Part. A.

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Begins: 13/10/87.
Ends: 14/12/87.

PO -CH /NL/0321

PART A

Chancellor's (Lawson) Papers:

THE INTERNATIONAL
MONETARY FUND: THE
UNITED KINGDOM
CONTRIBUTION TO THE
STRUCTURAL ADJUSTMENT
FACILITY

DD's: 25 Years

D Anderson

27/10/95.

PO -CH /NL/0321
PART A

FROM: D J BATT
DATE: 13 October 1987

1. MR WALSH ✓ H.U. 13/10

2. CHANCELLOR

Ch/ Content with the note, and for UKDEL to hand it over to Fund staff? DF 13/10

There will be v considerable resistance in the Fund to drawing on quotas as distinct from general [illegible] lesser priority further to SAF-eligible countries. Nevertheless, rather [illegible] proposed the new skewing in terms of [illegible] SAF [illegible] of the debt-distressed [illegible] later. NL

cc: Economic Secretary
Sir P Middleton
Sir G Littler o/r
Mr Evans
Mr Mountfield
Mr Turnbull
Mr R I G Allen
Ms Life o/r
Mr Stern
Miss Everest-Phillips o/r

IMF: SKEWING THE SAF TO LOW-INCOME DEBT-DISTRESSED COUNTRIES

We have been looking in more detail at how benefits from an enlarged SAF might be skewed towards low-income debt-distressed countries (LIDDs), as you proposed in Washington last month.

2. The attached note puts forward the idea that these countries might receive double the access of other SAF-eligible countries, to the SAF enlargement. This could go a long way towards refinancing their borrowing from the Fund (Fund credit outstanding is around SDR 4.0bn for the group as a whole) - though in a few cases (such as Sudan) extraordinary measures such as rescheduling would probably be needed as well.

3. The result of skewing the SAF along these lines would be - with an SDR 6bn enlargement - that the LIDDs would be eligible for SDR 3.9bn. The definition of this LIDD category is taken from a paper prepared by Fund and Bank staff in August. It comprises 25 countries, of which 22 are SSA (including six in the Commonwealth: Zambia, Tanzania, Uganda, Ghana, Sierra Leone and the Gambia). A good case can be made for ring-fencing these 25 though Nigeria will press its claims hard.

4. If you are content with the line in this note, we will ask UKDEL to hand over a copy to Fund staff in the next day or so, so as to influence their current work.

5. Further staff papers on modalities and conditionality of an enlarged SAF are expected at the end of this month. Camdessus will be asking us and others for firm indications by the end of next week on both the capital and subsidy elements of the enlargement. We shall submit separately on the UK response, as necessary, after we have further reports from UKDEL.

David Batt

D J BATT
IF1

DIFFERENTIAL ACCESS TO AN ENLARGED SAF

There is widespread agreement that the problems of the poorest and most heavily-indebted countries, especially in sub-Saharan Africa, are uniquely difficult and need special treatment. The UK initiative to reduce the burden of Paris Club debts, and the Fund's proposal to enlarge the SAF are of particular importance to these countries, as was recognised by the Venice Economic Summit in June. For these reasons the Chancellor of the Exchequer proposed - at the Interim and Development Committee meetings in September - that the ~~poorest and~~ most heavily indebted SAF-eligible countries should be given especially favourable access to additional SAF funds, in addition to relief through the Paris Club.

2. This note looks at one possible approach, along these lines, to differential access to the SAF enlargement. The UK looks to Fund staff to explore the full implications of this and other approaches which might be designed to achieve the same objective.

Criteria

3. The criteria for special access should include income-level, indebtedness, and the adoption of appropriate adjustment programmes. Fund and Bank staff have already drawn up an initial list of low-income debt-distressed countries, with a debt-service ratio of 30 per cent or more during 1988-90 (in the 19 August paper 'Proposals for Enhancing Assistance to low-income countries facing exceptional difficulties'). This totals 25 countries (of which 22 are in sub-Saharan Africa), as against a total of 60 countries eligible for SAF resources (excluding China and India).

4. There are of course a number of other ways of defining debt-distress. However in the interest of obtaining consensus among potential SAF contributors, the UK can accept the methodology used by Fund and Bank staff, and the resulting list of countries. It is important that the number of countries potentially eligible for more favourable access should be kept at around this level, and should be mainly from sub-Saharan Africa. The UK would not, for instance, wish to see a substantially lower cut-off point for debt-service ratio, with a corresponding increase in the numbers of countries which would qualify, and hence reduction in the scope for effective differentiation in access.

5. In order to receive more favourable access, eligible countries would of course need to be following adjustment programmes approved by the Fund and/or World Bank. But it is not possible to know in advance how many countries would come within this category. In calculating how differentiation might work, it is therefore necessary to look at all eligible countries as a single group (rather than attempting to construct a sub-group of those likely to follow adjustment programmes).

Access

6. The UK's starting point is that low-income debt distressed countries (LIDDs) should be given substantially more favourable access to the resources of an enlarged SAF. More precisely, we believe that it would be appropriate for LIDDs to have approximately double the access (expressed as a multiple of quota) of non-LIDDs.

7. The following tables illustrate the implications of this, in both quotas and SDRs, for enlargements of SDR 3, 4, 5 and 6 billion.

Table I: SAF access as percentage of quota

	Present SAF Access	Additional Access under Enlarged SAF			
		SDR 3bn	4bn	5bn	6bn
A) Uniform access	63.5	71.5	95.5	119.5	143
B) Differential Access					
LIDD	(63.5)	96	128	160	192
Non-LIDD	(63.5)	48	64	80	96

Table II: Quotas, SAF access and Fund credit outstanding (SDR bn)

	Quotas	Present SAF	Additional access under enlarged SAF				Fund Credit Outstanding
All SAF-eligible	4.2	2.7	3.0	4.0	5.0	6.0	6.2
LIDDs	2.05	1.3	2.0	2.6	3.3	3.9	4.0
Non-LIDDs	2.15	1.4	1.0	1.4	1.7	2.1	2.2

8. With an enlargement of SDR 6bn, the LIDDs and non-LIDDs would thus each - as a group - be eligible for additional SAF resources very similar to their present Fund credit outstanding. There would of course be considerable variation within each group. Annex I gives details for the LIDDs.

Implementation

9. Either of two approaches could be taken. The LIDDs could be established as a fixed group at the outset of the enlarged SAF; or SAF arrangements could be considered case-by-case with provision for differential access according to fixed criteria. The UK favours the former approach, which we believe to be clearer (though there might need to be provision for adding new countries to the LIDD category if their circumstances changed).

Conclusion

10. Substantially more favourable access to an enlarged SAF, for low-income debt-distressed countries, would be an effective way of channelling additional concessional resources to those countries most in need of these. It would also help deal with their problems in servicing their present market-rate borrowing from the Fund. The UK believes, though without prejudice to other possible approaches, that it would be appropriate for this group to receive double the access of other SAF-eligible countries to an enlarged SAF.

11. An enlarged SAF should be seen as complementary to, not a substitution for, debt relief for a group of the poorest countries through the Paris Club. The majority of debts of these countries are owed to governments and to IFIs, and action by both is required in order to provide the "special treatment" recognised by the Venice Summit.

HM Treasury
London
13 October 1987

ANNEX I

25 LOW-INCOME DEBT - DISTRESSED COUNTRIES

Present and additional SAF access (In SDR bn) assuming SDR 6 bn enlargement

	Quota	Existing Access 63.5%	Additional Access 191.5%	Total Access 255%	Fund credit outstanding
Benin	31.3	19.9	59.9	78.8	-
Bolivia	90.7	57.6	173.7	231.3	127
Burma	137.0	87.0	262.4	349.4	28
Comoros	4.5	2.9	8.6	11.5	-
Equatorial Guinea	18.4	11.7	35.2	46.9	5
Gambia	17.1	10.9	32.7	43.6	20
Ghana	204.5	129.9	391.6	521.5	593
Guinea Bissau	7.5	4.8	14.4	19.2	2
Guyana	49.2	31.2	94.2	125.4	72
Liberia	71.3	45.3	136.5	181.8	205
Madagascar	66.4	42.2	127.1	169.3	152
Mali	50.8	32.3	97.3	129.6	63
Mauritania	33.9	21.5	64.9	86.4	38
Mozamibique	61.0	38.7	116.8	155.5	-
Niger	33.7	21.4	64.5	85.9	71
Sao Tone/Principe	4.0	2.5	7.7	10.2	-
Senegal	85.1	54.0	163.0	217.0	212
Sierra Leone	57.9	36.8	110.9	147.7	70
Somalia	44.2	28.1	84.6	112.7	106
Sudan	169.7	107.8	325.0	432.0	605
Tanzania	107.0	67.9	204.9	272.8	41
Togo	38.4	24.4	73.5	97.9	63
Uganda	99.6	63.2	190.8	234.0	156
Zaire	291.0	184.8	557.2	742.0	706
Zambia	270.3	171.6	517.6	689.2	675
Total	2044.5	1298.3	3915.2	5213.5	4010

FROM: D J BATT
DATE: 15 October 1987

1. MR WALSH

H.W. 15/10

2. PS/CHANCELLOR

cc: Economic Secretary
Sir P Middleton
Sir G Littler o/r
Mr Evans
Mr Mountfield
Mr Turnbull
Mr R I G Allen
Ms Life o/r
Mr Stern
Miss Everest-Phillips

Mr Rawlings:
Now content.

Ch/ Content with revised text.
25 15/10

IMF: SKEWING THE SAF TO DEBT-DISTRESSED COUNTRIES

The Chancellor has commented that there will be very considerable resistance in the IMF to drawing a distinction on the basis of income level, within SAF eligible countries. Mr Taylor's minute of 14 October refers.

2. In practice we do not need to do this. The only SAF countries which are not 'low-income' (six small Caribbean/Pacific islands) are also not 'debt-distressed'. This means that we can avoid any income distinctions, and present our proposals simply in terms of skewing to 'SAF-eligible debt-distressed' countries, without any change to the earlier list of 25 'low-income debt-distressed' countries.

3. The attached note to Fund staff has been revised accordingly and sent to UKDEL Washington for handing over. [but will not be handed over unless you are content. 25 15/10]

David Batt

D J BATT
IF1

DIFFERENTIAL ACCESS TO THE SAF ENLARGEMENT

There is widespread agreement that the problems of the poorest and most heavily-indebted countries, especially in sub-Saharan Africa, are uniquely difficult and need special treatment. The UK initiative to reduce the burden of Paris Club debts, and the Fund's proposal to enlarge the SAF are of particular importance to these countries, as was recognised by the Venice Economic Summit in June. For these reasons the Chancellor of the Exchequer proposed - at the Interim and Development Committee meetings in September - that the most heavily indebted SAF-eligible countries should be given especially favourable access to additional SAF funds, in addition to relief through the Paris Club.

2. This note looks at one possible approach, along these lines, to differential access to the SAF enlargement. The UK looks to Fund staff to explore the full implications of this and other approaches which might be designed to achieve the same objective.

Criteria

3. The criteria for special access should include indebtedness, and the adoption of appropriate adjustment programmes. The number of SAF-eligible debt-distressed countries taking as a criterion for this a debt-service ratio of 30 per cent or more during 1988-90, totals 25 - of which 22 are in Sub-Saharan Africa; this compares with a total of 60 countries eligible for SAF resources (excluding India and China). (Although the categories 'SAF-eligible' and 'low-income' do not coincide exactly, the list is in practice the same as that of 'low-income debt-distressed countries' already identified by Fund and Bank staff in the paper 'Prospects for enhancing assistance to low-income countries facing exceptional difficulties').

4. There are of course a number of other ways of defining debt-distress. However in the interest of obtaining consensus among potential SAF contributors, the UK can accept the methodology used by Fund and Bank staff, and the resulting list of countries. It

is important that the number of countries potentially eligible for more favourable access should be kept at around this level, and should be mainly from sub-Saharan Africa. The UK would not, for instance, wish to see a substantially lower cut-off point for debt-service ratio, with a corresponding increase in the numbers of countries which would qualify, and hence reduction in the scope for effective differentiation in access.

5. In order to receive more favourable access, eligible countries would of course need to be following adjustment programmes approved by the Fund and/or World Bank. But it is not possible to know in advance how many countries would come within this category. In calculating how differentiation might work, it is therefore necessary to look at all eligible countries as a single group (rather than attempting to construct a sub-group of those likely to follow adjustment programmes).

Access

6. The UK's starting point is that debt distressed countries among those eligible for the SAF (DDs) should be given substantially more favourable access to the resources of an enlarged SAF. More precisely, we believe that it would be appropriate for these countries to have approximately double the access (expressed as a multiple of quota) of other SAF-eligible countries (non-DDs).

7. The following tables illustrate the implications of this, in both quotas and SDRs, for enlargements of SDR 3, 4, 5 and 6 billion.

Table I: SAF access as percentage of quota

	Present SAF Access	Additional Access under Enlarged SAF			
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B) Differential Access					
DD	(63.5)	96	128	160	192
Non-DD	(63.5)	48	64	80	96

Table II: Quotas, SAF access and Fund credit outstanding (SDR bn)

	Quotas	Present SAF	Additional access under enlarged SAF				Fund Credit Outstanding
All SAF-eligible	4.2	2.7	3.0	4.0	5.0	6.0	6.2
DD	2.05	1.3	2.0	2.6	3.3	3.9	4.0
Non-DD	2.15	1.4	1.0	1.4	1.7	2.1	2.2

8. With an enlargement of SDR 6bn, the DDs and non-DDs would thus each - as a group - be eligible for additional SAF resources very similar to their present Fund credit outstanding. There would of course be considerable variation within each group. Annex I gives details for the DDs.

Implementation

9. Either of two approaches could be taken. The DDs could be established as a fixed group at the outset of the enlarged SAF; or SAF arrangements could be considered case-by-case with provision for differential access according to fixed criteria. The UK favours the former approach, which we believe to be clearer (though there might need to be provision for adding new countries to the DD category if their circumstances changed).

Conclusion

10. Substantially more favourable access to an enlarged SAF, for debt-distressed countries, would be an effective way of channelling additional concessional resources to those countries most in need of these. It would also help deal with their problems in servicing their present market-rate borrowing from the Fund. The UK believes, though without prejudice to other possible approaches, that it would be appropriate for this group to receive <u>double</u> the access of other SAF-eligible countries to an enlarged SAF.

11. An enlarged SAF should be seen as complementary to, not a substitution for, debt relief for a group of the poorest countries

through the Paris Club. The majority of debts of these countries are owed to governments and to IFIs, and action by both is required in order to provide the "special treatment" recognised by the Venice Summit.

HM Treasury
London
15 October 1987

ANNEX I

25 SAF-ELIGIBLE DEBT - DISTRESSED COUNTRIES

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	Quota	Existing Access 63.5%	Additional Access 191.5%	Total Access 255%	Fund credit outstanding
Benin	31.3	19.9	59.9	78.8	-
Bolivia	90.7	57.6	173.7	231.3	127
Burma	137.0	87.0	262.4	349.4	28
Comoros	4.5	2.9	8.6	11.5	-
Equatorial Guinea	18.4	11.7	35.2	46.9	5
Gambia	17.1	10.9	32.7	43.6	20
Ghana	204.5	129.9	391.6	521.5	593
Guinea Bissau	7.5	4.8	14.4	19.2	2
Guyana	49.2	31.2	94.2	125.4	72
Liberia	71.3	45.3	136.5	181.8	205
Madagascar	66.4	42.2	127.1	169.3	152
Mali	50.8	32.3	97.3	129.6	63
Mauritania	33.9	21.5	64.9	86.4	38
Mozamibique	61.0	38.7	116.8	155.5	-
Niger	33.7	21.4	64.5	85.9	71
Sao Tone/Principe	4.0	2.5	7.7	10.2	-
Senegal	85.1	54.0	163.0	217.0	212
Sierra Leone	57.9	36.8	110.9	147.7	70
Somalia	44.2	28.1	84.6	112.7	106
Sudan	169.7	107.8	325.0	432.0	605
Tanzania	107.0	67.9	204.9	272.8	41
Togo	38.4	24.4	73.5	97.9	63
Uganda	99.6	63.2	190.8	234.0	156
Zaire	291.0	184.8	557.2	742.0	706
Zambia	270.3	171.6	517.6	689.2	675
Total	2044.5	1298.3	3915.2	5213.5	4010

Notes:

Bf with ogp or 19/10

FROM: J M G TAYLOR
DATE: 14 October 1987

MR BATT

cc Economic Secretary
Sir P Middleton
Sir G Littler
Mr Evans
Mr Mountfield
Mr Turnbull
Mr R I G Allen
Mr Walsh
Ms Life
Mr Stern
Miss Everest-Phillips

IMF: SKEWING THE SAF TO LOW-INCOME DEBT-DISTRESSED COUNTRIES

The Chancellor has seen your minute of 13 October.

2. He has commented that there will be very considerable resistence in the Fund to drawing a distinction on grounds of greater or lesser poverty within the SAF-eligible countries. He would much rather, therefore, make a proposal in terms of skewing the new SAF in favour of the debt-distressed.

3. He would be grateful if you could revise the draft along these lines.

JT

J M G TAYLOR

ps3/50T

CONFIDENTIAL

Amp

FROM: J M G TAYLOR

DATE: 16 October 1987

MR BATT

cc Economic Secretary
Sir P Middleton
Sir G Littler
Mr Evans
Mr Mountfield
Mr Turnbull
Mr R I G Allen
Ms Life
Mr Stern
Miss Everest-Phillips

IMF: SKEWING THE SAF TO DEBT-DISTRESSED COUNTRIES

The Chancellor was most grateful for your minute of 15 October. He is content with the revised text, which can now be handed over.

J M G TAYLOR

CONFIDENTIAL

FROM: H G WALSH

DATE: 21 October 1987

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir G Littler o/r
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Mr Kelly
Mr Watts
Mr Batt o/r
Ms Life
Miss Everest-Phillips

Mr Hyett, T.Sol
Mr Lankester, UKDEL

Ch/
Content for UKDEL to hand over this statement? Yes
Do you want IF to explore using the MIGA legislation for a capital contribution ('X' in para 10)? No
21/10

ENHANCED STRUCTURAL ADJUSTMENT FACILITY: UK POSITION STATEMENT

The IMF staff still hope that an enhanced SAF can be operational from next January and are looking for responses by 23 October to their request for national position statements on contributions to the enhanced SAF. The idea is that each country should make a (non-binding) statement of its position on a contribution and that these statement should be circulated to other members, prior to negotiations in the Executive Board and also perhaps a meeting of Deputies. UKDEL suggest that a written document would be the best form of statement for the purposes of the present request.

Background

2. A "protected" Trust Fund now seems to be the front runner as the agreed vehicle for the enhanced SAF. It is unlikely that IMF gold will have any major role to play - although the Germans and Japanese may dispute this point and we may wish to come back to gold if the present approach were to break down. The Fund Staff are examining ways to make the Trust Fund adequately secure, liquid and remunerative. Mr Camdessus is now willing to include amongst the assurances on the security of the Trust Fund a "solemn declaration" of willingness to stand behind it in the event of any calamities (although the US disapprove of any such declaration).

Such a declaration would probably be sufficient to <u>secure</u> the Trust Fund if made in addition to other more specific proposed undertakings.

(i) Subordination of the claims of the special disbursement account (which handles repayments of the current SAF) to claims of the new Trust.

(ii) The establishment of a reserve in the Trust (and the possible establishment of a sinking fund which would be repaid by debtors to the Trust into the reserve each year).

3. The <u>liquidity</u> of contributions to the Trust Fund could be assured by some combination of:-

(i) Making claims on the Trust transferable to other participants on a voluntary basis.

(ii) Provision to suspend temporarily calls on a participant's commitment in the event of balance of payments need.

(iii) Permission for holders of claims on the Trust to encash their claims in case of balance of payments needs by recourse to the reserve.

(iv) Making arrangements between participants to purchase the claims of other participants if they were in balance of payments need.

(v) The establishment of a~~n~~ "mobilisation facility" under which the Fund would stand ready to provide access to its general resources for any member country beyond any available reserve tranche position up to the amount of its claims on the Trust whenever a liquidity need was represented.

4. Remuneration arrangements on capital contributions have yet to be agreed but are likely to be the full Fund (market-related) rate.

A UK Contribution to an Interest Subsidy

5. The IMF staff say that the most practical means of funding the necessary subsidy would be in the form of grant contributions, which would be deposited into a interest subsidy account. While they would obviously welcome grants to be provided in full at the time operations commence, they envisage that subsidy contributions could be spread, say, over a 5 year period. We should want to spread our contributions over the whole period of the SAF so that subsidy is only paid as required over the entire 13 years or so of an individual SAF.

6. The public expenditure line for the UK in the first 3 years might be:-

SAF Interest Subsidy

£m

1988-89	**1989-90**	**1990-91**
6.5	13	20

The ODA have been asked but have not yet agreed to find the above sums from within an enlarged Aid Programme. This is somewhat different treatment than the one recommended for the subsidy under your initiative which would be additional expenditure under a separate PES sub-head.

7. The UK's position on the amount of a contribution to the SAF interest subsidy has already been made at the Commonwealth Finance Ministers meeting. It entails a contribution rising to $30 million a year (approximately 23 million SDRs). We can specify our contribution in pounds, dollars or SDRs. The draft at flag A specifies dollars and the equivalent in SDRs at a specific date, but does not commit us to a specific amount of SDRs in the future.

A Capital Subscription

8. The Staff have made the following estimates of capital

subscriptions after discussions with member states (we have repeatedly made clear that the UK has <u>not</u> committed itself to a capital contribution, but they have allocated to us the capital amount which our interest subsidy would support after it had built up to the maximum annual level of $30 million):-

	<u>SDRs million</u>
Saudi Arabia (parallel operation of Saudi Development Fund)	1,500
Japan	2,000
Germany	600
France	500
UK	400
Others	1,000
Total	**6,000**

The Staff feel that all countries would also contribute to an interest subsidy. The best that can be hoped for from the United States is a commitment by the present administration to use its best endeavours to make a contribution to the enlarged SAF in Fiscal 1989. The table includes no more than a token amount for the US. We may eventually have to consider whether there would be tactical advantages in making the same contribution as the French, eg for our position in the World Bank.

<u>Powers and Public Expenditure</u>

9. We have examined the question of what powers the UK should use to make a capital subscription to a legally separate SAF Trust Fund and whether it would score as public expenditure. The conclusions of this examination (see attached note at flag D for details) were that :-

(i) It would be undesirable to allow the ODA to use their powers under the Overseas Development Act of 1980 to pay a capital subscription <u>not</u> counting as public expenditure: this might encourage the ODA to try to use this Act for their own purposes on the same basis.

(ii) It would be wrong to use the Exchange Equalization Account Act either as it stands, or as it could be amended, because such a capital contribution would not be made for one of the existing purposes of the Act and it would undesirable to extend the Act to enable it to be used for a non reserve/exchange rate management purpose.

(iii) The best course would be to amend the IMF Act 1979 to allow for a capital contribution to the SAF from the NLF, either through an amendment to Section 1 (which would enable a <u>subscription</u> to the Trust Fund to be paid) or an amendment to Section 2 (which would enable a <u>loan</u> to the Trust Fund to be made).

(iv) It would be possible not to score a subscription or loans as public expenditure provided that the asset received in exchange was scored as part of the reserves. This means that it would have to be completely secure, highly liquid and be remunerated at market rates.

10. Option (iii) involves separate legislation which, under a normal timetable, would not be passed by until 1989. (But in the meantime we should be contributing by way of an interest subsidy). If a faster timetable (early 1988) were envisaged, it <u>might</u> be possible to use the MIGA legislation (already introduced) as a vehicle. But such a course could delay the MIGA legislation - and we are already somewhat embarrassed by not being able to ratify MIGA until after the initial deadline despite being the first G5 country to sign the treaty (Japan and Germany have ratified). If you wished to explore this, we will explore with ODA. But given the time taken to set up the Trust Fund, and then to disburse, a delay until 1989 in any UK capital contribution may not matter too much.

11. We are not yet in a position to reach a final decision on a capital contribution and believe most others are in the same position. We need to keep the pressure on to make the Trust Fund as secure, liquid and remunerative as possible. This all needs to

be firmed up before we can make any commitment and we shall submit separately when that stage is reached.

Recommendation

12. It is recommended that we should hand over to the Fund the attached one-page statement (flag A) of our position on:-

(i) An interest subsidy for the SAF, and

(ii) A capital contribution to the SAF.

If you agree, we shall transmit it to Mr Lankester for submission to the Staff.

H.W.

H G WALSH

STRUCTURAL ADJUSTMENT FACILITY: ENHANCEMENT

The UK supports a substantial enlargement of the Structural Adjustment Facility (SAF). We have received a request from the Fund to make a contribution to the interest subsidy account and a separate capital contribution.

Interest Subsidy Account

2. The existing SAF provides concessional finance to poor countries undergoing structural adjustment programmes. In the view of the UK, the new enhanced SAF should include provision for differentially favourable access for the most heavily indebted countries, especially in Sub-Saharan Africa. Our views on this are outlined in the paper "Differential Access to an Enlarged SAF" which has already been submitted to the Staff.

3. Any UK contribution to an interest subsidy account would be on an "as needed" basis and might build up to $30 million a year, which is equivalent to 23 million SDRs at present exchange rates.

4. Our contribution would be contingent on:-

(i) Other major creditor countries making an appropriate contribution.

(ii) Some form of differential access for highly indebted countries, especially in Sub-Saharan Africa.

Capital contribution

5. The details of a SAF Trust Fund are still evolving. Provided that such a Fund were sufficiently secure, liquid and remunerative the UK might consider a non-budgetary subscription. No firm commitment can however be made until it is clearer whether the asset obtained in exchange for our subscription would make the subscription qualify as non-budgetary. This would require the Trust Fund to be completely secure, very liquid and provide remuneration at a market rate - with a firm schedule for repayment of principal and remuneration.

HM Treasury
20 October, 1987

SAF ENLARGEMENT: POWERS

This note examines the powers we might use if we were to make a capital contribution to the SAF, on the assumption that the capital contribution would almost certainly be to a Trust Fund rather than to the General Resources Account (GRA) of the IMF itself.

Overseas Development and Co-operation Act 1980

2. We propose to use the powers under the above Act - either Section 1 or Section 4 (in the case of a Trust Fund, Section 4 would only be available if the Trust Fund itself could be classified as an "international development bank") - to make our interest subsidy contribution to any enlarged SAF. It has been suggested that it might be possible to use the same powers to provide a capital contribution. Our legal advice is that this would certainly be possible under Section 1.

3. We considered however that such a course had significant disadvantages:-

(i) It would be transparent that the main purpose of any payment would be for promoting development rather than making an investment.

(ii) The use of this particular Act might encourage the ODA to come forward with proposals for making similar contributions not scoring as public expenditure.

In the case of the use of Section 4 for our paid-in contributions to the IBRD, we certainly score these as public expenditure and want to continue to do so. All our payments under Section 1 also score as public expenditure. We should like to ringfence any contribution as tightly as possible if it is not to count as public expenditure.

Conclusion

4. The use of the existing powers under the above Act would only

be a runner if there were no alternative and if we were not concerned, on the one hand, about our capital contribution being public expenditure or, on the other, about the possibility of establishing an undesirable precedent if we did not count it as such. We are concerned about both of these matters. Therefore this Act is not a good source of powers.

Exchange Equalisation Account Act 1979 (Existing Powers)

5. We have powers under Section 3(1)(a) to invest in "securities" under this Act. Our advice is that we could probably frame our interest-earning contribution to the SAF so as to qualify it as an investment in a security.

6. But if we used this Act, we should also have to comply with its purposes as set out in Section 1. The only existing provision that is available is Section 1(3)(b). This provides for the use of the Account for: "securing the conservation or disposition in the national interest of the means of making payments abroad". At a pinch, it would probably be possible to construe this to mean that we could use the existing EEA Act 1979 to make our capital contribution to the SAF, and for this not to score as public expenditure, providing that it was a contribution to the IMF GRA itself.

7. A contribution to a Trust Fund, on the other hand, would be very difficult to justify unless the characteristics of any deposit were fully on a par with existing reserves so that our payment could be deemed to have a reserve purpose. The test should be whether we would be prepared to contemplate an investment in the Trust Fund if we were viewing it purely as a financial investment. This test is unlikely to be satisfied, since the liquidity arrangements for the Trust Fund are not likely to be on a par (say) with a marketable US Treasury note (we should have to establish a balance of payments need to get hold of our money in a hurry) nor is the security likely to be as good as for the GRA.

8. Both the Bank of England and MG Division have grave doubts about whether a capital contribution to a SAF Trust Fund would

qualify under existing Section 1(3)(b), given that it would be set up solely to assist non-creditworthy underdeveloped countries. (A SAF skewed to debt-distressed countries makes this point even stronger). The advice from these sources is that it would be improper to use the existing EEA Act to make such a capital contribution.

Amending the EEA Act

9. It would be possible to amend the EEA Act by specifically providing that the Account could be used for making a payment to the Trust Fund for carrying out the latter's purposes. MG see less difficulty with doing this than using the existing Act if there were no alternative. But both MG and the Bank of England would strongly oppose even using an amended Act, on the view that any such deposit or payment would be for developmental purposes and that it would be inappropriate to widen the EEA Act so as to facilitate such a payment.

10. Therefore the conclusion on amending the EEA Act is that it would be possible to amend the Act to permit a deposit with the SAF Trust Fund. But it would be an extension of the Act beyond its existing reserve/exchange rate management purpose which we might regret later if it became the beginning of a slippery slope.

International Monetary Fund Act 1979

11. Under this Act we have powers inter alia to pay a quota increase to the IMF under Section 1 and to lend to the IMF for the GAB under Section 2. In neither case is an increase in public expenditure involved. Unfortunately there is also no existing power in either case to pay money to a Trust Fund.

12. Our advice is that it would be possible to amend either Section 1 or Section 2 to facilitate a capital transfer to the SAF Trust Fund. Provided that the asset received in exchange for this payment could be counted as part of the reserves, it would not score as public expenditure. MG think that whether it could be counted as part of the reserves is an administrative decision, but

the Trust Fund would have to be adequately secure, liquid and remunerative if a passable version of a reserve asset is to result.

13. An amendment to Section 1 (or a completely new Section) could simply provide for a sum which the Government of the United Kingdom requires for the purposes of **paying a capital subscription** to the IMF Structural Adjustment Facility in accordance with the SAF's Articles of Agreement/Operating Rules to be paid out of the National Loans Fund. There would also have to be consequential amendments to the Act, including one which would facilitate repayments to the National Loans Fund (or the EEA) from the Trust Fund, ie to Section 3.

14. The appropriate amendment to Section 2, to facilitate a **loan** to the SAF Trust Fund, would simply be to extend the definition of eligible lending to include lending to the SAF Trust Fund from the NLF. There would also be at least two consequentials in this case: a (say) $500 million increase in the lending limit (ie an increase equal to our contribution to SAF capital) and the same type of repayment provision in Section 3 needed for an amendment to Section 2. The lending limit could be increased by Order.

15. An amendment to Section 1 of the IMF Act seems more appropriate than one to Section 2, if we are dealing with the disposition of reserves rather than a "loan". The GAB (Section 2) is <u>not</u> a precedent for lending to a quasi-IMF body which does not score as public expenditure, since if this Section were ever activated we should be lending to the IMF itself. But the choice of Section 1 or Section 2 can be left pending further legal advice in the light of better definition of the Trust Fund itself.

<u>Amendments: EEA versus the IMF Acts</u>

16. Thus the main issue, if an amendment were envisaged, is whether it would be better to amend the EEA Act or the IMF Act. The balance of argument seems to be in favour of the IMF Act because:-

(i) We could advance money to the Trust Fund in sterling as well as in foreign currency if we so wished.

(ii) There would be no risk of encouraging an extension of the use of the EEA Act to yet further purposes not strictly related to reserve/exchange rate management.

(iii) It is arguably improper or at least inappropriate to use the EEA Act for a developmental purpose.

Legislative Vehicles

17. If it were decided to pass fresh legislation then the obvious candidates for a legislative vehicle are the Finance Bill or the MIGA Bill that has now been introduced. Legal advice is that the normal scope of the Finance Bill could not contain provision for a SAF contribution because this involves a payment rather than the raising of finance. This stricture certainly applies to amendment of the IMF Act. There is also serious doubt whether an amendment to the EEA Act for the purpose proposed could be included in a Finance Bill because the House authorities would look to its underlying purpose.

18. This points to the MIGA Bill as one possible fast track. But Government business managers were persuaded that this Bill should be introduced early on the basis that it was simple and uncontroversial. While there would no doubt be general Parliamentary support for a SAF capital contribution, it cannot be claimed that this legislation would be as simple or as uncontroversial as the MIGA legislation, since we should have to widen the scope of the MIGA Bill. There would therefore be some possibility of delay. We are already in the embarrassing position of having been the first member of G5 to sign the MIGA convention but having missed the deadline for ratification because of our legislative timetable. We are therefore anxious to have the Bill pass as soon as possible. To use the MIGA legislation we should also have to be able to instruct Parliamentary Counsel on the precise form of the legislation by early November, before we know the exact form of the Trust Fund.

19. This leaves the possibility of completely free-standing legislation. Our advice is that a Bill could not be passed before Spring 1989 on a normal timetable. Whether this would be acceptable would of course depend on the progress of negotiations on the SAF. But in the meantime we could claim that we were making an adequate contribution by way of an interest subsidy (which would of course score as public expenditure), using the powers already available in the Overseas Development and Co-operation Act of 1980.

Recommendation

20. The best option seems to be an amendment of Sections 1 or 2 of the IMF Act 1979 as envisaged in paragraphs 11-15 above. Unless there is great pressure for speed, the preferred course would be to do this by free-standing legislation, but the MIGA Bill is a possibility if we were unexpectedly under early pressure.

21. This submission has been agreed with GEP, MG, T. Sol, and the Bank of England.

22. Sir Peter Middleton, the Accounting Officer, has agreed to the use of the NLF for this purpose if the Trust Fund can be adequately specified and all other arrangements are appropriate.

H G WALSH
IF1 Division
20 October, 1987

MR 2/29

CONFIDENTIAL

pmp

FROM: J M G TAYLOR

DATE: 22 October 1987

MR WALSH

cc: CST
FST
EST
Sir P Middleton
Sir G Littler
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Mr Kelly
Mr Watts
Mr Batt
Ms Life
Miss Everest-Phillips
Mr Hyett - T.Sol
Mr Lankester - UKDEL

ENHANCED STRUCTURAL ADJUSTMENT FACILITY: UK POSITION STATEMENT

The Chancellor has seen your minute of 21 October. He is content that we should hand over to the Fund the statement as drafted. He does not want you to explore with ODA the possibility of using the MIGA legislation as a vehicle for dealing with the capital contribution problem (your paragraph 10).

JT

J M G TAYLOR

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

CH/EXCHEQUER
REC. 9 NOV 1987
ACTION MR HP EVANS
COPIES TO SIR G LITTLER
MR CASSELL
MR MOUNTFIELD
MR WALSH.

November 2, 1987

Dear Mr. Chancellor:

I would like to express my thanks for the statement provided to us by Mr. Lankester of your Government's willingness to participate substantially in the interest subsidy account for the enhanced Structural Adjustment Facility. This statement also indicated your Government's willingness to consider a capital contribution; I would urge you please to pursue this possibility, and I can assure you that we will do all we can to meet your concerns about the security and liquidity of claims on the Trust. These expressions of support are particularly appreciated in view of the need for donors at the same time to set aside resources to finance the other initiatives which the SAF enhancement is designed to complement--the IDA VIII replenishment and your own proposals with respect to the Paris Club.

I listened attentively to your suggestion during the Annual Meetings that heavy indebtedness be a major factor in determining the allocation of funds under the enhanced SAF. As you know, we envisage a differentiation of access according to need as well as the strength of the adjustment effort as a central point of this initiative, and we are discussing your ideas in this area with your officials.

Thank you again for your support. I look forward to the success of all our joint endeavors.

Best regards,

Michel Camdessus

The Right Honorable
Nigel Lawson
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
London SW1P 3AG
United Kingdom

walsh/23.11/imf.saf CONFIDENTIAL

Of the viable options, Option D clearly seems preferable to Options C1 or 2. JA 2/12

FROM: H P EVANS
DATE: 2 December 1987

1. MR ANSON
2. CHIEF SECRETARY
3. CHANCELLOR

cc: Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Walsh
Mr Watts
Mr Batt
Ms Life
Mr Tyrie

Mr Hyett, T.Sol

IMF: UK CONTRIBUTION TO THE SAF

The IMF Board will meet on 11 December to discuss the final arrangements for the Enhanced Structural Adjustment Facility (ESAF). (The ESAF is the proposed enlarged SAF of 6 billion SDRs plus the remaining 2.2 billion SDRs carried over from the existing SAF, proposed to be combined in one facility). Sir Geoffrey Littler has come under pressure from Mr Camdessus for the UK to make a supplementary contribution in addition to the interest subsidy that we have already offered - on the argument that other countries would withdraw if the UK made no contribution.

<u>Summary</u>

2. It is now clear that we cannot find a way to make a capital or other supplementary contribution without this scoring as public expenditure (in which case Options A and B below are not worth pursuing; paras 8-13 refer). This leaves two further options:

Option C: to provide a concessional loan or a grant, para 14;

Option D: to increase the level of interest subsidy we have already offered. This could for instance be roughly doubled to support a capital contribution of 1000 m SDRs, para 15 .

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3. We have been told that Option D is preferred by the Fund. It would also be presentationally impressive. Both options involve extra public expenditure which involve calls on the Reserve. (This requires the Chief Secretary's specific approval). But the additional public expenditure costs of Option D are small compared with those of Option C over the current survey period. Slippage of your initiative means that part of the monies provisionally earmarked for Paris Club interest relief could be used to make up the difference (as shown at para 16). However the ESAF is not a substitute for your initiative. In later years the two may run in parallel and hence require additional monies over those previously earmarked.

Recent Developments

4. There has been further progress towards agreement on capital contributions. The Germans and Japanese have now agreed in principle, so the G-5 except for the US have all now offered some contribution. The US position remains that it is for those with a surplus on the balance of payments to meet the costs of the ESAF in the first instance, although they have not closed the door on a contribution in the future. Germany and Japan now accept that the Americans are unlikely to make an early contribution because of budgetary concerns, and possible complications while IDA8 and the GCI are steered through Congress.

5. The G7 and Saudi position on capital contributions is summarised in the table below.

SAF: G7 Contributions

Country	SDRm Capital
Canada	200
France	400
Germany	[400]
Italy	300
Japan	[2000]
US	-
UK	-
Saudis	[1500]
Others (residual)	1200

[ ] No commitment yet, but expected imminently.

Current UK Position

6. We have already offered (the Chancellor at the Commonwealth Finance Ministers meeting) an interest subsidy on the SAF rising to $30m per annum, sufficient to subsidise (at current SDR interest rates) capital lending of around $500m (SDRs 400m). It was subsequently agreed with the ODA as part of this year's PES settlement that they would meet the annual interest costs of this offer on the basis that the sterling sums involved were £6.5-13-20m respectively over the next three years. (ODA have now provisionally allocated £7 million within the Aid Framework for 1988-89). We have now explored the options for a capital contribution, and the rest of this submission records the results.

7. We have also expressed the view that low income, debt-distressed countries should have differential access to the ESAF. Fund Staff have accepted the principle of differential access. They propose however that this should be based on a case-by-case assessment of financing requirements, including the debt-service burden, rather than on a specific debt indicator. Because this is a case-by-case approach, we do not know in advance exactly what the results will be. But both we and Staff expect that poor and heavily indebted SSA countries, who are our main concern, will benefit differentially and substantially under this approach. We could not base a refusal to make a supplementary contribution on this difference of approach given that others are willing to go along with what the Staff propose.

Option A: Reserve Asset in SDRs

8. We have considered whether we could make a matching capital contribution, of around £300m (SDRs 400m) with the SDR-denominated asset we received in return qualifying as part of the reserves and the arrangement thus not scoring as public expenditure. We have concluded that this is a non-runner. For the asset we receive to qualify, it would have to be justified as an investment. The combination of security, liquidity and remuneration on offer - which we have now probably pushed to the limit with the Fund - is simply not good enough.

9. As regards <u>security</u>, this is for two reasons. First, the reserve proposed for the Trust Fund would cover only a 50 per cent rate of default (and much less than this in the first five years before repayments first become due). Second, the Fund, to provide the residual security, has only been willing to commit itself to the following:

> "The Fund is committed, if it appeared that any delay in payment by the Trust would be protracted, to <u>consider</u> fully and in good faith all such initiatives as might be necessary to assure final payment to lenders.

The above commitment cannot be made more categorical because explicitly or implicitly it involves the sale of gold. This would need a Board decision now by an 85 per cent vote and therefore a positive vote from the Americans. This in turn would require US <u>legislation</u> which the US Administration would not agree to seek - both because they oppose gold sales and because they believe it would not be passed by the US Congress.

10. Moreover, the <u>liquidity</u> on offer from the Fund is inadequate, since we should not automatically be able to get our money back without having to establish some sort of "need". The remuneration on offer would be only that which we could secure on a much more secure and liquid asset. So the asset we would receive would not be a sufficiently good investment to qualify as a reserve asset.

<u>Option B: A Sterling Asset</u>

11. A variation of Option A might be to make a contribution from the NLF but to receive in return a sterling asset (ie our contribution would be both serviceable and repayable in sterling; any exchange risk would be borne by the Trust Fund or borrowers and not by us). This would mean that the asset would not have to satisfy a 'reserve test', but we would still need to be satisfied:

(a) that it could be regarded as a proper use of the NLF (ie with sufficient security and liquidity to pass the normal 'NLF test')

(b) that it would not score as public expenditure.

12. Sir Peter Middleton has confirmed, as Accounting Officer, that the security is not good enough for our contribution to be scored as an NLF financing transaction rather than as public expenditure.

13. Options A and B are therefore not viable.

Option C: A Concessional Loan or Grant

14. The most straightforward (and expensive) option would be to make a capital contribution, and score this as public expenditure. No fresh legislation would be required. There are two variants:-

C1 A Concessional Loan

This would amount to about £300 million, disbursed over five years at a rate of £60m a year (or it could be front loaded). We would offer this to the Trust Fund as the need arose on the same terms that the Trust Fund itself would charge (½ per cent interest) to SSA countries. It could be carried on the ODA Vote as part of the Aid programme. On past precedent, in the aid area, only the capital element of the loan would score in PES, not the implicit subsidy element. Subsequent repayments of the loan would be negative public expenditure.

C2 A Grant

By analogy with IDA, a grant could be provided in the same amount as for Option C1, and would score in PES in exactly the same way except that there would be no repayments in later years (£60m a year carried on the vote).

These two options would subsume our existing offer of an interest rate subsidy. The excess over the £6.5/13/20 million already provided for in the PES settlement would have to be added to the Aid programme as ODA would be unable to absorb a larger sum. The excess would therefore be a claim on the reserve in 1988-89 and an agreed survey bid for the later years, amounting to £53.5/47/40 million in the first three years.

Option D: An Extra Contribution to an ESAF Interest Subsidy

15. Instead of offering a capital contribution, we could offer to increase our interest subsidy contribution. This could be carried on the ODA Vote and no fresh legislation would be required.

(i) Our current offer is to provide a subsidy of up to $30m a year, sufficient to subsidise lending of around $500m; at the time the offer was made, this was approximately equivalent to £20m a year. We expected this figure would be reached in the third year of the scheme.

(ii) We now expect the interest subsidy cost to peak in the fifth year. Movement of exchange rates means that we could now offer to subsidise lending of SDR 1bn at a cost of (with current interest rates) around £42 million in that year. Details of the costs are given in para 16 below. (The costs would come down if interest rates fell; we would however need to make clear that we would not take on additional costs if interest rates rose; we could avoid exchange rate risk by stipulating either a cash sum in sterling or that we were making our offer at current exchange rates).

(iii) Under this option, the additional interest subsidy cost would be added to the agreed PES allocation for aid, and shown as a separate sub-head in the Estimates.

16. The table below shows the costs of the viable options.

£m

	(i) current SAF offer	(ii) Chancellor's initiative	(iii) Total (i)+(ii)	(iv) Option D (subsidy)	(v) Options C1/C2 (capital)
88-89	6.5	10	16.5	8.5	60
89-90	13	30	43	17.0	60
90-91	20	40	60	25.5	60
91-92	(20)	(43)	63	34	60
92-93	(19)	(43)	62	42	60

Notes (1) the cost of a SAF subsidy would continue as long as SAF lending was outstanding. On current projections this would be until year 15, ie 2002. Costs would diminish after year 6 as loans started to be repaid. The capital contribution would close in 1992-93.

(2) the cost of the Chancellor's initiative would continue well beyond 1992, but no estimates are available at this stage.

(3) The cash cost of Option D, to 2002-03, would be about £330m. The npv would be about £210m - at a discount rate of 9.5 - (or about £260m at a discount rate of 5%). The npv of Option C1 would be around £120m (or £80m); the npv cost of Option C2 would be about £250m (or £275m).

Evaluation

17. Each of the viable options (C1, C2 and D) thus involve extra public expenditure which could be carried on the ODA Vote without fresh legislation. The justification would be the political one of keeping the UK in the forefront in providing debt relief for poor Sub-Saharan African countries. Moreover by 1990-91 the costs are all within the combined costs of our existing pledge and what has been earmarked provisionally in the Reserve for Paris Club relief for interest rate subsidies. (The Chief Secretary will remember that he deliberately left the 'Chancellor's initiative' out of the Aid Programme settlement with Sir G Howe; the figures in the table are a very provisional estimate of what it might cost, on certain estimates about eligibility and takeup).

18. Given the lack of progress on the initiative, it might be justified to use at least part of this money for the UK's contribution to the ESAF, but it would be a fresh call on the Reserve. However, some Paris Club relief is probably inevitable at some stage, in addition to the ESAF (or the same result will be achieved by default which will work through to the Exchequer eventually). It is not easy to say when the debt relief costs will fall, or how much they will be; but we should not assume that all the money in column (ii) above is available for reallocation.

19. The disadvantage of Options C1 and C2 is that they would use up all the money provisionally earmarked for Paris Club relief, and would beyond this require further calls on the Reserve in

1988-89 and 1989-90 (£8m and £26m respectively). We also need to consider whether, having added £40m to the Aid budget, there would be any realistic prospect that the SAF would be cut back after five years. If not, from the Treasury's point of view, they should be evaluated as a permanent addition to public expenditure.

20. Set against these difficulties with Options C1 and C2, Option D has the advantage of leaving room for some concessions in the Paris Club while keeping within the originally envisaged envelope of total resources. The extra costs covered with what has already been agreed are small over the current survey period (£2/4/5.5m). This is the option preferred by the Fund, because others such as the Japanese find it easier to contribute market rate capital rather than interest subsidy. It therefore fits in well with what others are doing.

21. The option recommended involves expenditure carried on the ODA Vote. It would have to be understood as part of the agreed arrangements that the Treasury would retain responsibility for the SAF as an IMF facility, as it would be intolerable for the ODA/FCO to be responsible for policy on the ESAF while we were responsible for policy on other IMF facilities.

Recommendation

22. To stick with the current position - proportionate UK contribution to a SAF interest subsidy, but no capital contribution and no likelihood of movement on the Chancellor's initiative - would save public expenditure by comparison with our expectations of a few months ago. But the UK would then be seen to be making a major retreat from its earlier position of leadership on SSA, and we should get a degree of blame for our decision not to make a supplementary contribution to the SAF - especially if as seems likely some other countries follow our example and the result is a somewhat lower SAF than envisaged.

23. On the merits of the case and given the pressure the UK is coming under, Option D - an increase in the SAF subsidy rising to an amount sufficient to support lending of a 1000m SDRs (at current interest and exchange rates) would be (and would probably be seen to be) an impressive response in the IMF, while not closing the door on initiatives to deal with bilateral debt.

24. If you agree with the above approach, we shall prepare a draft letter for you to send to the Foreign and Commonwealth Secretary for him to agree the arrangements.

25. We need a decision soon, if at all possible by Monday, 7 December.

David Brett

pp H P EVANS

015/4207

CONFIDENTIAL

FROM: **CHIEF SECRETARY**
DATE: **3 December 1987**

CHANCELLOR

I agree with the CST.

cc:
Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Anson
Mr Cassell
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Walsh
Mr Watts
Mr Batt
Ms Life
Mr Tyrie

Mr Hyett, Treasury Solicitor

IMF: UK CONTRIBUTION TO THE SAF

behind

I have seen Mr Evans' minute of 2 December. I agree with him and with John Anson that Option D looks the best.

2 My concern relates to the way in which we handle the public expenditure consequences for ODA. I am particularly concerned that we do not give the ODA any reason to believe that they have a call on the provision we have said we would make available for the Sub-Saharan debt initiative, for any other purpose.

3 In my bilateral discussions with Geoffrey Howe and Chris Patten our offer on access to the Reserve was to meet the costs of that initiative and that initiative alone. It was clearly understood on both sides that the special treatment agreed was because of the uncertainty surrounding the initiative. I would under no circumstances wish to give Geoffrey or Chris the impression that if that initiative does not materialise the "illustrative" sums are at their disposal.

4 In the first instance I think we should look to the ODA to absorb the cost in 1988-89. It is small - only £2 million in excess of the estimated cost of the SAF at the time of the Survey which ODA agreed to meet. If that represents a real problem I would of course be prepared to discuss with Chris Patten. But if we were to concede that addition I would not wish to link it in any way to the fate of the Sub-Saharan debt initiative which we must keep quite separate. We can discuss the later years in the 1989 Survey, though again I believe that the small sums involved (£4 million in 1989-90 and £5 million in 1990-91) mean we should start from the presumption that these costs should also be absorbed by ODA.

5 Subject to these points being reflected in your draft letter to Georffrey Howe, I am content.

John M.

JOHN MAJOR

FROM: J M G TAYLOR
DATE: 4 December 1987

MR H P EVANS

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Anson
Mr Cassell
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Walsh
Mr Watts
Mr Batt
Ms Life
Mr Tyrie
Mr Hyett - T. Sol

IMF: UK CONTRIBUTION TO THE SAF

The Chancellor has seen your minute of 2 December, on which the Chief Secretary has commented in his minute of 3 December.

2. The Chancellor agrees with the Chief Secretary's comments. I should be grateful if you could prepare a draft letter to the Foreign Secretary which takes account of these points.

JT

J M G TAYLOR

hpe23/30.11

FROM: **HUW EVANS**
DATE: **4 DECEMBER 1987**

CHANCELLOR

cc Chief Secretary
Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Anson
Mr Cassell
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Walsh
Mr Watts
Mr Batt
Ms Life
Mr Tyrie

Mr Hyett (TSol)

Ch, After discussion with PS/CST, I suggest a slightly tougher form of words in the last para of the draft. Content? — OK as shifted!
(The timing point in paras 3/4 of the note could be got round by your discussing this with Sir Geoffrey at your bilateral next Wednesday). — Right! Will do so at prior meeting.
JT 7/12

IMF: UK CONTRIBUTION TO THE SAF

I submit a draft minute for you to send to the Foreign and Commonwealth Secretary, incorporating the Chief Secretary's comments in his minute to you of 3 December. This has been cleared with AEF and GEP.

2. Informal soundings have already been made with ODA officials, to see whether ODA could absorb the additional costs in 1988-89. The results are not encouraging. We expect the Foreign and Commonwealth Secretary to reply to you saying that these costs cannot be absorbed (and pointing out that the agreement with ODA in this year's PES settlement was on the explicit basis of lower costs than we are now proposing). But if we seek to re-open the settlement from our side, there's a real risk that ODA will seek to re-open it on their side (e.g arguing that since the GDP deflator has changed since the settlement, they are entitled to more cash to maintain the new programme level in real terms).

3. The Foreign and Commonwealth Secretary's reply might reach you in the middle of next week. This will leave a problem on timing. The Chief Secretary has offered to discuss with Mr Patten. But Mr Patten is currently overseas, and does not return until 14 December. The IMF Executive Board discussion is scheduled for 11 December. We must announce our contribution at that meeting.

4. It might be necessary for you (or the Chief Secretary) to have an early word with the Foreign and Commonwealth Secretary after his reply.

HPE

H P EVANS

hpe24/30.11

DRAFT MINUTE

FROM: CHANCELLOR

TO: FOREIGN AND COMMONWEALTH SECRETARY

IMF: UK CONTRIBUTION TO THE STRUCTURAL ADJUSTMENT FACILITY

Discussions on the enlargement of the IMF's Structural Adjustment Facility (SAF) are in their final stages. We need to decide what the UK contribution should be, so that this can be announced at the Executive Board meeting on 11 December.

The SAF provides concessional medium-term lending to low income developing countries in support of structural adjustment programmes. The IMF's Managing Director has proposed that the existing Facility be enlarged by SDR 6 bn (around $8 bn). We would expect this to be of particular benefit to the poorer and heavily indebted countries of Sub-Saharan Africa.

Contributions are expected from other G7, except the US (which has pleaded Congressional difficulties). I have already offered a UK contribution of up to $30m a year in **interest subsidy**, sufficient to subsidise concessional lending of around $500m. But, despite looking exhaustively at the options, we find that we are unable to offer a **capital** contribution without this counting towards public expenditure (which, in view of the much larger sums involved, running into several hundred £m, would be out of the question).

I believe that we therefore need to increase our offer on interest subsidy, if we are not to be seen to be making a major retreat from our earlier position of leadership of Sub-Saharan Africa. I propose that we should offer to subsidise a sum of lending rising to SDR 1 bn under the Facility, at current interest and exchange rates. I believe that this would be seen as an impressive contribution, and would enable us to play an important part in discussion about how the Facility should operate.

You have already agreed as part of this year's PES settlement, that the costs of our initial offer on interest subsidy (rising to £20 million a year) should be met from the Aid Budget. The increase which I propose in our offer will result in only a very small increase in costs in 1988-89 - from £6.5m to £8.5m (this is much less than doubling because of different assumptions about the rate of SAF disbursement; we can of course make it clear to the Fund that our offer is cash limited).

I hope that ODA can absorb [this ~~these~~ additional sum[s]] ~~[this increase.]~~ ~~[I suggest that the position in later years be discussed in the 1989 survey - though I note that the increases involved are again small (about £4m in 1989-90; and £5½m in 1990-91).]~~ [The increase~~s~~ involved is ~~are~~ small. If the further increases ~~position~~ in later years cause~~s~~ difficulty this can of course be discussed in the 1989 Survey.]

Small

N L

pmp

7/12/87.

EST
Sir P Middleton
Sir G Littler
Mr Anson
Mr Cassell
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Walsh
Mr Evans
Mr Watts
Mr Batt
Ms Life
Mr Tyrie
Mr Hyett - T.Sol.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

FOREIGN SECRETARY

IMF: UK CONTRIBUTION TO THE STRUCTURAL ADJUSTMENT FACILITY

Discussions on the enlargement of the IMF's Structural Adjustment Facility (SAF) are in their final stages. We need to decide what the UK contribution should be, so that this can be announced at the Executive Board meeting on 11 December.

The SAF provides concessional medium-term lending to low income developing countries in support of structural adjustment programmes. The IMF's Managing Director has proposed that the existing Facility be enlarged by SDR 6 bn (around $8 bn). We would expect this to be of particular benefit to the poorer and heavily indebted countries of Sub-Saharan Africa.

Contributions are expected from other G7 countries, except the US (which has pleaded Congressional difficulties). I have already offered a UK contribution of up to $30m a year in interest subsidy, sufficient to subsidise concessional lending of around $500m. But, despite looking exhaustively at the options, we find that we are unable to offer a capital contribution without this counting towards public expenditure (which, in view of the much larger sums involved, running into several hundred £m, would be out of the question).

I believe that we therefore need to increase our offer on interest subsidy, if we are not to be seen to be making a major retreat from our earlier position of leadership on Sub-Saharan

Africa. I propose that we should offer to subsidise a sum of lending rising to SDR 1 bn under the Facility, at current interest and exchange rates. I believe that this would be seen as an impressive contribution, and would enable us to play an important part in discussion about how the Facility should operate.

You have already agreed as part of this year's PES settlement, that the costs of our initial offer on interst subsidy (rising to £20 million a year) should be met from the Aid Budget. The increase which I propose in our offer will result in only a very small increase in costs in 1988-89 - from £6.5m to £8.5m (this is much less than doubling because of different assumptions about the rate of SAF disbursement; we can of course make it clear to the Fund that our offer is cash limited).

I hope that ODA can absorb this additional sum. The increase involved is small. If the further small increases in later years cause difficulty this can of course be discussed in the 1989 survey.

Moira Wallace

pp N.L.

7 December 1987

(Approved by the Chancellor and signed in his absence.)

749/70

pmp

FROM: R I G ALLEN
DATE: 9 DECEMBER 1987

The House sits on Friday: but must ensure drafting goes and the PQ is tabled in time.

* PS. I should be grateful if Mr Forman would arrange for Mr Baker WHIS to table the question.

MR WALSH

cc PPS
Mr H P Evans
Mr Dyer
Mr Pickford
Mr Flitton
Mr N Forman, MP

IMF: UK CONTRIBUTION TO THE SAF

As I mentioned on the telephone, the Chancellor would very much like to give some publicity to this decision.

2. We clearly do not want to preempt the discussion in the IMF's Executive Board on 11 December, even though there is a slight risk that news of the Board's decision will leak out into the weekend press. What I would suggest, therefore, is that we table an arranged PQ for answer on Monday, 14 December. Tabling would be on Friday and Parliamentary Section have asked that you should let them have a text of the Question (though not necessarily the Answer) by close of play tomorrow. Mr Forman will then be able to arrange for a friendly MP to put the Question.

3. We intend to press release the Question and Answer.

4. I should be grateful if you would set the necessary drafting arrangements in hand.

Rm for Thes.

RA

R I G ALLEN

9/12/87.

MR B. This minute for SHEW to do. Clearly too late to amend.

CH/EXCHEQUER
REC. 09 DEC 1987
ACTION MR BATT
COPIES TO EST, SIR P MIDDLETON SIR G LITTLER, MR ANSON MR CASSELL, MR MOUNTFIELD MR PERETZ, MR TURNBULL MR RG ALLEN, MISS O'MARA MR WALSH, MR HP EVANS MR WATTS, MS LIFE MR TYRIE, MR HYETT T.SOL.

FCS/87/258

CHANCELLOR OF THE EXCHEQUER

IMF: UK Contribution to the Structural Adjustment Facility

1. Thank you for your minute of 7 December, which we discussed this morning.

2. Since you are now ruling out a capital contribution, I agree that the best option is to increase our interest subsidy contribution. That should enable us to keep up the momentum estabished by your sub-Saharan initiative. We should get political credit in Africa and elsewhere for our offer, and we can argue that the Fund has largely accepted your proposal to differentiate in favour of the poorest and most indebted. We must also maintain our credibility in the Fund, the more so as you seek to improve the quality of Fund programmes.

3. I cannot however agree with your proposals for handling the additional public expenditure costs. I agreed reluctantly to the PES settlement for aid, despite the fact that it does not enable us to maintain the real value of our bilateral country programmes. This was on the basis that I would meet the cost of the Treasury's interest subsidy contribution to the enlarged Structural Adjustment Facility which you had already offered, ie to support lending equivalent to SDR 400 million. The annual costs agreed between us were £6.5 million - £13 million - £20 million for the three PES years. In

/his

his letter of 21 October setting out the basis of the PES settlement, John Major confirmed that a capital contribution would be met separately, and would not be treated as part of the aid programme. Since your latest proposal is in lieu of such a capital contribution, the same understanding should obviously apply to it.

4. Against this background it is not reasonable to suggest now that I should meet the higher costs of an increased offer. Apart from 1988/89, for subsequent years the additional costs of your proposal are by no means as small as you suggest: for the two years beyond the present PES period they amount to £14 million and £22 million respectively, over and above the £20 million increase in the aid baseline which it was agreed should be used for this purpose. I could not absorb these amounts, nor can I agree to find the additional £2 million required for 1988/89.

5. I am, however, content for you to take the line you propose at the IMF meeting on 11 December provided that we agree beforehand that the additional costs to the aid programme would be met by an agreed claim on the Reserve for 1988/89. It must also be understood that any additional costs in later years wil similarly be funded from outside the existing aid programme.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
9 December 1987

walsh/7.12/saf CONFIDENTIAL

Ch/ Draft minute to Sir GH enclosed with minute of 10/12, behind.

As we are in the position of demandeurs, I would regretfully accept option ii as the only means to get instructions out for the Board meeting

A 9/12

FROM: H G WALSH
DATE: 9 December 1987

1. MR ANSON
2. CHIEF SECRETARY
3. CHANCELLOR

OK – JT 19/12

cc: Economic Secretary
Sir P Middleton
Sir G Littler o/r
Mr Cassell
Mr Evans o/r
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Watts
Mr Batt
Ms Life
Mr Tyrie

Mr Hyett, T.Sol

A 9/12

JiM/.

Option II it must be but why was AEF's advice (para 5) not available earlier? It is contrary to earlier advice on the PES settlement. J 10/12

IMF: UK CONTRIBUTION TO THE ENHANCED SAF (ESAF)

The Foreign and Commonwealth Secretary has now replied to the Chancellor's minute of 7 December (copies attached) on the Enhanced Structural Adjustment Facility. He takes the position that the ODA cannot absorb the additional £2 million required in 1988-89 for the UK contribution to the SAF, and seeks further assurances about the years 1989-90 to 1992-93.

2. This issue needs to be finally settled by Friday morning in advance of that day's IMF Board meeting.

Public Expenditure

3. The existing public expenditure figures up to 1992-93 are as follows:-

£m

	(i) SAF: Existing Provision	(ii) Proposed Addition	(iii) Proposed Provision (ESAF)
1988-89	6.5	2.0	8.5
1989-90	1.3	4.0	17.0
1990-91	2.0	5.5	25.5
1991-92	-	-	34.0
1992-93	-	-	42.0

The Foreign and Commonwealth Secretary wishes to have the figures for 1988-89, 1989-90 and 1990-91 in the second column as agreed bids on the Reserve which would be added to the Aid budget baseline. In addition he wishes in effect for it to be agreed now that £34 million should be added to the baseline in 1991-92 in the 1988 PES Round, and £42 million added for 1992-93 in the 1989 PES Round - anticipating the outcome of the next two Surveys.

4. The options are:-

(i) Stick with our existing position, ie ODA to absorb £2 milion in 1988-89 and no commitment for future years.

(ii) Go for a compromise. This could be to accept the £2 million for 1988-89 as an agreed claim on the Reserve. Claims for succeeding years to 1990-91 (ie the present Survey period) would be recognised as agreed additional bids to be added to the aid budget in next year's PES. But no quantified assurances (except goodwill) could be given in respect of later years, for which no PES baseline exists.

(iii) Agree to what the Foreign and Commonwealth Secretary is seeking.

Assessment

5. Option (i) is not negotiable and in any case AEF advise that the extra £2 million in 1988-89 should be accepted as an agreed call on the reserve, on the grounds that the increase in our contribution to the SAF is a fresh Treasury initiative, which alters the basis on which the PES settlement was reached.

Option (ii) could be tried, but the ODA are very wary of any loose wording. They bitterly regret the similar open-ended commitment they gave in respect of the Soft Loans Scheme, and are are determined not to be caught again. They are especially opposed to any deal which might lead them to carry a significant part of the extra cost of the ESAF as it builds up to significant amounts (especially in the fourth and fifth years). It may be negotiable, but this may need a quick further discussion between the Chancellor and the Foreign and Commonwealth Secretary. Time is short.

Option (iii) is not negotiable, by definition.

6. Despite the fact that the contributions are proposed to be carried on the ODA Vote, the ODA and FCO regard them as IMF (and hence Treasury) expenditure and associate this expenditure with the Chancellor's Sub-Saharan initiative.

Conclusion

7. It would theoretically be possible to delay giving a final view on the supplementary contribution beyond the Board meeting on Friday, but this would probably mean that the UK would be seen to be lagging behind other major creditors as a contributor to the ESAF. A quick agreement can probably only be secured on the basis of option (ii).

8. AEF agree with this submission.

H.W.

H G WALSH

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Ch.

Sorry to bother you with this again

– do you want version A or version B of the minute to Sir G Howe?

(See Mr Walsh's minute of 10 December, behind)

Option A.

(CST should really be drafting this)

FROM: H G WALSH
DATE: 10 December 1987

CHANCELLOR

cc: Chief Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Sir G Littler o/r
Mr Cassell
Mr Evans o/r
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Watts
Mr Batt
Ms Life
Mr Tyrie

Mr Hyett T.Sol

IMF: UK CONTRIBUTION TO THE ENHANCED SAF (ESAF)

I attach a draft minute for you to send to the Foreign Secretary, putting forward the compromise option (ii) described in my submission of 9 December.

2. The problem is the nature of the assurances which the Foreign Secretary seeks about the two years beyond the present PES period. We have been unable to resolve this with ODA officials. The final sentence of the draft contains the two alternative formulations:

Version A, which we have offered:

".... which would be taken into account in settling the Aid budget for those two years".

Version B, which ODA are holding out for:

"... and the Aid budget will have to be increased correspondingly".

3. It would be open to us to agree to Version B, though this does go beyond the assurance of 'goodwill' to which the Chief Secretary has agreed.

David Booth

pp. H G WALSH

DRAFT MINUTE

FROM: CHANCELLOR
TO: FOREIGN AND COMMONWEALTH SECRETARY

IMF: UK CONTRIBUTION TO THE STRUCTURAL ADJUSTMENT FACILITY

Thank you for your minute of 9 December.

2. I can agree that the additional costs of our contribution in 1988-89 (£2 million) be accepted as an agreed claim on the Reserve. I can also agree that the additional costs for the succeeding years to 1990-91 (ie £4 million in 1989-90 and £5.5 million in 1990-91) be recognised as agreed additional bids to be added to the aid budget in next year's PES.

3. As you will realise, I cannot accept as agreed bids any additions for the following two years, 1991-92 and 1992-93, because we have by definition no baseline for those two years. When however we come to discuss PES provision for those years, the Treasury will of course recognise that our contribution to the SAF will in each year involve further calls on the aid budget, over and above the level of our contribution in 1990-91,

A: which would be taken into account in settling the Aid budget for those two years.

B: and that the Aid budget will have to be increased correspondingly.

NL

This means... etc

RM2.16

CONFIDENTIAL

cc CST
EST
Sir P Middleton
Sir G Littler
Mr Anson
Mr Cassell
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Miss O'Mara
Mr Watts
Mr Batt
Ms Life
Mr Walsh
Mr Tyrie
Mr Hyett - T.Sol.

MP

Treasury Chambers, Parliament Street, SW1P 3A
01-270 3000

FOREIGN SECRETARY

IMF: UK CONTRIBUTION TO THE STRUCTURAL ADJUSTMENT F

Thank you for your minute of 9 December.

I can agree that the additional costs of our contribution in 1988-89 (£2 million) be accepted as an agreed claim on the Reserve. I can also agree that the additional costs for the succeeding years to 1990-91 (ie £4 million in 1989-90 and £5.5 million in 1990-91) be recognised as agreed additional bids to be added to the aid budget in next year's PES.

As you will realise, I cannot accept as agreed bids any additions for the following two years, 1991-92 and 1992-93, because we have by definition no baseline for those two years. When however we come to discuss PES provision for those years, the Treasury will of course recognise that our contribution to the SAF will in each year involve further calls on the aid budget, over and above the level of our contribution in 1990-91, which would be taken into account in settling the aid budget for those two years. This means that the starting-point for the PES negotiations about these years will include an addition to cover these extra costs of the SAF (£8.5 m for 1991-92 and £16.5 m for 1992-93 less any uplift factor) although it will always be open to the Treasury to seek a reduction from this starting point, just as it will be open to you to ask for a further increase.

pp. N.L.
10 December 1987

[Approved by the Chancellor and signed in his absence]

CONFIDENTIAL

043525
MDADAN 8872

✓ I agree, but it is essential. N

ADVANCE COPY

CONFIDENTIAL
FM UKDEL IMF/IBRD, WASHINGTON
TO DESKBY 110800Z FCO
TELNO 308
OF 102300Z DECEMBER 87

IMF: ENHANCED SAF: INFORMAL SESSION OF FUND DIRECTORS

SUMMARY
1 MD CALLS UK SUPPORT FOR ESAF ''A VERY REMARKABLE CONTRIBUTION'' IN INFORMAL SESSION WITH EDS. ESAF WITHIN SIGHT OF DOLLARS 6 BN ADDITIONAL CAPITAL CONTRIBUTION. GRANT ELEMENT STILL SHORT OF REQUIRED TOTAL, BUT MORE CONTRIBUTIONS EXPECTED, AND MD PLANS TO LAUNCH ESAF ON 1 JANUARY WITH 0.5 PER CENT INTEREST RATE AS ORIGINALLY PROPOSED.

DETAIL
2 MD HELD INFORMAL MEETING OF EDS THIS AFTERNOON TO DISCUSS ESAF. WE HAD EARLIER, AFTER RECEIVING CONFIRMATION OF UK CONTRIBUTION FROM LONDON, PASSED THE INFORMATION ON TO THE STAFF, WHO WERE KEEN TO USE IT TO ENCOURAGE OTHERS TO INCREASE THEIR AMOUNTS.
3 MD REPORTED FUND ''WITHIN SIGHT'' OF DOLLARS 6 BN ADDTIONAL CAPITAL CONTRIBUTION. DOLLARS 6 BN HAD ACTUALLY BEEN ACHIEVED SEVERAL TIMES WITHIN LAST FOUR DAYS, BUT THERE HAD BEEN SOME SLIPPAGES (COMMENT: THIS INCLUDES THE SCANDINAVIANS). ONCE DOLLARS 6 BN WAS FIRMLY ACHIEVED, THE MD WOULD ANNOUNCE IT. HE HOPED THIS WOULD OCCUR BEFORE THE END OF THE YEAR.
4 THE MD STRESSED THE CENTRALITY OF THE G7 IN CARRYING THE SAF FORWARD SINCE VENICE. CONTRIBUTIONS FROM THE G7 WERE REPORTED AS:
FRANCE - SDR 500 MN, POSSIBLY MORE TO BE ANNOUNCED VERY SHORTLY
WEST GERMANY - SDR 700 MN LOAN: GRANT SOMEWHAT LOWER
CANADA PLUS ITALY - AROUND SDR 700 MN TOGETHER
JAPAN - ''STANDS READY TO PROVIDE ADDITIONAL LOANS WHICH TOGETHER WITH THE GRANT-ONLY CONTRIBUTION WILL PLAY A VITAL ROLE''. NO SPECIFIC FIGURE WAS GIVEN, BUT THE MD GAVE SDR 4 BN AS THE G7 TOTAL. (COMMENT: THIS CONFIRMS OUR EARLIER DEDUCTIONS FROM THE STAFF PAPERS THAT THEY EXPECTED SDR 2 BN FROM THE JAPANESE.)
5 TOTAL AVAILABLE FROM OTHER COUNTRIES AT PRESENT SDR 1 3/4 BN, INCLUDING SAUDI LOANS ON HIGHLY-CONCESSIONAL TERMS IN PARALLEL TO LOANS OF THE ESAF TRUST.

6 TURNING TO THE SUBSIDY CONTRIBUTIONS, THE MD REPORTED THE UK AS AGREEING TO CONTRIBUTE AN AMOUNT THAT AT EXISTING INTEREST AND EXCHANGE RATES WOULD SUPPORT SDR 1 BN OF CAPITAL. HE THANKED THE UK AUTHORITIES VERY WARMLY AND CALLED THIS A ''VERY REMARKABLE CONTRIBUTION''. (AFTER THE MEETING THE MD SOUGHT OUT ENOCH, WHO WAS ATTENDING IN MY ABSENCE, TO EXPRESS ONCE MORE HIS DEEP APPRECIATION.)

7 OVERALL, THE MD REPORTED THAT THE ESAF WAS, HOWEVER, LAGGING ON ITS REQUIRED SUBSIDY CONTRIBUTIONS. ON BEST ESTIMATES, PRESENT CONTRIBUTIONS WOULD ENABLE A SDR 6 BN FACILITY TO ON-LEND AT INTEREST RATES BETWEEN 1 1/4 PER CENT AND 1 3/4 PER CENT. HE EMPHASISED THAT THIS WAS ''TOO HIGH, TOO HIGH''. HE EXPECTED FURTHER GRANTS IN THE NEXT FEW DAYS AND STRESSED THAT HE WOULD MAINTAIN PRESSURE UNTIL SUFFICIENT GRANT WAS OBTAINED TO REDUCE THE INTEREST RATE TO 0.5 PER CENT. SOME CONTRIBUTIONS COULD, FOR BUDGETARY REASONS, ONLY BE ANNOUNCED IN JANUARY: HE MENTIONED SWITZERLAND.

8 DESPITE THE PRESENT SHORTFALL IN GRANT, THE MD ANNOUNCED HIS INTENTION TO START THE FACILITY WITH AN INTEREST RATE OF 0.5 PER CENT IN JANUARY, WITH THE UNDERSTANDING THAT THE ESAF WOULD BE REVIEWED BY END-JUNE.

9 THE MD CONCLUDED THAT IMPORTANT CHOICES WOULD BE MADE AT THE BOARD MEETING TOMORROW (FRIDAY). NO PRESS STATEMENT WOULD BE ISSUED UNTIL THE EXECUTIVE BOARD HAD MADE ITS DECISION AND EACH COUNTRY HAD SAID ITS LAST WORD. NO INDIVIDUAL FIGURES WOULD BE PUBLISHED WITHOUT A COUNTRY'S AGREEMENT. (KAFKA, BRAZIL, WAS CONCERNED THAT LATIN AMERICAN CONTRIBUTIONS SHOULD NOT BE IDENTIFIED, EVEN AS A GROUP.) THE BOARD MEETING TOMORROW WOULD SET A DATE FOR A FINAL MEETING (PROBABLY EITHER TUESDAY, 15 OR THURSDAY, 17 DECEMBER) AT WHICH THE LEGAL DOCUMENTATION WOULD HOPEFULLY BE APPROVED.

COMMENT

10 THE NEWS OF THE UK CONTRIBUTION WAS VERY TIMELY, AND EXTREMELY WELL RECEIVED. SEVERAL EXPRESSIONS OF APPRECIATION WERE MADE BY DIRECTORS AND STAFF, AS WELL AS THE MD.

11 THE SHORTFALL IN THE SUBSIDY CONTRIBUTIONS TO DATE CLEARLY WORRIES THE GERMANS AND JAPANESE, WHO ARE THEREFORE DOUBTFUL OF THE MD'S PROPOSAL TO BEGIN ON 1 JANUARY WITH AN INTEREST RATE OF 0.5 PER CENT. THEY FEAR THAT IF REQUIRED GRANTS ARE NOT FORTHCOMING BY, SAY, JUNE, THEY WILL BE APPROACHED AGAIN WITH A VIEW TO INCREASING THEIR CONTRIBUTIONS. BOTH DIRECTORS ARE LIKELY TO RAISE THIS ISSUE TOMORROW AND SEEM AT PRESENT INCLINED TO SUGGEST AN INITIAL

INTEREST RATE AROUND THE LEVEL COVERED BY THE GRANTS ALREADY MADE.

12 WHILST WE UNDERSTAND THE GERMAN/JAPANESE CONCERNS, WE SEE MERIT IN PROCEEDING AS THE MD SUGGESTS. DOING SO GIVES A STRONG SIGNAL THAT THE ESAF IS ON TRACK, AND ENABLES THE MD TO MAINTAIN PRESSURE ON OTHERS TO MAKE OR INCREASE THEIR CONTRIBUTIONS. (STAFF HAVE MADE CLEAR THAT THEY INTEND TO USE THE MAGNITUDE OF OUR CONTRIBUTION AS A YARDSTICK AGAINST WHICH THEY WILL PRESS OTHERS TO MEASURE THEIRS.) THE RISKS OF THIS STRATEGY ARE RELATIVELY LIMITED: ESAF PROGRAMMES ARE UNLIKELY TO BE AGREED SO QUICKLY THAT SIGNIFICANT AMOUNTS OF INTEREST WILL BE AT STAKE BEFORE JUNE 1988, AT WHICH TIME INTEREST RATES CAN BE RAISED IF NECESSARY.

13 OUR SUGGESTION, THEREFORE, IS THAT WE AGREE TO GO ALONG WITH THE MD'S PROPOSED STRATEGY, OF LAUNCHING THE ESAF IN JANUARY WITH AN INTEREST RATE OF 0.5 PER CENT, SUBJECT TO A REVIEW BY JUNE 1988, WHICH SHOULD INCLUDE THE POSSIBILITY OF RAISING INTEREST RATES AT THAT STAGE IF NECESSARY, AND MAKING CLEAR THAT WE WILL IN ANY EVENT NOT BE WILLING TO MAKE ANY FURTHER CONTRIBUTIONS. 1X

14 FCO PLEASE ADVANCE TO PS/CHANCELLOR, EVANS AND WALSH (HMT), WARE (BOE), T RICHARDSON (ERD) AND VERECKER (ODA).

LANKESTER

YYYY

DISTRIBUTION 9

ADVANCE 9

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ODA
PS/CHANCELLOR
MR. EVANS HMT
MR. WALSH
MR. WARE, B.O.E.

NNNN

OK as amended

FROM: H G WALSH
DATE: 11 December 1987

CHANCELLOR

cc: Chief Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Sir G Littler
Mr Cassell
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Mr Dyer
Miss O'Mara
Mr Watts
Mr Batt
Ms Life
Mr Tyrie

Mr Hyett T.Sol

Ch/ Content? (Amendments telephoned by Mr Walsh). And should this be Press Released?

Yes amended (This note)

IMF: UK CONTRIBUTION TO THE ENHANCED SAF (ESAF)

I attach for ~~comments~~ approval a draft reply to a priority written PQ put down by Mr Bowen Wells for reply on Monday, and a suggested note for editors.

H.W.

H G WALSH

to Editors &c

~~[illegible]~~

Can [illegible] @ all! grateful if ACSA w have a look @ this.

To ask Mr Chancellor of the Exchequer whether he will make a statement on the UK contribution to the Enhanced Structural Adjustment Facility of the International Monetary Fund.

The proposed enhanced structural adjustment facility (SAF) of the International Monetary Fund, which is designed

DRAFT REPLY

At ~~the September~~ annual meeting of Commonwealth Finance Ministers (in September) I announced that the UK would make a contribution to the interest subsidy associated with ~~this Facility~~ to support structural adjustment programmes in low income countries. Since then I have reviewed the UK's contribution to ~~this facility,~~ the enlarged SAF, decisions on which should be completed by the end of this month. The UK Executive Director to the IMF has now been authorised to increase ~~our~~ HMG's earlier offer ~~of an interest subsidy~~ to an ~~amount~~ interest subsidy sufficient, at present interest and exchange rates, to subsidise lending rising to 1 billion SDRs (the equivalent of £750 million). This is more than double our earlier offer.

The Facility will complement the UK's own initiative for measures to relieve the burdens of bilateral debt servicing of ~~relief to~~ these countries, which I announced last Spring in Washington and which we are continuing to press. There is increasing international recognition of the need to relieve the ~~grinding poverty and~~ debt burdens of ~~many~~ the poorest African countries, ~~through~~ provided they are pursuing sustained programmes of economic reform.

Additional funds will be made available to the Overseas Aid Programme to cover the costs of this increased contribution. The additional costs in 1988-89 will be charged to the Reserve and will therefore not add to the total of planned public expenditure.

Ch/ see telegram, behind

The prospect of this ~~This~~ additional contribution has been warmly welcomed by the IMF Managing Director and is being made on the basis that appropriate contributions will be made by other major countries and that differentially favourable access will be given to those in greatest need, especially the low-income ~~and~~ heavily-indebted countries of Sub-Saharan Africa.

NOTE FOR EDITORS

(B) The IMF's Structural Adjustment Facility was established in March 1986 to provide balance of payments assistance in the form of loans to eligible low income members in support of structural adjustment programmes. The loans involved are highly concessional, and interest is charged at ½ per cent on the outstanding balance. Repayment of each loan are made in 10 equal instalments beginning 5½ years and ending 10 years after the date of disbursement. The source of funds for the existing SAF is repayments by members of loans from the IMF Trust Fund which was funded by sales of IMF gold in the 1970s.

(A) The Venice Economic Summit this year endorsed the enlargement of the SAF to finance and encourage and help finance structural adjustment programmes in low income countries. The UK [illegible] contribution ~~of a~~ is an interest subsidy would be sufficient to subsidise lending rising to 1 billion SDRs. This is equivalent, at current interest and exchange rates, to providing the subsidy on one-sixth of the enlargement of 6 billion SDRs of the Facility, sought by the IMF.

ps3/5T

UNCLASSIFIED

FROM: J M G TAYLOR
DATE: 14 December 1987

MR H G WALSH

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir G Littler
Mr Cassell
Mr Evans
Mr Mountfield
Mr Peretz
Mr Turnbull
Mr R I G Allen
Mr Dyer
Miss O'Mara
Mr Watts
Mr Batt
Ms Life
Mr Tyrie
Mr Hyett - T.Sol.

IMF: UK CONTRIBUTION TO THE ENHANCED SAF (ESAF)

The Chancellor was grateful for your note of 11 December.

... 2. He has slightly recast the Answer as enclosed.

JT

J M G TAYLOR

To ask Mr Chancellor of the Exchequer whether he will make a statement on the UK contribution to the Enhanced Structural Adjustment Facility of the International Monetary Fund.

DRAFT REPLY

At the annual meeting of Commonwealth Finance Ministers in September, I announced that the UK would make a contribution to the interest subsidy associated with the proposed enhanced structural adjustment facility (ESAF) of the International Monetary Fund, which is designed to support structural adjustment programmes in low income countries. Since then I have reviewed the UK's contribution to the enlarged SAF, decisions on which should be completed by the end of this month. The UK Executive Director to the IMF has now been authorised to increase HMG's earlier offer to an interest subsidy sufficient, at present interest and exchange rates, to subsidise lending rising to 1 billion SDRs (the equivalent of £750 million). This is more than double our earlier offer.

The Facility will complement the UK's own initiative for measures to relieve the burdens of bilateral debt servicing of these countries, which I announced last spring in Washington and which we are continuing to press. There is increasing international recognition of the need to relieve the debt burdens of the poorest African countries, provided they are pursuing sustained programmes of economic reform.

Additional funds will be made available to the Overseas Aid Programme to cover the costs of this increased contribution. The additional costs in 1988-89 will be charged to the Reserve and will therefore not add to the total of planned public expenditure.

The prospect of this additional contribution has been warmly welcomed by the IMF Managing Director and is being made on the basis that appropriate contributions will be made by other major countries and that differentially favourable access will be given to those in greatest need, especially the low-income heavily-indebted countries of Sub-Saharan Africa.