer, would leave it to firms to decide whether to do so, in their own commercial judgement, but advise them only to accept on a

conditional basis, subject to any ultimate multilateral deal. Discussion with other creditors in Paris this week suggests that they do not face the same legal problems and can, by one means or another, prevent or persuade their policy holders from accepting.

36. Discussion of the UK position in Paris has strengthened suspicions, particularly within the Fund, that the UK intends to "do a unilateral deal" with the Nigerians. It will be important to continue to put the record straight on this and to explain the legal and contractual position set out in paragraph 35 above. In the meantime, the Nigerians are expected to agree to defer temporarily a formal offer to insured creditors and to agree to a creditors request for a technical meeting to discuss the position.

37. The majority of uninsured exporters have agreed to the Nigerians' offer to reschedule arrears on the basis of the offer made in April (rescheduling on the basis of 6 year promissory notes with 2½ years grace at 1 per cent over LIBOR). If the registration and reconciliation process progresses as planned the first promissory notes may issue in September.

UK position

38. Traditionally Britain's political and commercial links with Nigeria have been strong. Britain remains Nigeria's leading trade partner. But the aftermath of the Dikko kidnapping and Nigerian suspicions that Britain is concerting trade credit agencies' negative stance and encouraging IMF intransigence have placed normally cordial relations under some strain. However, the Ministry of Finance has recently recognised cooperation over the past few months.

PHILIPPINES

39. After serious financial and economic problems in the Philippines over the last 18 months, the crisis seems a little nearer resolution. Political uncertainty after the assassination of opposition leader Aquino last summer, coupled with an already weak external position, has led to severe capital flight. As usual the primary requirement is an IMF programme, which would then facilitate rescheduling and arrangement of regular bank finance.

IMF talks

40. Proposals for an 18 months SBA for SDR 615m have finally been agreed with the Philippine authorities. They are currently being considered by Fund management. Lengthy discussions have begun over the financing package needed to support the

programme, including bilateral aid and funds from the commercial banks. The prolonged delay in reaching agreement with the IMF reflected the government's relatively relaxed attitude to adjustment. Difficult policy changes were postponed until after the general election in May. The subsequent discovery of a significant overstatement of the Philippines' reserves caused further delay. A notionally restrictive monetary policy stance was comprehensively undermined by heavy Central Bank lending both to the government, to compensate for falling revenue and to finance the election, and in emergency advances to a number of financial institutions (notably the Philippines National Bank and most recently Banco Filipino) which are in a critically weak position. Policy implementation has been hampered by the inability of some banks to meet reserve requirements.

41. With inflation currently running at around 50 per cent the IMF will undoubtedly call for much greater monetary restraint. However this will prove difficult to achieve whilst a loss of confidence in the banking system exists. Indeed there is a danger that such action could itself precipitate collapse of the financial sector.

42. The balance of payments for Q1 1984 was in overall deficit of $204 million with the trade deficit narrowing to $216 million from some $650 million in the same period of last year. This has been achieved largely through a cutback in imports, down in value terms by around 20 per cent over the 1983 level. This is now also affecting industrial performance through lack of imported inputs and will in turn adversely affect export performance. Reserves at $600 m (around 1 month's imports) are critically weak.

43. Under US pressure, the Philippine authorities have recently introduced a number of measures, including a devaluation of the peso which went some way to meeting the IMF's requirements for agreeing a Letter of Intent. The provisionally agreed programme includes strong demand management measures, and action to tackle structural problems notably in the tax system, public enterprises and financial institutions. Given the very poor Filipino track record with the Fund, these will largely be implemented before the start of the programme. In view of the difficult negotiations with the commercial banks over the financing package, the programme is unlikely to reach the Fund Board before the end of October.

Banks

44. Last Summer the authorities made a moratorium request, initially for a period of only 3 months but subsequently extended at 3-monthly intervals with the agreement of lending banks, on all principal repayments of non trade-related bank credits (estimated

to equal approximately one half of total external debt of around $25 bn). Interest payments on commercial debt continue to be met, albeit with a 2-3 month lag.

45. The Advisory Committee of Banks which was formed after the first moratorium request has said that it would not discuss formal rescheduling without an operational IMF programme. Similarly the commencement of Paris Club discussions will hinge upon agreement with the IMF, as will the release of new credit facilities from the banks ($1.65 bn) and concessionary loans (a further $1.65 bn).

POLAND

46. Poland's dash for industrialisation in the 1970s under Gierek - largely funded by foreign borrowing - found the centralised economic system ill-suited to rapid intensive growth. It collapsed in 1980-81 in the face of pressures both from within (ill-judged and uncompleted investment, Solidarity) and from without (high international interest rates, low export market growth, deteriorating terms of trade). Jaruzelski's regime has succeeded, at some cost, in restoring a degree of order to the economy'. Despite the severe belt-tightening of the past two to three years and the partial introduction of certain economic reforms it is still weak and unable either to meet the aspirations of the populace or support the burden of foreign debt accumulated in the 1970s.

Hard-currency debt and rescheduling

47. Poland's hard-currency debt, including interest arrears, stood at $28 bn at end-March 1984. Apart from the $16 bn owed to official Western creditors (including Brazil) and $8 bn owed to Western commercial banks, Poland owes nearly $2 bn to CMEA creditors, and Middle East and other countries (including Argentina). Official Western creditors agreed to reschedule $2 bn of principal and interest due in 1981. Following the declaration of martial law at the end of that year, Nato sanctions were introduced suspending further debt rescheduling talks with the Poles. Since then the Poles have failed to service their obligations to official creditors including those under the 1981 agreement. When martial law was lifted in mid-1983 contact was re-opened. The Poles have now agreed to meet the creditors' demands for payment of 20 per cent of arrears due under the 1981 rescheduling ,including arrears to the US. Poland has also formally requested rescheduling of 1982, 1983 and 1984 maturities. A technical meeting of the task force on 14 September could lead to plenary negotiations in the autumn. (New money of $200 m should have been made available in early September as part of the 1984-87 bank rescheduling, sufficient to meet official creditors' demands).

48. The Western commercial banks have now signed four rescheduling agreements, covering virtually all the original stock of debt. The last of these, signed in London in July, was a multi-annual agreement covering some $1.6 bn falling due in the period 1984-87. The Poles have so far been able to meet interest payments due to the banks - probably $\$\frac{3}{4}$ bn annually - with the aid of some new trade-credit provided by the banks and helped by the non-payment of debt service due to other creditors; but repayments of rescheduled principal loom increasingly large from mid-1986 onwards, and there is little prospect of the Poles being able to cope with these in the absence of further generous relief. Even on (optimistic) Polish projections, Poland will not be able to meet interest payments and stop accumulating debt until the end of the decade.

IMF membership

49. Poland applied to rejoin the IMF in 1981 as a precondition imposed by creditors for negotiations on 1982 debt maturities. Following imposition of martial law later that year, progress has been blocked by US opposition. We should have been prepared to support Polish membership but went along with the US. It now looks as though the US may be prepared to relax their position following the recent amnesty. Provided the amnesty is completely carried out, the US has indicated willingness to lift their political reserve shortly. It is not clear whether this will be before the US Presidential election in November.

50. We should support Poland's application provided that the US reserve is lifted. Depending on the negotiations and the data, a quota of some SDR 750m might be reasonable. Since Poland would undoubtedly want to borrow from the Fund, this could be a significant drain on IMF resources, although it would ensure IMF conditionality. Poland has similarly applied to join the IBRD.

YUGOSLAVIA

51. The one-year standby agreed by the Fund in April has formed the basis of Yugoslavia's adjustment efforts this year and paved the way for the restructuring of 100 per cent of 1984 maturities over seven years with four year's grace. The agreement with banking and official creditors have now been concluded (without new money).

52. There are signs of some recovery in the domestic economy with industrial production rising by 4.6 per cent in the first half of the year compared with the same period last year. The main concern remains inflation which is running at over 60 per cent even on optimistic official figures. The rate could approach 100 per cent by end 1984.

[illegible]. It has been agreed in principle that the Chancellor should meet the Yugoslav Finance Minister in the margins of the Annual Meetings.

Relations with the IMF

54. A three-year programme was completed without formal breakdown at the end of 1983, but structural adjustment had been weak. Much remains to be done.

55. Because of generous past Fund support, the new programme was pitched at only 60 per cent of quota (SDR 370 m). Taking account of interest, Yugoslavia will actually make a small net repayment to the Fund this year.

56. Central to the new programme is achievement of positive real interest rates by end-March 1985. On the external side the main aims of the programme are to increase the convertible-currency current account surplus to \$0.5 bn (from \$0.3 bn in 1983) and external reserves by \$0.5 bn. The programme also required the real depreciation of the exchange rate since the start of 1983 to reach 25 per cent by end-June and thereafter to be maintained at that level by monthly adjustments. The recorded convertible-currency current account surplus totalled \$0.2 bn in the seasonally weak first half of the year and the Yugoslavs expect the surplus for the year as a whole to exceed the IMF target at some \$0.8 bn.

57. Failure to lift the price freeze on 1 May to the extent required under the programme rendered Yugoslavia ineligible to make its first drawing until a waiver and modification of performance criteria were subsequently approved on 6 June. A further minor waiver, in respect of public sector revenue, on 31 August permitted the second drawing. An IMF mission has recently visited Yugoslavia to review performance under the standby programme.

Rescheduling

58. The banks are expected to meet the Yugoslavs in October to discuss 1985 financing requirements (including treatment of the \$0.9 bn short-term lines which expire on 17 January 1985). Yugoslavia may lobby for another intergovernmental support operation, including multi-year rescheduling and possibly new credit. Yugoslavia's prospects are probably too poor to justify multi-year rescheduling (see debt brief B3).

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H M TREASURY

IMF/IBRD ANNUAL MEETINGS 1984

COMMONWEALTH FINANCE MINISTERS' MEETING 1984

International trade (including GATT)

Line to take

(a) **Protectionism:** world economic recovery an opportunity to promote trade liberalisation. Agreement on trade at this year's OECD Ministerial Meeting and Economic Summit are useful steps in the right direction. Welcome progress on Phase one of rollback.

(b) **GATT round:** important part of trade liberalisation process. But must be properly prepared. Need for wide consultation - to include all GATT members - on objectives, content and timing. Willing to make positive progress before November meeting of GATT Contracting Parties.

Background

The OECD Ministerial Meeting in May agreed to implement phase one of rollback, the main elements of which are an acceleration of GATT Tokyo Round tariff cuts from 1986 to 1985 (mostly 1 January) and almost complete elimination of quotas on imports from the least developed countries. However, it looks as though the US will be unable to secure Congressional approval. The EC will make a final decision on its participation in the autumn.

2. OECD Ministers also agreed a work programme for phase two of rollback. The UK will explore the scope for a package involving broadly equivalent concessions from all parties, avoiding unilateral disarmament. The proposal for a new GATT round probably offers a better prospect for a balanced package of trade liberalisation.

3. Support for a new round is growing, primarily among developed countries. Although LDCs, particularly India, continue to be cautious, the Asean and Latin American countries are now more positive with doubts about the content and timing rather than the principle. We support a new round as best prospect for advancing our objectives in services, agriculture and integrating NICs into the open trading system. The EC is divided, with France particularly reserved.

4. The EC has taken the lead in efforts to make progress on the GATT work programme before 26-28 November meeting of Contracting Particies (CPs). The EC has

indicated readiness to make progress on such matters as QRs, tropical products, exchange rate fluctuations, safeguards, counterfeiting and services.

5. The GATT work programme will not be completed by the November meeting of CPs. Another meeting of CPs in early 1985, followed by GATT ministerials in November 1985 and early 1986, is likely to be necessary. The last, if called, would fall during the UK's EC presidency.

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September 1984