

PO-CH/NL/0326 PT B

Part - B,

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Begins: 3/4/87.

Ends: 2/10/87.



PO -CH /NL/0326



PART B

Chancellor's (Lawson) Papers:

INITIATIVES FOR
RELIEVING INTERNATIONAL
DEBT IN AFRICA

/NL/0326

-CH

PO

PART B

DD 's: 25 years

Dr. Miller

1/11/95

From : H P Evans
Date : 3 April 1987

CHANCELLOR

*[Not to discuss when I say what]
[also complete work]
[at balance (Mans)
numbers & reviews]*

cc Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Lavelle
Mr Mountfield
Mr R Culpin
Mrs Case
Mr Walsh
Mr A Hudson
Mr Ross Goobey

Mr Lankester -
UKDEL/IMF

Mr Loehnis - B/E

DEBT INITIATIVE

I attach a revised version of the speech on debt, reflecting our discussion on Wednesday.

2. In Washington, apart from further drafting, we shall need to do some shortening of the speech for delivery (a full version can be handed to the press). The Interim Committee is the best place to launch this (speaking early in the afternoon), to be followed by a much shorter version, concentrating on SSA, for Development Committee on Friday.

HPE

HUW EVANS

UK DEBT INITIATIVE

The debt crisis hit us all in 1982. Nearly five years later we are entering a new phase : this may prove the most challenging period of all.

2. At the start of the period the credit standing of many developing countries plummeted. The international banking system was under threat. Our aim has always been to enable debtors to restore their credit standing. That way they will be able to take advantage of burgeoning international capital markets. But that could not be achieved quickly : we had to buy time.

3. In many ways, this time has been well spent. The banking system has strengthened its capital base and raised provisions. Reform programmes have been put into effect in many debtor economies : there is a greater realism about budget deficits and about interest rates; and a greater appreciation of the benefits of market mechanisms. There have been individual successes. All this despite the further pressures arising from oil price changes.

4. New policies have been put in place by the international institutions. The Fund has tried to give prominence in its programmes to the need to create the right conditions for economic growth. The World Bank's role has been enlarged, especially for policy lending.

The World Environment

5. Over this period the world economic environment has been helpful in some respects. True, there has been marked weaknesses in commodity prices. But there has also been a six point fall in interest rates; GNP growth averaging $3\frac{1}{2}$ per cent since 1982; and import growth into OECD countries averaging over 7 per cent. The fall in the dollar has meant a reduction in the burden of debt.

6. So we can take satisfaction both in the nature of the strategy that was adopted and from its case-by-case

What 2 fall since 1982?

implementation. And the full effects of some policy changes introduced have yet to come through.

Analysis

7. But despite these efforts, we cannot avoid an unwelcome conclusion : most debtors are actually further away from creditworthiness than in 1982. This has been reflected in greater difficulty in the Fund's putting together programmes and in the banks' providing new money. The evidence is as follows :-

- i) by 1986 the ratio of debt to exports in the Baker 15 group had risen from 270 per cent in 1982 to 343 per cent in 1986. The ratio of interest paid to export earnings has barely declined despite interest rates almost halving. The ratio of debt to GDP in the Baker 15 had risen from 42 per cent in 1982 to 50 per cent in 1986. The trends are the same for other groupings of debtors, and do not depend on the choice of particular years.
- ii) capital flight, as a recent IMF paper showed, has probably been at a lower rate than in earlier years; but has continued in the years since 1982 at a high level.
- iii) valuations placed on sovereign debt in the secondary markets have declined.

The message from the markets and from the banks is that it is high time to look again at the debt strategy.

8. What can we do? It is time to re-emphasise that this is a proper area for commercial and market judgements and realities. It is time to look for more ways of sharing the risks and opportunities. It is time to be more concerned with the quality of programmes. It is time to look hard at ways of helping the poorest.

Distinguishing the Very Poorest

9. We need to distinguish carefully between the very poor countries of sub-Saharan Africa and the middle income debtors. Many countries in sub-Saharan Africa, apart from being extremely poor and heavily indebted, face a range of problems : reliance on one or two commodities for export earnings, weak administration, the legacy of mistaken policies especially in industry and agriculture, and so on. Debt is mainly to governments and to the Fund and World, rather than to banks. Many of these countries have little prospect of servicing their external debt and ever gaining access to financial markets. But we should recognise that many are now implementing reform policies in difficult circumstances. ~~It is in this~~ ^{to} area of Sub-Saharan Africa ~~that~~ I shall ^{be} making the ~~most positive~~ ^{sp/2 hi} suggestions for developing the debt strategy.

Middle Income Debtors

10. For larger, mainly middle income, countries the commercial banks are the largest creditors. In the longer-term, there is a feasible route back to high credit standing and spontaneous new finance. This route is to implement reform policies and service debts. This offers the prospect of sustained growth, through full participation in world financial and trading markets.

11. We have to recognise that even where reform efforts are being made, the markets are telling us that progress is too slow. The response cannot solely be new money - that is how the debt crisis arose. Nor can we rely on a further major improvement in the world economy.

Strengthening the Strategy

12. How then can we strengthen the debt strategy, building on what has already been achieved?

- i) Make more use of market mechanisms. Secondary markets in debt, though sometimes thin, serve to illustrate the gap

between the face value of debt and reality. These markets, which allow claims to be redistributed, perform a useful function in trading financial assets. We should encourage, as a long-term goal, greater securitisation of these assets, especially when it spreads risk outside the banking system.

- ii) Look for more ways in which lenders and borrowers can share in both the considerable opportunities and risks in developing countries. Debt/equity swaps, direct investment, portfolio investment - all these are valuable. There is encouraging progress in some countries. We welcome the efforts of the International Finance Corporation as a catalyst in this area.

In time these approaches will be able to make a major contribution. But they will not be on a large scale in the short-term. We need therefore to go further in strengthening the debt strategy :-

- iii) We have seen over the past year an insidious weakening of conditionality at the IMF. Some programmes are being put in place with poor prospects of medium-term viability for the balance of payments. This is simply not in the long-term interests of debtors themselves nor of the Fund. We must resist and reverse this trend. This means that : the Fund Management must not put forward weak programmes; the Fund Board must not support them; and the official creditors in the Paris Club must not reschedule without firm assurances. This will give a clear and positive signal to the banks, already worried about loss of conditionality. With stronger policies in place, banks will be more ready to lend money. Creditor governments will play their part.
- iv) Generally, we see a growing need to re-establish and strengthen incentives for strong reform policies in countries seeking Fund/Bank assistance. The obverse of this is that countries which reject such policies cannot

expect to re-establish their creditworthiness with external financial help.

v) Finally we need to recognise the enormous problems and special claims of sub-Saharan Africa. I propose that the main creditors, initially in the Paris Club, should consider changing their approach to a group of countries with both very low incomes and high debt burdens. For this group, and in conjunction with appropriate World Bank and Fund programmes, we need to go beyond generous rescheduling. The new approach has four main elements :-

*Bank banks
Paris Club
reschedule
sub-Saharan
(the 20 or so
countries...)*

(1) Countries in this group will need to reinforce their reform policies, with agreement case-by-case on Bank and Fund programmes.

(2) We shall need to consider the special problems posed by large repurchases due to the IMF from some countries [for example, we may need to study the possibility of rescheduling IMF debt].

(3) Governments will look to commercial banks to play a constructive role.

(4) Creditor governments should start with conversion of aid loans to grants - a process the UK has largely completed. The UK will also consider rescheduling on longer-term maturities. Finally, and most important of all, the UK will consider - for Paris Club debt and on a multilateral basis - reducing interest rates to well below market rates.

*debt
repurchase
(some of the
debt...)
(there was a
policy mistake,
was to reduce
interest rates...)*

Conclusion

13. Let us now seek together to strengthen the debt strategy. Mistakes have been made by all parties and costs have been incurred. There are no easy solutions. These costs cannot be

SUB-SAHARAN DEBT

Cathy Ad you get
SING or Moutfield or Case
onto this 1st thing?

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 5422
GTN 215
(Switchboard) 01-215 7877

Ch/Pps with you
Duk
6/4



Secretary of State for Trade and Industry

[Handwritten signature]

6 April 1987

*
Not made
helpful.
Butter be
off a share
massive
under 15
Thurs
type
fly out

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER	
REC.	6 APR 1987
ACTION	Sing Kuttler
COPIES TO	CST EST Sir B Middleton Sir T Bluns Mr FER Butler Mr Cassell Mr Moore Mr H Evans Mr Moutfield Mr Turnbull, Mr Walsh Mrs Case Mr Culpin Mr Ross Gookey

Dear Nigel:

SUB-SAHARAN AFRICAN DEBT

Thank you for sending me a copy of your letter of 31 March to Geoffrey Howe.

I agree with your analysis leading to the conclusion that the prospects of the so-called Sub-Saharan debtors being able to repay or even service their debt in the foreseeable future is very slim indeed. I accept that a strong case exists in humanitarian and political terms for affording them relief, and that there are strong arguments that commercial realism also points in this direction.

However, I am worried about two points in particular. First, although you recognize the importance of designing an adequate "ring fence" to ensure that any concessions are given only to those debtors that we judge really deserving, there must surely be a high risk that whatever we do will have spill-over effects in the wider field. It would be sanguine to believe that special concessions for the Sub-Saharans, however carefully this group is defined, will not be used by some other debtors to justify a more intransigent attitude on their part. We need to be as sure as we can that we are not launching ourselves on a slippery slope.

Second, the cost of even the limited relief that you are proposing could be serious for ECGD. In discussions between officials, I understand that it has been indicated that Treasury might be

JF5BVU



agreeable to treating the cost of special interest relief as direct public expenditure and so protecting the ECGD Trading Account. This is a matter of great importance from my point of view and needs to be taken into account in the further study you propose asking officials to undertake.

I believe we must ensure that we have satisfactory answers on these two points before taking a final decision to go ahead with specific measures.

I am copying this to the other recipients of your letter.

ms,
Paul

PAUL CHANNON



8

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

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

7 April 1987

SUB-SAHARAN AFRICAN DEBT

Thank you for your letter of yesterday, which I thought I should answer before going off to Washington later this morning.

I understand the points you make. There must of course be some risk of pressure from all debtors to be given any concessions offered to any of them. But I am satisfied that there is a sufficient political as well as financial recognition of the special Sub-Saharan group - reinforced by their having had a degree of exceptional treatment in the past - for us to "ring fence" those countries for the purposes of this particular initiative.

On cost, I have already asked my officials to examine the most sensible options and discuss them with ECGD. There is bound to be a period of intensive international discussion before any ideas in this area are agreed and implemented. I shall want to make sure that we are agreed on domestic arrangements before we reach specific agreements internationally.

I am copying this letter to Geoffrey Howe, Robin Leigh-Pemberton and Sir Robert Armstrong.

NIGEL LAWSON

DRAFT LETTER TO:-

Secretary of State for Trade and Industry
c.c. Foreign Secretary
Governor, Bank of England
Sir Robert Armstrong

ch/ Letter to issue?
OK as
answer
(we have in discussion as all right!)
2/4

SUB-SAHARAN AFRICAN DEBT

Thank you for your letter of yesterday, which I thought I should answer before going off to Washington later this morning.

I understand

~~The points you make are well taken here.~~ There must of course be some risk of pressure from all debtors to ~~take advantage of~~ *be given* any concessions offered to any of them. ~~And we cannot exclude having to face losses elsewhere at some stage.~~ But I am satisfied that

there is a sufficient political as well as financial recognition of the special Sub-Saharan group - reinforced by their having had

a degree of

~~some exceptional treatment in the past - for us to "ring fence" those countries for the present, and to take as a separate future decision any loss by force majeure or deliberate concession we might have to face elsewhere.~~

The purpose of this particular initiative.

3. On cost, I have already asked my officials to examine the most sensible options and discuss them with ECGD. There is bound to be a period of intensive international discussion before any ideas in this area are *agreed* implemented. I shall want to make sure that we are ~~at one on our own technical~~ *agreed on domestic* arrangements before we reach specific agreements internationally.

4. Copies as before. I am copying this letter to Geoffrey Howe, Robin Leigh-Pemberton and Sir Robert Armstrong.

CONFIDENTIAL

RD

FROM: A P HUDSON
DATE: 7 April 1987

CHANCELLOR

cc: PS/EST
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Lavelle
Mr Mountfield
Mr Culpin
Mr Walsh
Mrs Case
Ms Life
Mr Pitcairn
Mr Dolphin
Mr Ross Goobey
Mr Allan

DRAFT SPEECH ON DEBT INITIATIVE

... I attach a revised version of the speech on debt. This incorporates comments from Messrs Cassell, Mountfield, Allan, Pitcairn, Kuczys, and Ms Life. I am most grateful to Mr Mountfield and Ms Life, in particular, for some rapid fact-finding yesterday.

A P HUDSON

REVISED DRAFT OF CHANCELLOR'S SPEECH ON DEBT INITIATIVE**Background**

1. It is now nearly 5 years since the debt crisis broke. These meetings provide an opportunity to take stock of how we have coped with it, and how policy should develop in the future.

2. In 1982 the position was very serious indeed. The credit standing of many developing countries plummeted. There were worries about the stability of the international banking system and about the possible repercussions on the world economy itself.

3. The immediate need was to buy time, with the aim of putting the finances of developing countries on a sounder footing, and reducing the vulnerability of the banking system.

4. Over the past 4½ years, a good deal has been achieved.

- Many debtor countries have implemented reform programmes, and are now pursuing policies which will lead to a sustainable solution to their debt problems. In particular, a number have come to appreciate the benefits of letting

markets work ^{more} freely, and of bringing their budget deficits under control.

- The international institutions have become more closely involved. The Fund has played an important role in stressing the need for countries to pursue more sustainable policies. And the World Bank has expanded its activities, particularly in lending that is tied to the pursuit of sound policies.
- The banking system is ^{in better shape,} ~~stronger,~~ as banks have strengthened their capital base and increased debt provision.

5. A further step forward is that ~~in most respects,~~ the world economy is healthier than in 1982. Growth in the major seven countries has averaged $3\frac{1}{2}$ per cent a year since then, compared with less than $2\frac{1}{2}$ in the previous decade, and inflation in 1986 stood at 2 per cent, compared to 7 per cent in 1982.

6. Although many developing countries have suffered from the marked fall in commodity prices, with some acutely affected by the collapse of the oil price, most have stood to benefit from the faster growth of imports into OECD countries. The cost of servicing debt has been reduced by the fall in dollar interest rates, which are now 6 points lower than in 1982.

7. These developments mean that the world economic background is now more favourable than it has been for some time, with continued growth forecast in both GNP and ~~imports~~ ^{trade} for major countries.

8. Thus it is clear that the original strategy adopted in 1982 has achieved at least its ~~short-run~~ ^{medium-term} objectives. And the case-by-case strategy has brought a number of successes. The question is how we take forward the solution of the debt problem.

Analysis

*But let us not delude ourselves.
The debt problem remains acute.*

9. The long term objective has always been to help the debtor countries to regain the ability to service their debt - that is, to generate, on a sustainable basis, sufficient income to cover their interest payments abroad. That way, they can restore their credit standing in the international capital markets.

*+ capital
sometime?*

10. But the plain fact is that most debtors are actually further away from creditworthiness than in 1982.

- The ratio of debt to exports in the Baker 15 countries has risen, from 270 per cent in 1982 to 343 per cent last year. And in spite of the fall in interest rates, the ratio of interest paid to export earnings has barely declined.
- The ratio of debt to GDP has also risen, from 42 per cent in 1982 to 50 per cent last year.

- Capital flight, which damages the growth prospects of developing countries, has continued at a high level. For countries with recent debt-servicing problems, the IMF estimate that capital flight fell only very slightly from an average of \$17 billion a year in the three years before 1982 to an average of \$16 billion in the three following years.

The markets are putting a much lower valuation on the debts of the problem countries. One source [Institutional Investor] shows that, comparing 1981 with 1986, Brazil's rating fell from 49 to 35, and Mexico's from 69 to 31. In 1982, the [unweighted] average of the Baker 15 was actually one point higher than that for all countries - 49 against 48; but by 1986, the Baker 15 had fallen to 26, and the overall only to 41.

- These problems have been reflected in the greater difficulty which the Fund has had in putting together its programmes, and in the reluctance of the banks to provide new money.

11. Thus although the debt strategy has succeeded in its short-run objectives, it is no nearer to the ultimate aim of bringing the debtor countries back into the world's financial markets. It is therefore time for a reassessment of how far that aim is realistic, and what policies we should now adopt.

Middle income debtors

12. ~~For the larger, middle income debtor countries, I think that there is a feasible route back to high credit standing and hence new finance from the market, in the longer term.~~ But there is no easy way for these countries to achieve this. *It is clear that return to genuine creditworthiness, for I have seen* Providing them with new

finance without any changes in their policy stance would be counter productive - that is how the debt crisis arose in the first place. And we cannot rely *Simply* on a further major improvement in the world economy - indeed, the strategy needs to be robust enough to cope with the inevitable cyclical fluctuations.

The way forward is therefore for the debtor countries themselves to implement reform policies and service their debts, so as to achieve sustained growth and a better trade performance, and thus regain the confidence of the financial markets.

13. This is the strategy we have been pursuing since 1982, and it has brought a number of successes in individual cases. But as I have demonstrated, not enough progress has been made. We need to strengthen the way the strategy is implemented.

Moreover,

14. I have become increasingly concerned over the past year at the insidious weakening of conditionality at the IMF. Some of the new programmes have very little prospect of bringing about the necessary adjustments in the countries in question. This is not in the interests

This is the weakest bit: the earlier analysis leads the reader to expect more than this - which is essentially mixture as before (+ all down to debtors)

of debtors themselves, nor of the Fund, and the trend must be reversed. I hope that the Fund Management will ~~consistently incorporate firm conditions~~ ^{always insist on adequate adjustment instruments} in its programmes in future. ~~The Fund Board should only support programmes which include such conditions.~~ ^{and I include here supply-side improvements.} ~~And the~~ ^{of the kind.} creditors in the Paris Club should not reschedule a country's debt repayments without firm assurances that the appropriate policies are in place.

15. In short, we need to strengthen the incentives for countries seeking assistance from the Fund or the Bank to implement strong reform policies.

16. ~~In the longer run,~~ ^{As an integral part of this,} I should like to see more use made of market mechanisms, ~~to help to reduce the risk of the debt problem turning into a crisis.~~

- ~~The~~ ^{can usefully} secondary markets in debt ^{spread more widely.} allow claims to be redistributed. ^{therefore} We should ~~encourage~~ ^{encourage} as a ~~long-term goal,~~ greater securitisation of creditors' assets, especially where this spreads risk outside the banking system, ^{altogether.}
- Lenders and borrowers can engage in more direct forms of partnership. Debt/equity swaps, direct investment, and portfolio investment are all valuable, and I welcome the efforts of the International Finance Corporation here. The UK is second only to the United States in the scale of its annual direct investment in the developing countries. ~~Much of this is, of~~

This is positive proposal & should be brought forward

course, by the private sector, but the Commonwealth Development Corporation has played an important catalytic role.

The very poorest countries - Sub-Saharan Africa

17. That, then, is the way forward for the middle income debtor countries.

But I have to say this.

18. ~~But we have to recognise that it is simply not viable for the very poor countries of sub-Saharan Africa, [mainly those countries covered by the World Bank's Special Facility arrangements].~~

this process cannot

or applies to

The first characteristic of these countries is their grinding poverty - their GNP per head is typically less than \$350. And they are also heavily indebted, with debt per head at about \$250. ~~Economic growth is sluggish, and many of the countries are reliant on one or two commodities for their export earnings and have suffered from the fall in commodity prices.~~ It is true that many of ~~the~~ ^{their} problems result in part from ~~past~~ ^{these} errors in industrial and agricultural policies. ~~But~~ ^{But improvement, almost necessary -} a growing number of countries have recognised the need to follow more sensible policies and are working more closely with the Fund and the Bank.

most of it official.

with it or through

19. The UK has almost completed the process of converting our aid loans to Sub-Saharan Africa into grants, and I urge other creditor Governments to help in this way, as many are already doing. We have also consistently argued in the Paris Club that these

outgoing

countries need special treatment, and have helped to formulate the proposal for longer repayment periods.

20. But these measures do not go far enough to enable the sub-Saharan countries to put their economies back on a sound footing.

21. I therefore propose a new method of assisting these countries. The key problem, in many cases, is that the interest rate on their debt is simply too high for them to pay. It therefore tends to be capitalised, so that the total debt actually mounts faster than the countries' capacity to pay it. I therefore propose that creditor countries should join together to reduce the interest rate on this debt to well below market levels, to give these poor countries the chance to start to reduce their overall burden - in short, to provide them with some light at the end of the tunnel. But this concession should apply only where countries are pursuing appropriate reform policies.

Could use a few
- figures here
- continuous
- compounding
etc.

very

very a few priority points

I must make it clear that

22. I hope that all creditor countries will consider this proposal very seriously, and that the commercial banks will also play a constructive role. We need to act together, in partnership with the countries themselves.

This three-point is a recognition of reality. 16 Apr

23. My proposal recognises the economic reality facing the sub-Saharan countries, in a way that best enables them to make progress in reducing the debt burden. But,

which was expressed in the Paris Agreement and assisted the African Development Bank

more important, there is ~~an~~ obligation on us to help this group of countries which are simply too poor to recover by themselves.

** **

** who wants it?*

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FM FCOLN TO PARIS
161300Z APR
GRS 377

RESTRICTED
FM FCO
TO PRIORITY PARIS
TELNO 212
OF 161300Z APRIL 87
INFO ROUTINE UKDEL IMF/IBRD WASHINGTON

X *to the court.*
At the time of the report
to the court. I was not at a pos-
Balladur (except discuss
but I did go to London
Review - one of the Balladur's
did discuss the G5
Balladur's
did not discuss the
gives us).

SUB-SAHARAN AFRICAN DEBT

UKDEL IMF TELNOS 1 - 2 TO MOGADISHU

1. THE CHANCELLOR'S INITIATIVE ON SUB-SAHARAN AFRICAN DEBT WAS WELL RECEIVED IN LAST WEEK'S INTERIM AND DEVELOPMENT COMMITTEE MEETINGS IN WASHINGTON, PARTICULARLY BY THE DEVELOPING COUNTRIES. BUT IT STOLE SOME OF THE ATTENTION FROM BALLADUR'S PROPOSALS TO HELP THE POOREST AFRICAN COUNTRIES BY ALLOWING THEM MORE FAVOURABLE TERMS UNDER THE IMF'S COMPENSATORY FINANCING FACILITY, AND BY SETTING UP A NEW CONCESSIONAL WORLD BANK FACILITY.

2. THE CHANCELLOR GAVE BALLADUR A FULL PREVIEW OF WHAT HE PROPOSED TO SAY, BOTH AT THE INFORMAL ECOFIN AND AT THE G5/7 MEETINGS IN WASHINGTON. MOUNTFIELD, HMT WILL TRY TO SPEAK TO THE FRENCH BEFORE THE PARIS CLUB'S RESTRICTED MEETING ON SUB-SAHARAN AFRICA ON 24 APRIL TO SET THE RECORD STRAIGHT IF NECESSARY. THERE REMAINS THE RISK, HOWEVER, THAT WE MAY INADVERTENTLY HAVE UPSET THE FRENCH.

3. IT IS NOT IN OUR INTERESTS TO DO SO, NOR DO WE WANT TO. WE AND THE FRENCH HAVE MORE INTEREST THAN MOST OTHER PARIS CLUB MEMBERS IN PROMOTING A SCHEME TO HELP THE POORER AFRICAN COUNTRIES. WE HAVE GREATLY VALUED FRENCH CHAIRMANSHIP OF THE CLUB. WE SHALL OF COURSE CONSIDER THE FRENCH PROPOSALS

X

RESTRICTED

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CAREFULLY. AS YET THERE IS, HOWEVER, LITTLE SUPPORT FOR THEM:
AND ALTHOUGH WE LACK DETAILS OF BALLADUR'S PROPOSALS, WE HAVE
SERIOUS RESERVATIONS ABOUT COMPENSATORY FINANCING FOR THE
AFRICANS ON CONCESSIONAL TERMS, WHICH GOES AGAINST THE BASIC
PRINCIPLES OF THE FUND'S CFF THAT FUNDS ARE MADE AVAILABLE TO
OFFSET (AT LEAST IN PART) TEMPORARY FLUCTUATIONS IN COUNTRIES'
EXPORT EARNINGS. THE RISK OF AN OPEN-ENDED CONCESSIONAL FACILITY
IS THAT THE COUNTRIES WHO DRAW ON IT WOULD HAVE NO INCENTIVE TO
MAKE THE NECESSARY ADJUSTMENTS TO THEIR ECONOMIC POLICIES.

4. YOU SHOULD NOT RAISE THE MATTER YOURSELF, BUT IF QUESTIONED
SHOULD STRESS OUR COMMON INTEREST IN WORKING IN THE PARIS CLUB
FOR A SCHEME WHICH WILL FIND GENERAL FAVOUR AMONG CLUB CREDITORS
AND WHICH WILL HELP THE POOREST AFRICAN DEBTORS. THERE ARE NO
DIFFERENCES BETWEEN US ON THE BASIC OBJECTIVES.

HOWE

OCMIAN 9192

NNNN

YYYY

MAIN

MONETARY

ERD

Cathy

GRS 140

CONFIDENTIAL

CONFIDENTIAL
FM TOKYO
TO PRIORITY FCO
TELNO 327
OF 210830Z APRIL 87

*For let us
have a multi-lateral
discuss of
point, with
options.*

YOUR TELNO 278 : SUB SAHARAN AFRICAN DEBT

1. THE MFA WAS GRATEFUL FOR PRIOR INFORMATION ABOUT THE UK DEBT-RELIEF SCHEME (PARA 2 OF TUR). AT PRESENT THE JAPANESE FEEL MORE ATTRACTED TO THE FRENCH SUGGESTION (DETAILS NOT KNOWN) THAT THE MEASURES TO BE TAKEN INCLUDE NOT ONLY BILATERAL DEBT BUT ALSO MULTI-LATERAL DEBT. THIS PACKAGE APPROACH WOULD HELP DEFUSE THE PROBLEMS OF AFRICAN DEBT REPAYMENT THE IMF AND WORLD BANK ARE NOW FACING.

2. THE JAPANESE BELIEVE THAT THE MEETING ON 24 APRIL WILL NOT BE ENOUGH TO HAMMER OUT DETAILS OF THE NEW INITIATIVES, AND THAT A SECOND MEETING WILL BE NECESSARY.

WHITEHEAD

YYYY

TYHPAN 1527

MONETARY
ERD
FED

*Mounfried is doing a note
early next week reporting
back on some meeting he is
at tomorrow.*

*+ I assume this
means IMF/World
Bank drafts.*

TOKYO
TEL.
327
21/4

CONFIDENTIAL

** B. India, it will be
struggle & have a
situp on when we
sh with both programs
+ an audit of eg
for a unit.*

NB DO NOT Return to divisional files!!

Ch
I suspect this means it was Mountfield

AA & a memo n..

purp

From: Sir G.Littler
Date: 23 April 1987

MR ALEX ALLAN


AA

c.c. Mr Lavelle
Mr H.P.Evans
Mr Mountfield
Mrs Case
Mr Walsh
Miss Life

SUB-SAHARAN AFRICAN DEBT

Thank you for your minute of 22 April about Telegram No 612 to Paris. As you say, this was incorrect - Ballardur was not told either at Knokke or in the G5. The mistake arose from misreading of the fact that Sub-Sahara was mentioned in Knokke and that some press reports seemed to anticipate your own proposals. I have been in touch with Garside in Paris and the FCO to correct the message: I gather that fortunately none of our people in Paris had had occasion to discuss this with French contacts and therefore the mistake went no further.

2. I had a call from Schneiter of the French Embassy here, during which he expressed surprise that you had not disclosed your proposals at Knokke. He put this as a personal comment, low-key. I said that you had not wanted to launch the idea ahead of the Washington meetings. One consideration had been anxiety to avoid the risk of an immediate and adverse U.S. reaction: I told him you had spoken to Baker privately before the G5 and asked him - and successfully as it turned out - not to reject the idea out of hand. Schneiter took this very calmly, and we went on to agree that the important thing was the joint UK/France recognition of the need to alleviate the high cost of debt for certain countries, and that we should cooperate on this in the Paris Club, etc.


(Geoffrey Littler)

indebted', with special reference to the UK's preferred 'interest/exports' ratio; adjustment to be demonstrated by commitment to an SBA and/or SAF or SAL (to put debt relief in the context of long-term recovery plans). It was clever of the French to start here, because it got people talking about substance without wasting too much time recording reservations about the policy.

(b) **FORM OF RESCHEDULING.** I got it widely accepted that we would have to proceed by way of a formal Paris Club settlement for each potential applicant (important if there is to be genuine burden-sharing; I quoted your speech, to make it clear that we are not making a unilateral gesture, but giving a lead for concerted multilateral action. This will have to include, in most cases, reconsolidation on the new terms of previously-rescheduled debt (because some figures modelled by the Bank of England demonstrated clearly that operating on new debt maturities alone doesn't produce enough relief to make a big difference).

(c) **INTEREST RELIEF.** A clear split here, on the most important aspect. USA remains opposed at present (though I have hints from Washington that they are thinking about it very hard; they can't fault our analysis, but are doubtful about carrying any new measures through Congress. The danger is that Congress might simply subtract the costs from the total Aid Budget), Japan is 'still thinking', but I guess will join us if they see a bandwagon developing. FRG is likewise 'still thinking', and will have budgetary problems; but I got very favourable signs. (They should decide in the next two weeks). The surprising news is that France is almost ready to join a consensus - while still preferring their own proposal for a new IBRD refinancing facility funded by voluntary contributions. I took a lot of trouble to mend fences with France, but the real reason for their change seems to be that they have an unexpected underspend on their Aid Budget which can be used to fund the first year or so of an interest relief scheme. The rest divided into 'pro'

(Sweden) and 'probably pro' (most smaller Europeans); and doubtful (Italy, Switzerland; Belgium). The key to all this is the US: if they won't play, the operation won't work.

42 | **WHERE NEXT?** The 'Chairman's Summary' doesn't bind anyone, but it notes that these points will be considered by all parties in the run-up to the OECD Ministerial, the Summit, and UNCTAD. Thereafter France intends to call another working meeting, probably in September, to finalise a scheme which can be endorsed by the Annual Meetings. I have privately urged the World Bank to revive Stern's proposal for a further meeting under their auspices, or the Fund's to consider parallel action (eg form of conditionality; long-term debt profile analysis; what to do about debt owed to the IFIs themselves; and incidentally, to put paid to the French proposal for an IBRD facility - which no-one but Belgium supported).

UK ACTION? We must obviously keep up the pressure. You may want to revert to the theme at the next ECOFIN, particularly if the Germans have made up their minds by then. Mr Walsh has already given the FCO some draft language for the OECD Communique, and you will probably want to give this a push in your speech there. Sir G Littler will be able to advise on how to play this at Venice, but once again some Communique language would be useful. We can deal with UNCTAD a bit later on. There may be other bilateral and G5/G7 opportunities to move the operation on, but we don't see any immediate ones.

PUBLIC EXPENDITURE AND ACCOUNTING ARRANGEMENTS. I owe the Chief Secretary a report on these aspects; this will follow an internal meeting Mr Lavelle is to hold shortly. Meanwhile the Chief Secretary will see how difficult it is to quantify the costs at this stage, when so many parameters remain unsettled. But we can let him have some illustrative figures. Incidentally it now looks (ODA tell me) as if we shall be able to score the costs as Aid in the international league tables, however we treat them domestically.

COMMONWEALTH ASPECTS. Meanwhile the FCO is understandably anxious to coin as much political kudos as possible from your initiative. (Inevitably the Commonwealth Secretariat wants to get in on the act too; but Sir Peter Marshall is for once trying to be helpful). Both parties have suggested that it would help to buy friends if you were to write to Commonwealth African finance ministers, enclosing your speech and assuring them that we are pressing ahead with your proposals. (You can't be very specific, but you can convey a generally-helpful impression.) As part of the run-up to CHOGM, this seems a sensible move, and I attach a draft. If you approve, this can be sent by telegram to posts, with instructions to deliver.

I don't think any further Ministerial action is needed at present; we shall report progress as we go along.

R1

P MOUNTFIELD



Ch

You asked for a meeting on debt. We have arranged this for tomorrow, so as to get the discussion in before OECD. Can you confirm you still want to go ahead?

AWK

7/5

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man
Council @
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...



FROM: A P HUDSON
DATE: 28 April 1987

(with debt papers, pl.)

CHANCELLOR

POSSIBLE SPEECH ON DEBT INITIATIVE

At Prayers on Friday, you said that you wanted to make a speech very soon to give more publicity to the debt initiative.

2. The only existing opportunity in the near future is at dinner with Battersea Conservative Association next Wednesday (6 May). This is, of course, the day before the local elections, and you might want to use the occasion for something different, eg a short piece on how well the economy is doing, or comparisons between local authorities in Battersea (Lambeth) and Wandsworth. But you could perfectly well use it as a peg for a press release on debt.

3. I take it you will want to keep the arguments pretty simple, and stress two points:

- this is a UK initiative;
- and it will be of real help to the poor countries of Sub-Saharan Africa.

It would, as always, be helpful to have something new to announce. I suspect the most eye-catching thing would be the likely cost to the UK of the initiative, though officials might not welcome this!

... 4. I attach a first shot at an outline. If you are interested in delivering the speech on 6 May, it would be helpful to have a discussion very soon - I have spoken to Alastair, but not to others so far.*

* Peter Mountfield has since rung. I explained the broad line of the speech, but didn't mention the possibility of quoting a cost.

APH

A P HUDSON

APH

Thanks. outline (subject to an) for deletion! I stress with a news client for a time of what has happened since last night - a set of cuts in child response for gov (see Brummie press!) push to the occasion: for work big hand on spec.

UNCLASSIFIED

● **OUTLINE OF SPEECH ON SUB-SAHARAN AFRICA**

1. A few weeks ago, in ~~international meetings~~, I launched an initiative to assist countries in sub-Saharan Africa (SSA) to deal with their economic problems.

2. 2½ years ago, the problems of SSA touched the heart of the British people. Drought, famine, etc.

3. Remarkable generosity shown. ~~[Mention work of Bob Geldof?]~~ And Government played its part in alleviating the immediate crisis.

4. But job of Governments is to look beyond immediate crisis. Need to help countries to help themselves, and find way back to sustainable economic progress. "Give a man a fish, and you feed him for a day; teach him to fish, and you feed him for life".

5. Much depends on countries themselves. But have to help where we can. One such area is debt.

6. UK already has a good record - converted loans into grants. But recognised, still not enough. Without some further action, debt problem will get worse.

7. Therefore launched initiative. Three point plan:

- All countries to convert loans into grants;
- Longer repayment periods, and generous grace periods;
- Completely new feature: reduced interest rates.

All to apply only where debtor countries pursue appropriate policies.

8. Initiative important, because gets to heart of problem. ~~And would give real and direct measure of help - for example, could cost Government £X million a year.~~

9. Clear this is right thing to do. Now working urgently to persuade all creditor countries to join in programme.

UNCLASSIFIED



FROM: A P HUDSON
DATE: 30 April 1987

CHANCELLOR

PUBLICITY FOR DEBT INITIATIVE

You wanted a piece of paper to give to MPs about the debt initiative. I have had a quick word with Robert about this.

... 2. I attach the section of the Interim Committee speech. You could shorten it by omitting the first paragraph, if you wish.

3. The options for circulating it seem to be a letter from you to every Tory MP, or a letter from Peter Lilley to those whom we reckon will be interested. Which do you prefer?

Handwritten in red ink:
The latter, please.

A P HUDSON

FROM: ROBERT CULPIN
DATE: 30 APRIL 1987

CHANCELLOR

*Thanks. I had
missed the Brummer
Enclosure. I agree
with X.*

cc Chief Secretary
Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Lavelle
Mr H P Evans
Mrs Case
Mr Walsh
Mr Hudson
Mr Ross Goobey
Mr Pickford (or)

TAKING CREDIT FOR THE DEBT INITIATIVE

Mr Evans told you that you would win a Guardian award for your debt initiative. Here it is - in the Brummer piece you missed over Easter.

X | 2. I think the best thing to do next is for Peter Lilley to send a one-page extract from your Interim Committee speech to those MPs who might be interested. The letter might be addressed to some luminary and copied round. Andrew Hudson is giving you a text. (below)

3. We will certainly have an EPR article, when we next have an EPR.

4. And you will have to plug away on the international circuit, most obviously at the OECD and the Summit. We can use those jamborees as pegs for re-advertising the initiative. (Maybe the meetings will be covered by journalists who weren't in Washington.)

5. It doesn't look as if anything much will happen, in public, much before the Autumn Fund meetings. Between now and then, it will largely be a matter of re-running the initiative and mustering support for it. We should be able to get some mileage out of that.

Rc

ROBERT CULPIN

Encs

THE GUARDIAN

Loan "ranger"

THERE ARE few more austere finance ministers in the West than the Chancellor, Nigel Lawson. When it comes to the debts of developing countries Mr Lawson is normally the first man in the committee room arguing for strong economic discipline with the same enthusiasm as he has battered down the financial hatches in Britain.

It was, therefore, a severe shock when Mr Lawson arrived at this spring's gatherings of the IMF and World Bank carrying the kind of radical proposals for sub-Saharan Africa which one normally associates with the group of 24 developing countries. Even Britain's own permanent delegation to the IMF and World Bank were taken by surprise.

The Lawson proposal is genuinely radical. As well as taking on board traditional solutions, such as the conversion of official loans to Africa into grants, it introduced the fresher concepts of interest rate concessions and stretching out of debt re-scheduling for troubled African countries. Under the Lawson interest rate proposal, some 15-20 sub-Saharan African countries, which have taken steps to introduce economic reforms, would qualify for a three-point below market interest rate. This, it is estimated, would cost the British taxpayer some £40 millions a year and the industrial countries as a block some \$250 millions annually.

Mr Lawson's motivations are a puzzle. While Britain has always maintained a special interest in Africa, dating from colonial times, the Thatcher government until now has shown only marginal interest in the cause. Certainly, it has never before so graphically described the "grinding poverty" of the continent.

It would also be too cynical to argue, as at least one sceptical Washington observer did, that it was a grab "for the liberal vote." More likely, however, is that now Mr Lawson has stabilised the UK's financial position (at the cost of high unemployment), he believes that Britain can use its position in the inner-councils of the group-of-five and group-of-seven industrial countries to make a gesture towards a region which everyone agrees is heading for disaster.

Almost as interesting as the proposal itself is the speed with which it was taken aboard during the Washington deliberations. The policy-making Interim Committee of the IMF pledged in its final communique "as a matter of priority to consider means for granting exceptional financial relief . . . particularly in sub-Saharan Africa."

Indeed, by the end of the spring meetings, Western Governments were beginning to outbid each other in efforts to help Africa. The French, for instance, unveiled their own four-point plan incorporating the longer rescheduling proposal of Mr Lawson and adding an extra dimension — the use of IMF commodity price fund to compensate African countries. Even the frugal Japanese may be prepared to spend some of their huge surpluses in this area. The Japanese Prime Minister, Mr Nakasone, has signalled that he will unveil a \$10 billions foreign aid plan.

The consensus that something has to be done in sub-Saharan Africa has been a long time coming and there are still obstacles in its way. Proposals, for instance, that 45 per cent of the resources of a strengthened International Development Association be spent in Africa have been accepted. But footdragging by the US Congress and other industrial countries, who insist on "burden-sharing," mean that, in spite of the debt and economic emergencies in the region, funds will probably not be as forthcoming as hoped.

Alex Brummer

FINANCIAL TIMES

Japan plans big loans to Latin America

JAPAN plans to lend up to \$30bn (£18.4bn) to Latin American debtor countries, as part of a policy of taking a broader role in the world economy, a special envoy of Mr Yasuhiro Nakasone, the Japanese Prime Minister, said yesterday, Reuter reports from Washington.

Mr Shintaro Abe, former foreign minister, said in an interview, published in the Washington Post, that the funds would be taken from surpluses Japan has earned in trade with other countries.

Tensions have risen over Japan's large trade surpluses, and the US has urged Japan to play a greater role in the international economy.

The Japanese loans — over three years — are seen as a part of Mr Nakasone's reaction to the US call. Japan is also planning to stimulate its domestic spending, so as to draw in additional foreign goods.

"I hope the new scheme will be seen in its broader context of Japanese-US co-operation in coping with international problems," Mr Abe was quoted as saying.

He said the Japanese government would guarantee some of the loans through its Export-Import Bank, and the money would not be tied to purchases of Japanese products.

Daily Telegraph

Japanese to lend \$30,000m

By Anne Segall, Economics Correspondent

JAPAN yesterday announced plans to lend debt-ridden South American countries \$30,000 million (£18.5 billion) over three years as part of a programme to recycle its huge trade surpluses.

The money will be provided in the form of untied credits, which will allow countries like Brazil, Mexico and Argentina to expand their economies after several years of austerity caused by crippling international debts.

The Japanese initiative was announced in Washington by Mr Shintaro Abe, a former foreign minister, who is acting as special envoy for the Japanese Prime Minister, Mr Yasuhiro Nakasone.

Mr Nakasone is expected to confirm the plan and provide further details when he arrives in Washington next week for talks with President Reagan aimed at defusing international trade tensions.

The Americans recently hit Japan by imposing 100 per cent duties on \$300 million (£185 million) worth of imported consumer electronic goods.

Major campaign

The Japanese have mounted a major campaign to persuade the Americans to reverse their trade sanctions, but so far with little effect.

Yesterday's news of a direct funding programme for the world's biggest debtors is being interpreted as an attempt to convince the world that Japan is taking its financial responsibilities seriously.

The Japanese initiative will be seen as a major breakthrough for developing countries and their creditors, including American banks, with bank shares already reacting euphorically in late trading yesterday.

20/1.

8/85

CONFIDENTIAL

FROM: MRS A F CASE
DATE: 5 May 1987

- Some manuscript changes M 5/5
1. MR LAVELLE
 2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Evans
Mr Mountfield
Mr Peretz
Mr Culpin
Mr Pitcairn
Mr Lankester

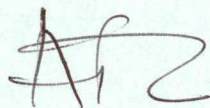
Ch
OK for me to write as below? With a postscript recording the latest news from Zambia (see separate folder)?
AWK
S/S

INTERNATIONAL FINANCIAL SCENE

I attach the latest report to No 10 from your Group on the international debt.

2. As well as reporting developments at the Washington meetings and subsequently - particularly on the Sub-Saharan initiative - the draft letter picks up the latest information from Brazil on the intentions of the new Finance Minister, which seem to be hopeful.

you psr (an →)



MRS A F CASE

CONFIDENTIAL

A type
for my 52

~~DRAFT~~ LETTER TO No 10

cc DTI
FCO
Bank of England

Charles Powell Esq
10, Downing Street

INTERNATIONAL FINANCIAL SCENE

I attach the regular report on developments in the international debt scene.

2. Since our last report at the end of March the Interim and Development Committee meetings have taken place in Washington. These meetings were dominated to a great extent by the problems of world growth, imbalances and exchange rates. The world economic prospect was generally ^{judged} ~~acknowledged~~ to be less buoyant than assumed at the time of the annual meetings, ~~Current forecasts are rather worse than the outlook~~ ~~we were assuming even as recently as the Budget,~~ with a greater chance of adverse developments than ^{of} improvements ^{eg} upward pressure on US interest rates and slower than expected growth in Germany and Japan.

3. On debt, the meetings confirmed the growing perception of weaknesses in the present strategy. ~~but did not lead to the formulation of any alternative~~ ~~to put in its place. There was no new thinking on~~

As regards

many speakers took refuge in

middle income debtors: ~~merely~~ ritual incantation of the need to strengthen the Baker strategy. ^{however} ~~The~~ ^{Persistent} continuing acute nature of the debt problem is, if anything, leading to an expectation that in the next stage official creditors will be expected to take ^{more effective} the lead.

~~The ^{great} danger is that as discussed, that will need to be handled with considerable care.~~

~~Discussion of the low-income debtors was undertaken,~~

4. This was underscored by the successful launch of the Chancellor's initiative on the debt of the poorest and most indebted countries in sub-Saharan Africa. Since the Washington meeting, the Paris Club aspects have been taken further in a special meeting on 24 April. That meeting suggested a broad consistency of view about which countries were likely to qualify for any new facility and no serious problems about taking forward the idea of longer term reschedulings for qualifying countries. On the more difficult question of interest relief, the key will be to get the US, who are worried about Congress, on board. If we can persuade them we would expect the French, Germans and Japanese all to participate. We shall need to keep up the pressure for action at forthcoming international meetings eg the OECD Ministerial meeting and the Venice Summit.

5. Turning to individual countries, the main focus of attention continues to be Brazil, where the replacement of Funaro as Finance Minister by Bresser Pereira (and Gros by Milliet as Central Bank President)

looks a hopeful development against a very poor economic position. Bresser Pereira visited London last month, and made a good impression: not an ideologue like his predecessor and prepared to negotiate. Since taking office the new Finance Minister has announced a devaluation of the Cruzado of 8.49% and outlined his intentions, including a lower short term growth rate (3% to 3½% rather than 7%), early restoration of large trade surpluses, greater control over public expenditure and short term stabilisation of inflation (albeit at present high levels). Debt service is to remain suspended until the Government is able to introduce a non-recessive internal adjustment plan and Brazil is generating sufficient external surpluses to resume servicing the debt. The commercial banks see this appointment as encouraging and Bresser Pereira himself as someone they can negotiate with.

6. Recent news has been ~~good~~^{settle} on Mexico, Argentina and the Philippines. The commercial bank package for Mexico became effective - at last - on 30 April enabling the \$500 million bridging loan to be repaid and \$3.5 billion of new money to be disbursed. The Advisory Committees have reached agreement with Argentina and the Philippines, although there could well be delays before these packages secure sufficient participation to become effective. The Argentine package, however, includes incentives designed to

streamline the negotiating process and avoid the delays which have dogged other recent packages.

7. Other small items worth noting have been the \$50 million FRN signed by Colombia (the first Eurobond issued by a Latin American borrower since 1982) and Bolivia's debt buy-back scheme, ^{which} remains under consideration by the banks. The news on Nigeria is also a little better. Following action by the government, the Fund programme seems to be back on track and the second tranche of the World Bank loan has been disbursed.

8. Despite these ^{positive individual developments} ~~nuggets of good news~~, the prospect ^{in many respects} remains ^L as difficult as ever. For debtors whose packages are at an early stage of negotiation, the key issue, as the Chancellor made clear in his speech to the Interim Committee, will be to resist the weakening of IMF conditionality. On Egypt, and also Zaire, the programmes coming before the Fund Board do not contain nearly enough adjustment. In neither case is there any prospect of medium term balance of payments viability. On Egypt, the present position is ^{not} ~~whilst~~ ^{any} none of the G7 creditors has been prepared to give commitments about filling the financing gap, the Managing Director now seems prepared to put the SBA to the Board on an assumption of "best endeavours" by creditors and of an as yet unspecified further strengthening of the programme in the autumn. We

will need to take a hard look at Camdessus' proposal and the programme before the Board discussion.

9. Elsewhere, Ecuador's position has deteriorated rapidly, in part reflecting the impact of the earthquake and other natural disasters. In Africa, Anglophone countries (Tanzania, Ghana, the Gambia) seem to have been doing better with their programmes than Francophone countries (problems with Cote d'Ivoire, Mali, Gabon among others). However, the latest news from Zambia is less good.

10. I am copying this letter to Tony Galsworthy (FCO), Tim Walker (DTI) and John Footman (BOE).

AWK

1 Tony
2 C

CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 6 May 1987

SIR PETER MIDDLETON

cc: Principal Private Secretary
PS/Economic Secretary
Sir G Littler
Mr Cassell o/r
Mr Lavelle
Mr H P Evans
Mr Mountfield
Miss Noble
Mr Walsh

Handwritten notes:
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LOMAX
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INTERNATIONAL DEBT: UK BANKS' PROVISIONS

If you get the opportunity tomorrow, you could usefully cross-question the Deputy Governor about the Bank's supervisory initiative to increase the level of UK banks' provisions against problem country debt. With the Governor in Africa until today, your telephone conversation with the Deputy Governor last week was the only formal notice we had of what could turn out to be a controversial as well as significant move. Brian Quinn has been keeping me in the picture, but, in normal circumstances, there would probably have been some discussion at Governor/Chancellor level before the Bank made any move.

2. I gather that Rodney Galpin saw the Chief Executives of the Big Five clearers individually last week, to tell them that over the next few years they should be aiming to increase their provisions to something like 20% of their exposure to problem country debtors (I understand this is defined as the Baker 15, plus Egypt, Poland, Rumania and - probably - South Africa). The Bank are looking for "visible movement" in the 1987 interims: and if the clearers are not prepared to act voluntarily, the supervisors will require them to do so.

3. The Chief Executives seem to have taken this quite calmly and are consulting with their Chairmen, prior to producing a considered response. Two issues were of immediate interest to them: the fiscal aspect, and the implications for new money

CONFIDENTIAL

programmes. They have not yet responded, but the Bank may hear something by the end of this week.

4. The Bank's initiative comes as no great surprise - to us, any more than to the clearers. It follows discussion at the Board of Banking Supervision in April and at Basle (following a paper on international banks provisioning from the Cooke Committee). Although UK banks have improved their capital ratios, there has been concern about the level of their provisions for some time: a year ago, for example, the supervisors told David Peretz that they would want to think about taking stronger action if the 1986 results failed to show a marked increase in total provisions. (In the event, what we saw was a switch from general to specific provisions, within a broadly unchanged total.) As noted in Basle, a marked difference has emerged between the level of provisions by continental European banks, on the one hand, and by UK, US and Japanese banks on the other. (There are also significant differences in tax treatment, of course.) The Bank's new resolve is consistent with the gloomier analysis of the international debt situation set out in the recent Treasury paper, as well as in the TCSC report.


5. However welcome the Bank's initiative, it raises issues that we ought to discuss with them. For example, how did they arrive at this particular objective (20% over 3 years)? How does it compare with what they expect other supervisors to seek? What are the implications for the UK banking system, where the position of the consortium banks must be a particular worry; and what sort of effect on the clearers' share prices (and vulnerability to takeover) do they expect?

6. There is also an important tax angle. I understand that the Bank have not yet talked to the Inland Revenue, and while the supervisors do not care whether the banks make general or specific provisions, this will be a matter of the keenest interest to the clearers. The Inland Revenue's attitude will no doubt depend to some extent on our analysis of the situation, as well as the Bank's action.

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You might also like to ask the Deputy Governor whether he expects news of this initiative to seep out, and if so, with what result. Is there a risk of upsetting the American authorities and the IMF, if, as could happen, the UK clearers say they are only prepared to go along with this initiative under duress, and, consequently, cannot be expected to produce new money for, say, Argentina or Brazil.

8. I doubt whether either you or the Chancellor will have time for a detailed discussion of these issues in the next few weeks. But you might want Huw Evans and me to go over the ground with our opposite numbers in the Bank and report back later in the month (by which time we should also have a reasonable idea of how the banks are reacting).

A handwritten signature in dark ink, consisting of the letters 'R' and 'L' in a cursive, stylized font, followed by a period.

RACHEL LOMAX

EGYPT

CONFIDENTIAL

FROM: P MOUNTFIELD
DATE: 6 May 1987

CHANCELLOR

cc Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mrs Case
Mr Walsh
Mr Pitcairn
Mr Sheridan
Mr Ross Goobey

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with
the
numbers
in para 11

EGYPT: IMF, MILITARY DEBT AND PARIS CLUB

This note seeks your instructions on the line Mr Lankester should take at the IMF Board on 15 May. It also suggests that you may want to talk to Secretary Baker about this in the margins of the OECD Ministerial next week, if you go. The Foreign Secretary wants to talk to you about Egypt on Friday.

MOUNT
FIELD
To
C/lex
6/5

Background

2. You will remember that there is already a considerable degree of UK commitment to support an IMF programme for Egypt and a parallel rescheduling. This is the result of enormous American political lobbying, strongly supported by the FCO (and to some extent by No.10).

State of Play

3. Camdessus has now decided to go ahead with the very weak IMF programme, without formal guarantees from G7 countries. You have given him assurances that the UK will play its part in a Paris Club rescheduling; will (as usual) accord precedence to debt due to the IMF; will continue with the export credit and (very small) aid already in the pipeline; but you have refused to make any further commitments beyond those. We understand that other G7 countries, to varying degrees, are giving similar commitments.

The Programme.

4. We have now received the paper for the Board on 15 May. It is a good paper, but a thoroughly unsatisfactory programme. We have discussed its analysis with the Bank of England, and concluded that the projections (running forward into the 1990s) are broadly correct, and if anything under play the down side risks. Egypt is running a current account deficit of some \$4 billion, and that is expected to increase in the medium-term. Import substitution (particularly in agriculture) and a sustained increase in non-oil exports are required. A more competitive exchange rate, the removal of price distortions in agriculture and industry, as well as removing impediments to the private sector's ability to trade and compete - all these are needed, and the Fund and Bank Staff are unhappy with the limited progress being made and in prospect. These policies, even if implemented, need the support of stronger fiscal and monetary policies: real interest rates are still substantially negative, while the public sector deficit is high. Reduction of this deficit - from over 21 per cent in 1985/6 to 13 per cent envisaged by the programme in 1987/8 - will require a resolve from the authorities that has usually been lacking in the past. If passed, the Egyptian programme will set a bad precedent both for major debtors in Latin America where there may be political sensitivities that are just as important for the Americans, and for the countries of Sub Saharan African that are in just as dire straits as Egypt. For instance, it will be difficult to take a firm line on Zaire, which is coming up in the Board on the same day as Egypt and where an avstention would be the right response to a weak programme.

Financing the Programme.

5. Under the proposed IMF programme, Egypt would (continue to) pay interest on only part of its debt. Rescheduling and

capitalising the existing burden of debt would provide, in effect, debt relief though the debt burden would rise in the medium-term. At some stage, much of the debt will have to be written off. The Fund projections do not include very much by way of further export credit flows or aid (though we are asking Mr Lankester to check on this: in particular, on the assumptions used about further American civil aid, now running at about \$2bn a year). The assumptions on export credit seem to be realistic, although the UK, along with other G7 countries has just been asked to indicate its likely attitude, and to estimate the sums still in the pipeline.

Egyptian Measures

6. The paper outlines the measures taken so far, and the further areas in which action is required by the time of the first review in November. We are satisfied that there is little scope for persuading the Egyptians to take further immediate action. We must concentrate on the steps needed before November, and on making sure that corrective action is taken if the Egyptian economy deviates from the chosen track before then. Specifically this means action on exchange rates, exchange allocation mechanisms, and - perhaps most importantly - positive real interest rates and energy prices. (Other measures are also envisaged).

Options

7. Theoretically, the Fund has two options now: to wash its hands of Egypt for a number of years; or to continue along the path of weak but (we hope) progressively improving adjustment programmes. On the first course, Egypt would lapse into default on its overseas debt, would be forced to compress imports to the point where civil unrest would spread; and would eventually be driven back to its creditors for help. This is the course we might consider for a less politically-sensitive country: for example, Peru. But politically, it does not seem realistic

for Egypt. If so, then the only choice is to continue down the present path, and to push Egypt as far and as fast as we think we can - and can get support from our partners for doing.

Tactics at the Board

8. We would like to say 'no' to this programme, but given the line we have taken so far, under FCO pressure, and the political constraints, we think that Mr Lankester's tactics should be to say 'yes but'. The 'but' includes the further measures to be taken by the time of the first review, and, equally important, a clear signal that additional reinforcing measures would be needed progressively over the next few years, and that the UK will not sign up on the next SBA unless those measures are taken. This is a bit of an empty threat, unless we can persuade the other creditors to take an equally tough line. We are therefore going to ask Mr Lankester to seek such support as he can among the other G7.

Military Debt.

9. You have also suggested that it should be a condition of our support, for the programme and for the Paris Club operation, that the Americans offer more generous terms on military debt. We think we have pushed them about as far as we can. Their first response is that their main form of support to Egypt is by their \$2bn civilian aid (on top of further military aid which does not appear in the balance of payments figures at all). On the existing stock of military debt, Egypt has been offered a choice. Either it includes this in the Paris Club operation (which means capitalising the accrued interest and rescheduling it at the existing rate, or some lower rate if Congress will wear it; or bilaterally reducing the rate (from about 11% to about 7%) but capitalising the difference and paying it off 20 years hence. At present, Egypt is holding out for better terms still. But it is unlikely that the US can do better than this. The reasons are Congressional. The lending agency is

the Federal Finance Bank, which also provides funds for the student loan and agricultural programmes. The Administration believes it cannot cut the Bank's interest rates to Egypt and leave these other two, larger, categories unchanged. Mr Lankester's view is that we cannot push further on this score. Reluctantly, I think he is right. But if you wish to pursue this point, your best opportunity before the Board would be to speak to Secretary Baker about it in the margins of the OECD meeting next week, if you go. If you don't, a telephone call or telegram might just work. We will defer sending final instructions on this point to Mr Lankester until you have decided how to play it.

FCO angle.

10. All this is subject to the views of the Foreign Secretary; who, I am told, will want to speak to you about this on Friday. His concern, is, as usual, that the UK should not find itself in splendid but impotent isolation at the Board. I think the tactics outlined above, including an approach to the other G7 countries, will avoid this, and you may wish to assure him that you understand his concern but do not feel we can soften our approach further than this.

Recommendation

11. We therefore recommend that we instruct Mr Lankester:

(a) To lobby other G7 members before the Board, to ensure that he is not alone in criticising the programme or proposing further measures.

(b) To raise a number of technical questions about the assumptions used by the Staff, particularly about the assumed level of US aid in future;

(c) Subject to satisfactory assurances on these points, to indicate reluctant agreement with the main lines of the present SBA;

(d) To pursue the 'yes but' line indicated above, specifying faster progress in defined areas before the First Review; and requiring Egypt to take further corrective action if the economy deviates from course before then;

(e) To indicate that further and stronger adjustment measures would be needed in the next phase of a follow on SBA if the UK is to support it;

(f) To confirm the understandings you have already given to Camdessus; but not to make further American support a condition of his agreement.

12. Subject to resolution of the point on American military debt, we will draft a telegram to Mr Lankester to go early next week.

R1

P MOUNTFIELD

From : H P Evans
Date : 7 May 1987

CHANCELLOR ✓

cc Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Lavelle
Mr Mountfield
Mrs Lomax
Mr Walsh
Mr Carpinter o/r
Ms V Life
Mrs Case
Mr Ross Goobey

*Thanks. I had like
to discuss this
when home
show resume.*

EVANS
to
CH/EX
75

INTERNATIONAL DEBT

Before the Spring Meetings in Washington we discussed papers on general debt issues (produced by IF) and on sub-Saharan Africa debt (produced by AEF). Your intervention at the Interim Committee covered both themes, with the sub-Saharan initiative naturally getting the headlines. This minute, on issues excluding sub-Saharan Africa, is background for your meeting on 8 May.

Discussions in Washington

2. I talked to a number of people in the Fund and the Bank, in the Fed, State Department, Brookings, etc. With the exception of the Fed and the bankers in the IIF, I was struck by the convergence of views at technical levels : the conclusion of our debt paper and one of the main points in your intervention at the Interim Committee was that most debtors were further away from creditworthiness than in 1982. But there is great reluctance in the Fed and Treasury to accept this conclusion.

3. Our difficulty in drawing clear policy conclusions - beyond the need for the banks and other creditors to provision more and for the IFIs to tighten up on conditionality if they were able to - was shared by most of the people I talked to. Global solutions remain out of favour, and there was a disposition to persevere with something like the present strategy for want of any clearly articulated alternative, while preparing for the worst.

Considerable risks were perceived attaching to an early adoption of market solutions, particularly from a US perspective. There was a widespread desire to believe that the whole problem would be much more manageable if only the world economy would grow faster and interest rates would come down - both at the same time.

4. The weakness of the US banking system means that the US authorities have been anxious that debt service payments by systemic debtors should be maintained even if banks have to be pressed into providing new money to facilitate this. Because bank managements have to justify their actions to their Boards (and to the New York Stock Exchange), US banks like others will only provide money on the back of an IMF programme. Since the crisis in 1982, fears about the possible need for write-downs has been a major factor that has predisposed the Administration to be lax about the imposition of conditionality in IMF programmes. While the most recent Mexico programme seems to be turning out to be reasonably satisfactory so far, this will probably not be the case with the Argentina programme. US actions in the Paris Club indicate that we cannot rely on the Americans to hold out for adequate conditionality when a Brazilian programme eventually comes before the IMF or World Bank Board.

5. The US attitude to debt is worrying. The major banks especially are still very exposed to Latin American debt, and unwilling to make substantially increased provisions: instead they seem to rely on the ability and willingness of the Administration to bail them out. This essentially all or nothing approach goes a long way to explaining the Administration and Fed's desire to keep debtors current in the short-term, whatever the long-term consequence of weak programmes.

Role of the World Bank

6. The World Bank is taking an increasing role on debt in terms of lending to middle income debtors and more policy based loans, and there are pressures for it to do more. New ideas for solutions, eg the proposal for a debt buyback facility gaining momentum in Congress, envisage a central role for the Bank. While we have yet to form a view on this or some of the other newer ideas, it is clear that the Bank could be playing a major part in the immediate future. But in order to do so it will need capital backing. The Americans were not prepared for an agreement to be reached on a new GCI at the Spring Meetings because of their appropriation difficulties. But the position is worsening.

7. The big fall in the dollar over the past two years has reduced the ability of the World Bank to lend : the recent article by Stewart Fleming in the FT (27 April, had wrong numbers and a misleading headline "World Bank Lending to Debtor Countries Hit by Fall in Dollar").* It is not true that World Bank lending so far has been affected, but World Bank management and others (including Stoltenberg) are concerned about the substantially reduced amount of headroom for extra lending : we and the Bank are working on this and will report findings. It could be raised at the Venice Summit, with a view to getting substantive agreement in principle at the time of the Annual Meetings.

Zaire, Egypt, and Conditionality

8. These were the examples given by David Finch when in March he announced his resignation from the Fund. Both countries come before the Board again on 15 May and represent further evidence of the "progressive weakening of conditionality" you referred to at the Interim Committee. The succession to Finch - Whittome's move to ETR - does not suggest any change of course.

*
copy
attached

9. The continuing risks to the debt strategy in Africa are shown by Zambia's action in following Peru and limiting its debt service payments to 10 per cent of exports (calculated after essential imports have been purchased). Zambia is an example of an African country whose debt service problems could only be adequately dealt with by extending relief on official debt outside the Paris Club and including debt to the IMF. The French have already put forward a plan including a special facility for development and debt reduction and softening the terms of the IMF Compensatory Financing Facility. We may have to consider measures such as :-

- i) Rescheduling at the IMF;
- ii) Enlarging the Structural Adjustment Facility;
- iii) To facilitate further concessional IMF facilities or enlargement of the SAF, envisaging further sales of IMF gold (which requires the approval of 85 per cent of IMF votes);
- iv) Increasing yet further the proportion of World Bank lending to Africa under IDA8 (at present projected to be about 50%);
- v) Rescheduling at the World Bank (a bad option since it would affect the World Bank's market standing) and in any case not very relevant since non-concessional World Bank debt outstanding in SSA is generally small (on average, only 4 per cent for the 17 most heavily indebted and poorest countries).

HPE

H P EVANS

GRS 400

Confidential

CONFIDENTIAL
FROM UKDEL IMF/IBRD, WASHINGTON
TO FCO DESKBY 180900Z
TELNO 157
OF 172300Z JUNE 87
INFO IMMEDIATE LAGOS

Let me know when we have the truth. A.S. [unclear]

b/f with
note from
P. Mountfield
(or 23/6) p)

IMF: NIGERIA

TELE
17/6
NIGERIA

SUMMARY

1 IMF STAFF VERY CONCERNED ABOUT RECENT WIRE SERVICE REPORTS THAT NIGERIANS HAVE MODIFIED OPERATION OF FOREIGN EXCHANGE AUCTION.

DETAIL

2 WE UNDERSTAND (IN STRICT CONFIDENCE - PLEASE PROTECT) THAT IMF STAFF ARE VERY CONCERNED BY A REPORT CARRIED BY AFP LAST WEEK THAT THE AUTHORITIES HAVE TAKEN VARIOUS STEPS TO MODIFY THE OPERATION OF THE AUCTION IN ORDER TO HELP SUPPORT THE NAIRA.

3 THE FUND HAVE NOT BEEN ABLE TO VERIFY THIS DIRECTLY BUT THEY HAVE HEARD A RECENT CENTRAL BANK CIRCULAR HAS PROHIBITED:

- (i) THE TRADING OF FOREIGN EXCHANGE BETWEEN THE BANKS; AND
- (ii) SPECULATIVE PURCHASES (IE WHERE THE BANK HAS NOT IDENTIFIED A CUSTOMER IN ADVANCE).

4 FUND STAFF CANNOT, OF COURSE, FORM FIRM VIEWS UNTIL THEY HAVE ALL THE DETAILS. THEY ARE, HOWEVER, VERY CONCERNED AND WILL BE LOOKING FOR CLEAR ASSURANCES ON THE OPERATION OF THE AUCTION BEFORE THEY WILL BRING THE REVIEW OF THE SBA BACK TO THE BOARD (SEE OUR TELNO 140 OF 26 MAY).

5 WE UNDERSTAND THAT MARK ALLEN IS DUE TO SEE AHMED IN LONDON TOMORROW (THURSDAY) AND WILL RAISE THIS ISSUE THEN.

6 FCO PLEASE ADVANCE TO MOUNTFIELD AND WALSH (HMT), WARE (BOE), T RICHARDSON (ERD), BREACH (ECGD) AND WOOTTON (ODA).

LANKESTER

YYYY

ORWBAN 2363

MONETARY

WAD.

(ADVANCED AS REQUESTED)

py cha
T.
Tony
P. Mountfield is waiting for a paper from the bank before submitting advice
MF 24/6
Nigel
Thanks.
B/F 26/6 p)

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REF : SOA

851 262405 =

- HONORABLE NIGEL LAWSON
- CHANCELLOR OF THE EXCHEQUER
- GOVERNOR OF THE INTERNATIONAL MONETARY FUND
- FOR THE UNITED KINGDOM
- H.M. TREASURY
- PARLIAMENT STREET
- LONDON SW1P 3AG
- ENGLAND

BT

WASHINGTON DC - 19-JUN-87

THE EXTRAORDINARILY DIFFICULT PROBLEMS AND PROSPECTS OF THE POOREST COUNTRIES PRIMARILY IN SUB SAHARAN AFRICA HAVE BEEN GIVEN CONSIDERABLE ATTENTION BOTH BY DONOR AND RECIPIENT GOVERNMENTS IN THE RECENT PAST. A NUMBER OF PROPOSALS HAVE BEEN MADE TO ORGANIZE APPROPRIATE PACKAGES OF DEBT RELIEF AND CONCESSIONAL ASSISTANCE FOR THE MOST SEVERELY AFFECTED COUNTRIES THAT ARE UNDERTAKING ADJUSTMENT PROGRAMS WITH THE ASSISTANCE OF THE FUND AND THE BANK. THE ECONOMIC DECLARATION ISSUED AT THE END OF THE VENICE SUMMIT CONFERENCE RECOGNIZED THAT THE PROBLEMS OF THE POOREST COUNTRIES WERE UNIQUELY DIFFICULT AND REQUIRED SPECIAL TREATMENT, INCLUDING LOWER INTEREST RATES ON EXISTING DEBT, LONGER REPAYMENTS AND GRACE PERIODS, AND ADDITIONAL RESOURCES FOR THE STRUCTURAL ADJUSTMENT FACILITY.

IN VIEW OF THE BROAD SUPPORT EXPRESSED FOR SPECIAL EFFORTS TO ASSIST THOSE LOW INCOME COUNTRIES THAT ARE UNDERTAKING EFFECTIVE ADJUSTMENT PROGRAMS, THE IMF AND THE WORLD BANK BELIEVE THAT IT IS NOW NECESSARY AND OPPORTUNE TO TRANSLATE THESE PROPOSALS INTO AN EFFECTIVE, WELL-COORDINATED PROGRAM OF SPECIAL ASSISTANCE FOR THE HEAVILY INDEBTED LOW-INCOME COUNTRIES WITH ADJUSTMENT PROGRAMS. WE UNDERSTAND THAT SENIOR TREASURY OFFICIALS OF 6-10 COUNTRIES WILL BE IN PARIS ON JULY 9 IN CONNECTION WITH AN OECD MEETING AND THIS MIGHT BE A CONVENIENT OCCASION TO INITIATE A DISCUSSION OF THIS ISSUE. ACCORDINGLY, WE WOULD GREATLY APPRECIATE IT IF YOUR GOVERNMENT COULD ENVISAGE PARTICIPATING IN A MEETING TO BE HELD IN PARIS ON JULY 10. THE MEETING WILL REVIEW THE ECONOMIC SITUATION AND FINANCING REQUIREMENTS OF THESE COUNTRIES. MORE SPECIFICALLY, IT WILL FOCUS ON THE NEED FOR (AAA) A SUBSTANTIAL INCREASE IN THE RESOURCES AVAILABLE FOR THE IMF STRUCTURAL ADJUSTMENT FACILITY, AND (BBB) ADDITIONAL MEASURES INCLUDING FURTHER DEBT RELIEF PLUS THE FEASIBILITY OF AN EXPANDED AND MORE TARGETED COFINANCING PROGRAM (WITHIN EXISTING DEVELOPMENT ASSISTANCE BUDGETS) WITH THE BANK TO SUPPORT ADJUSTMENT EFFORTS IN THE LOW-INCOME DEBT-DISTRESSED AFRICAN COUNTRIES. WE HOPE THAT IT WILL BE POSSIBLE FOR YOUR DELEGATION TO INCLUDE REPRESENTATIVES WHO ARE FULLY AUTHORIZED TO DISCUSS ON BEHALF OF YOUR GOVERNMENT ALL THE ISSUES MENTIONED ABOVE. THE BEGINNING OF THE SESSION WOULD BE DEVOTED TO A DISCUSSION OF THE REPLENISHMENT AND OPERATIONAL OBJECTIVES OF THE STRUCTURAL ADJUSTMENT FACILITY. THE SECOND PART WOULD ADDRESS DEVELOPMENT FINANCING ISSUES. THE MANAGING DIRECTOR WILL REPRESENT THE IMF AND THE SENIOR VICE PRESIDENT, OPERATIONS, WILL REPRESENT THE WORLD BANK AT THE MEETING. BACKGROUND DOCUMENTS WILL BE SENT TO YOU NEXT WEEK. WE THANK YOU FOR YOUR GOVERNMENT'S CONTINUING CONCERN AND COMMITMENT TO THE SOLUTION OF ONE OF THE MOST DIFFICULT DEVELOPMENT PROBLEMS WHICH THE INTERNATIONAL COMMUNITY MIGHT ADDRESS IN THE COMING YEARS. MICHEL CAMDESSUS, MANAGING DIRECTOR, IMF, AND BARBER CONABLE, PRESIDENT, WORLD BANK.

*As R Culpin
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A party*

*As R Culpin
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CH/EXCHEQUER	
REC.	22 JUN 1987
ACTION	MR WALSH
COPIES TO	CST EST SIR P MIDDLETON SIR T BIRSK SIR G LITTLE MR MOUNTFIELD MR H. P. EVANS MR TURNBULL MRS CASE

MR CULPIN
MR S. MATTHEWS
MS LIFE

2/6

CONFIDENTIAL

CONFIDENTIAL

FM LAGOS

TO IMMEDIATE FCO

TELNO 791

OF 271245Z JULY 87

INFO IMMEDIATE HM TREASURY, DTI, BANK OF ENGLAND, ODA, ECGD
INFO PRIORITY UKDEL IMF/IBRD WASHINGTON

CONSULTATIVE COMMITTEE ON NIGERIA

1. FINANCE MINISTER OKONGWU TELEPHONED ME THIS MORNING TO SAY THAT HE WOULD BE VERY GRATEFUL IF HE COULD HAVE AN EARLY MEETING WITH THE CHANCELLOR OF THE EXCHEQUER. THE WEEK BEGINNING 3 AUGUST WOULD SUIT HIM BEST AND HE WOULD COME TO LONDON FOR THE MEETING AT ANY TIME WHICH SUITED THE CHANCELLOR. THE PURPOSE WOULD BE TO DISCUSS THE FORMATION OF A CONSULTATIVE GROUP ON NIGERIA, ON WHICH HE VERY MUCH HOPED THAT BRITAIN WOULD TAKE THE LEAD.

2. INFORMAL CONSULTATIVE GROUPS FOR PARTICULAR COUNTRIES ARE OF COURSE NOTHING NEW, AND GIVEN THE LIKELIHOOD THAT NIGERIA WILL BE A FOCUS OF CONCERN FOR THE INTERNATIONAL FINANCIAL COMMUNITY FOR SOME YEARS TO COME, IT SEEMS NO BAD IDEA THAT A GROUP OF THIS NATURE SHOULD BE FORMED. THERE WAS A CONSULTATIVE GROUP FOR NIGERIA UNDER THE IBRD BUT THIS HAS PRESUMABLY LAPSED. SPEAKING SOMEWHAT AT RANDOM, OKONGWU SAID THAT HE WAS SURE THAT THE FRENCH, GERMANS AND THE JAPANESE WOULD AGREE TO BECOME MEMBERS. IF SO, THIS MIGHT BE A WAY OF ENCOURAGING THE JAPANESE IN PARTICULAR TO BE MORE FORTHCOMING IN THEIR SUPPORT FOR NIGERIA.

3. A MEETING WITH OKONGWU MIGHT ALSO PROVIDE AN OPPORTUNITY FOR THE CHANCELLOR TO DISCUSS WITH HIM THE WAY THE NIGERIAN ECONOMIC RECOVERY PROGRAMME IS SHAPING UP. I VERY MUCH HOPE THAT A MEETING CAN BE ARRANGED.

EWANS

LAHPAN 2392

MONETARY

WAD

CONFIDENTIAL

Ch.
Do you agree with
the commensuration in para 7?

FROM: P MOUNTFIELD
DATE: 28 July 1987

CHANCELLOR

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mr Pitcairn
Mr May

(? bilateral
in Barbados)

26
28/7

right ✓

NIGERIA

Finance Minister Okongwu has asked for an urgent meeting with you early next month, to discuss the formation of a consultative group on Nigeria, with Britain in the lead. I recommend that you see him in September, after the holidays; use the opportunity to send him a message about the Nigerian economy; but decline to lead a consultative group.

Background.

2. Lagos Telegram 791, attached, conveys Okongwu's request. It came without any warning from Lagos. But we were, in any case, about to advise you to send a message to Okongwu, urging him to get the IMF programme back on track quickly.

3. The last IMF mission has reported serious problems. Nigeria has failed to complete its first review under the SBA and missed the 5 June deadline set by the Fund Staff for introducing the necessary corrective measures. These are needed to address an over-expansionary fiscal policy, with a budget deficit estimated to be 3-4 per cent of GDP higher than originally forecast. The measures negotiated with the Staff involve reducing petroleum subsidies and raising interest rates, but nothing has yet happened. The Staff have delayed making a report to the Board and go out to Lagos again early next month. But unless the necessary measures are introduced before then, there is little

prospect of signing a letter of intent and getting a paper to the Board to complete the review before the Annual Meetings in September. Either way it is planned to put an Article IV paper to the Board at the end of August to allow Board discussion of the situation.

4. There are also problems on the debt side. ECGD are still having difficulty agreeing a coherent debt list with the Nigerian Central Bank. The commercial banks have still not finalised their agreement. They in turn (having bought up many of the promissory notes issued to uninsured trade creditors) are getting concerned about the failure to reach agreement with that group. This seems attributable to a mixture of bureaucratic incompetence and genuine cash flow shortage. The risk of a breakdown in the negotiations can not now be ruled out. The only hope of averting that is for Okongwu himself, with the support of Governor Ahmed, to reassert control. We are not even sure that he is aware of the problem, and a message from you might do the trick.

5. In sending such a message, you could take credit for the reopening of ECGD cover, which was announced midday today.

6. You should, however, avoid getting the UK into the lead on a consultative group. Such groups are normally convened by the World Bank to coordinate the actions of aid donors. Apart from some small technical cooperation, we have no aid programme in Nigeria, nor could ODA afford one. Such a group might also develop into a means of putting pressure on the IMF to soften their terms (quite inappropriately, in our view); or to reopen the current debt agreement, which in any case falls due for extension in January. It is important not to undermine the position of the Paris Club on the debt question.

Recommendation.

7. That you should plead the imminence of the holiday season; offer to see Okongwu in September; suggest that there might

be difficulties over a donor's group; and ask him to take the necessary urgent action to get the programme back on track. If you agree, a draft on these lines, cleared with FCO, ODA and the Bank, will be submitted later this week. They have already agreed the tactics suggested in this note.

RM

P MOUNTFIELD

CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 29 July 1987

*BF with response
(Cor 31/7)*

MR MOUNTFIELD

cc: CST
EST
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mr Pitcairn
Mr May

NIGERIA

The Chancellor has seen your minute of 28 July.

2. He agrees with your advice. He would, however, prefer to see Finance Minister Okongwu in the margins of the Commonwealth Finance Ministers' meeting in September. I should be grateful for a draft.

A handwritten signature in dark ink, appearing to be "JMG".

J M G TAYLOR

OUT TELEGRAM (CONT)

	Classification	Caveat	Precedence
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1	<p>1 <<<<</p> <p>2 <<<<</p> <p>3 in our view): or to reopen the current debt agreement, which in</p> <p>4 any case falls due for extension in January. It is important not</p> <p>5 to undermine the position of the Paris Club on the debt question.</p> <p>6 The line taken by Husein (your telno 802) does not affect those</p> <p>7 considerations. It would be wrong to use a consultative group in</p> <p>8 an effort to rally domestic political support.</p> <p>9 3. This message to Okongwu is a useful opportunity to register</p> <p>10 our concern over Nigerian economic backsliding. However, to</p> <p>11 avoid giving ammunition to those of Okongwu's officials (some of</p> <p>12 them influential) who are out of sympathy with the reform</p> <p>13 programme and the IMF, it is low-key terms and does not dwell</p> <p>14 heavily on the need for IMF support (on which the Nigerians have</p> <p>15 shown themselves sensitive).</p> <p>16 4. It is however important that Okongwu is left in no doubt of</p> <p>17 the need to correct recent economic backsliding and come up with</p> <p>18 a timetable which will meet IMF requirements. Important fiscal</p> <p>19 measures need to be taken soon. The Nigerians will need to</p> <p>20 demonstrate action to the IMF staff who are to visit again in</p> <p>21 August. Grateful if you could register these concerns orally</p> <p>22 with Okongwu, particularly the need for renewed endorsement by</p> <p>23 the IMF. You could say you understand that the main issues are</p> <p>24 likely to be those mentioned in the Chancellor's letter (the</p> <p>25 foreign exchange system, monetary and fiscal policy, including</p> <p>26 particularly the size of the budgetary deficit and domestic</p> <p>27 interest rates.) You could then ask him how he sees the next</p> <p>28 moves, and emphasise that the UK Executive Director cannot</p> <p>29 support a programme which the Fund staff themselves do not</p> <p>30 recommend. You should underline that our export credit package</p> <p>31 is still contingent on good progress with the IMF programme.</p> <p>32 Please also report as soon as possible Okongwu's preferences on</p> <p>33 the timing of his meeting with the Chancellor.</p> <p>34</p>		
	<p>HO WE</p>		
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N.P.S.
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1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34	<<<<	<p>As you know, the United Kingdom Government remains very anxious to help Nigeria through its current economic difficulties. I was very glad that it proved possible to announce the resumption of ECGD cover, which took place on 28 July. We much appreciate the close cooperation which has developed among our officials, and we continue to attach great importance to hearing your analysis of recent developments.</p> <p>In this connection, I was concerned about recent changes in the foreign exchange system. It is important that the market should be left to work flexibly and freely to ensure the efficient use of Nigeria's foreign exchange inflows. And I was also somewhat worried to hear about the size of the public sector deficit. No doubt another important concern in your own mind at this time is finding a way forward in reaching an early settlement with the uninsured creditors, and in reaching a final agreement with the commercial banks. All this is relevant to the discussion in the IMF Executive Board in September following the recent visit of an IMF Article IV Mission. It is important that significant progress will have been made, to enable the UK Executive Director to give his full support to the programme both then and at the first review of the current Stand By Agreement. This in turn will help with your approach to the Paris Club for the next round of rescheduling of official debt.</p> <p>I hope we can also discuss your suggestion of a consultative group in some detail when we meet. The usual practice, as you know, is for the IBRD to take the lead in arranging such groups, and I am sure your best course is to discuss the idea with them. However, you can be sure that the United Kingdom would wish to play a constructive part in such a group, and we would be pleased to discuss the arrangements for such a meeting with your own people and of the staff of the World</p>
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Bank. For such a meeting to be a success it will be important to demonstrate that the present Nigerian recovery programme has the backing of the international financial institutions.

With warm personal good wishes,
Nigel Lawson.

Ends

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YYYY

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Ch
Content for this to go? On 'X' below - if you don't want to see Okongwu before CFM, delete the passages in square brackets in the drafts. 25/30/77

From P Mountfield
Date 30 July 87

PS/Chancellor

cc Sir G Little
Mr Pitcairn

NIGERIA: MESSAGE TO OKONGWU

The Chancellor approved the tactics suggested in my minute of 28 July. I now attach a draft message to Okongwu, cleared with Bank, FCO and ODA, together with covering instructions to the High Commissioner in Lagos.

X | I draw attention to the bit about a visit in early September. I know the Chancellor will be busy then. But I believe it is important to give Okongwu an early shove in the right direction, and only the Chancellor can do this with sufficient authority.

If the Chancellor is content with the draft, it should be typed for his signature in the usual way and sent to the FCO Private Office for despatch. Meanwhile, when instructed by you, I will tell FCO to send the telegram so that the text can be delivered in Lagos without delay; the signed copy will follow for confirmation.

Apologies for manuscript.

RM

Tdm
Mmmmm.
SHAL not type letter

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FM FCOLN TO LAGOS
311100Z JUL
GRS 511

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FM FCO
TO IMMEDIATE LAGOS
TELNO 521
OF 311100Z JULY 87

MIPT: OKONGWU

1. FOLLOWING IS TEXT OF LETTER FROM CHANCELLOR OF THE EXCHEQUER
TO THE NIGERIAN FINANCE MINISTER.

BEGINS

OUR HIGH COMMISSIONER IN LAGOS, MARTIN EWANS, HAS CONVEYED
TO ME YOUR SUGGESTION OF AN EARLY MEETING, TO TALK ABOUT
NIGERIA'S ECONOMIC PROBLEMS AND YOUR HOPE TO ESTABLISH A
CONSULTATIVE GROUP OF FRIENDLY COUNTRIES.

I AM MOST GRATEFUL TO YOU FOR YOUR SUGGESTION OF A MEETING,
AND I LOOK FORWARD TO THIS. I AM AFRAID THAT YOUR REQUEST
REACHES ME JUST AS I AM ABOUT TO START MY SUMMER HOLIDAY, AND IT
WILL NOT BE POSSIBLE TO FIT IN A MEETING IN AUGUST. WE
SHALL OF COURSE BE SEEING ONE ANOTHER AT THE COMMONWEALTH FINANCE
MINISTERS' MEETING IN BARBADOS AT THE END OF SEPTEMBER, AND I
SHOULD BE DELIGHTED TO ARRANGE A BILATERAL TALK THEN.

AS YOU KNOW, THE UNITED KINGDOM GOVERNMENT REMAINS VERY
ANXIOUS TO HELP NIGERIA THROUGH ITS CURRENT ECONOMIC
DIFFICULTIES. I WAS VERY GLAD THAT IT PROVED POSSIBLE TO
ANNOUNCE THE RESUMPTION OF ECGD COVER, WHICH TOOK PLACE ON
28 JULY. WE MUCH APPRECIATE THE CLOSE COOPERATION WHICH HAS

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DEVELOPED AMONG OUR OFFICIALS, AND WE CONTINUE TO ATTACH GREAT IMPORTANCE TO HEARING YOUR ANALYSIS OF RECENT DEVELOPMENTS.

IN THIS CONNECTION, I WAS CONCERNED ABOUT RECENT CHANGES IN THE FOREIGN EXCHANGE SYSTEM. IT IS IMPORTANT THAT THE MARKET SHOULD BE LEFT TO WORK FLEXIBLY AND FREELY TO ENSURE THE EFFICIENT USE OF NIGERIA'S FOREIGN EXCHANGE INFLOWS. AND I WAS ALSO SOMEWHAT WORRIED TO HEAR ABOUT THE SIZE OF THE PUBLIC SECTOR DEFICIT. NO DOUBT ANOTHER IMPORTANT CONCERN IN YOUR OWN MIND AT THIS TIME IS FINDING A WAY FORWARD IN REACHING AN EARLY SETTLEMENT WITH THE UNINSURED CREDITORS, AND IN REACHING A FINAL AGREEMENT WITH THE COMMERCIAL BANKS. ALL THIS IS RELEVANT TO THE DISCUSSION IN THE IMF EXECUTIVE BOARD IN SEPTEMBER FOLLOWING THE RECENT VISIT OF AN IMF ARTICLE IV MISSION. IT IS IMPORTANT THAT SIGNIFICANT PROGRESS WILL HAVE BEEN MADE, TO ENABLE THE UK EXECUTIVE DIRECTOR TO GIVE HIS FULL SUPPORT TO THE PROGRAMME BOTH THEN AND AT THE FIRST REVIEW OF THE CURRENT STAND BY AGREEMENT. THIS IN TURN WILL HELP WITH YOUR APPROACH TO THE PARIS CLUB FOR THE NEXT ROUND OF RESCHEDULING OF OFFICIAL DEBT.

I HOPE WE CAN ALSO DISCUSS YOUR SUGGESTION OF A CONSULTATIVE GROUP IN SOME DETAIL WHEN WE MEET. THE USUAL PRACTICE, AS YOU KNOW, IS FOR THE IBRD TO TAKE THE LEAD IN ARRANGING SUCH GROUPS, AND I AM SURE YOUR BEST COURSE IS TO DISCUSS THE IDEA WITH THEM. HOWEVER, YOU CAN BE SURE THAT THE UNITED KINGDOM WOULD WISH TO PLAY A CONSTRUCTIVE PART IN SUCH A GROUP, AND WE WOULD BE PLEASED TO DISCUSS THE ARRANGEMENTS FOR SUCH A MEETING WITH YOUR OWN PEOPLE AND OF THE STAFF OF THE WORLD BANK. FOR SUCH A MEETING TO BE A SUCCESS IT WILL BE IMPORTANT TO DEMONSTRATE THAT THE PRESENT NIGERIAN RECOVERY PROGRAMME HAS THE BACKING OF THE INTERNATIONAL FINANCIAL INSTITUTIONS.

WITH WARM PERSONAL GOOD WISHES,

NIGEL LAWSON.

ENDS

GLENARTHUR
MONETARY
WAD
MR MUNRO
MR REEVE

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69838 - 1

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311100Z JUL
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CONFIDENTIAL
FM FCO
TO IMMEDIATE LAGOS
TELNO 520
OF 311100Z JULY 87

YOUR TELNO 791: OKONGWU

1. MIFT CONTAINS TEXT OF A LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO OKONGWU. SIGNED ORIGINAL FOLLOWS BY FIRST AVAILABLE BAG. PLEASE SEEK AN EARLY OPPORTUNITY TO HAND OVER THE TEXT TO OKONGWU.
2. FOR YOUR OWN INFORMATION, THE CHANCELLOR'S PREFERENCE WOULD BE FOR A BILATERAL WITH OKONGWU DURING THE COMMONWEALTH FINANCE MINISTERS' MEETING IN BARBADOS (23-4 SEPTEMBER). THE CHANCELLOR'S LETTER ALSO MAKES CLEAR HIS RESERVATIONS ABOUT GETTING THE UK INTO THE LEAD ON ANY CONSULTATIVE GROUP. SUCH GROUPS ARE NORMALLY CONVENED BY THE WORLD BANK TO COORDINATE ACTIONS BY AID DONORS. IT IS IMPORTANT THAT NO FALSE EXPECTATIONS ON THIS SUBJECT ARE GIVEN TO OKONGWU, WHO MAY SEE THIS AS AN OPPORTUNITY TO GET MONEY FOR NOTHING. WE HAVE NO (NO) PLANS TO EXPAND OUR EXISTING SMALL TECHNICAL COOPERATION PROGRAMME IN NIGERIA, NOR COULD ODA AFFORD TO DO SO. A CONSULTATIVE GROUP MIGHT ALSO DEVELOP INTO A MEANS OF PUTTING PRESSURE ON THE IMF TO SOFTEN THEIR TERMS (QUITE INAPPROPRIATELY, IN OUR VIEW): OR TO REOPEN THE CURRENT DEBT AGREEMENT, WHICH IN ANY CASE FALLS DUE FOR EXTENSION IN JANUARY. IT IS IMPORTANT NOT TO UNDERMINE THE POSITION OF THE PARIS CLUB ON THE DEBT QUESTION. THE LINE TAKEN BY HUSEIN (YOUR TELNO 802) DOES NOT AFFECT THOSE

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CONSIDERATIONS. IT WOULD BE WRONG TO USE A CONSULTATIVE GROUP IN AN EFFORT TO RALLY DOMESTIC POLITICAL SUPPORT.

3. THIS MESSAGE TO OKONGWU IS A USEFUL OPPORTUNITY TO REGISTER OUR CONCERN OVER NIGERIAN ECONOMIC BACKSLIDING. HOWEVER, TO AVOID GIVING AMMUNITION TO THOSE OF OKONGWU'S OFFICIALS (SOME OF THEM INFLUENTIAL) WHO ARE OUT OF SYMPATHY WITH THE REFORM PROGRAMME AND THE IMF, IT IS LOW-KEY TERMS AND DOES NOT DWELL HEAVILY ON THE NEED FOR IMF SUPPORT (ON WHICH THE NIGERIANS HAVE SHOWN THEMSELVES SENSITIVE).

4. IT IS HOWEVER IMPORTANT THAT OKONGWU IS LEFT IN NO DOUBT OF THE NEED TO CORRECT RECENT ECONOMIC BACKSLIDING AND COME UP WITH A TIMETABLE WHICH WILL MEET IMF REQUIREMENTS. IMPORTANT FISCAL MEASURES NEED TO BE TAKEN SOON. THE NIGERIANS WILL NEED TO DEMONSTRATE ACTION TO THE IMF STAFF WHO ARE TO VISIT AGAIN IN AUGUST. GRATEFUL IF YOU COULD REGISTER THESE CONCERNS ORALLY WITH OKONGWU, PARTICULARLY THE NEED FOR RENEWED ENDORSEMENT BY THE IMF. YOU COULD SAY YOU UNDERSTAND THAT THE MAIN ISSUES ARE LIKELY TO BE THOSE MENTIONED IN THE CHANCELLOR'S LETTER (THE FOREIGN EXCHANGE SYSTEM, MONETARY AND FISCAL POLICY, INCLUDING PARTICULARLY THE SIZE OF THE BUDGETARY DEFICIT AND DOMESTIC INTEREST RATES). YOU COULD THEN ASK HIM HOW HE SEES THE NEXT MOVES, AND EMPHASISE THAT THE UK EXECUTIVE DIRECTOR CANNOT SUPPORT A PROGRAMME WHICH THE FUND STAFF THEMSELVES DO NOT RECOMMEND. YOU SHOULD UNDERLINE THAT OUR EXPORT CREDIT PACKAGE IS STILL CONTINGENT ON GOOD PROGRESS WITH THE IMF PROGRAMME.

5. PLEASE ALSO REPORT AS SOON AS POSSIBLE OKONGWU'S PREFERENCES ON THE TIMING OF HIS MEETING WITH THE CHANCELLOR.

GLENARTHUR
MONETARY
WAD
MR MURDO
MR REEVE

CONFIDENTIAL



phyp
cc: Sir G Little
Mr Mountfield
Mr Pitzier
(with
enclosed letter)

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

3 August 1987

Russell Dixon Esq
APS/Secretary of State
Foreign & Commonwealth Office
Downing Street
LONDON SW1A 2AL

Dear Russell

... We spoke about this letter from the Chancellor to the Nigerian Minister of Finance. You kindly undertook to arrange for its despatch.

Yours sincerely

Jonathan Taylor

J M G TAYLOR

CONFIDENTIAL



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

31 July 1987

His Excellency Dr S P Okongwu
Minister of Finance

A handwritten signature in dark ink, appearing to read 'John Major', written in a cursive style.

Our High Commissioner in Lagos, Martin Ewans, has conveyed to me your suggestion of an early meeting, to talk about Nigeria's economic problems and your hope to establish a consultative group of friendly countries.

I am most grateful to you for your suggestion of a meeting, and I look forward to this. I am afraid that your request reaches me just as I am about to start my summer holiday, and it will not be possible to fit in a meeting in August. We shall of course be seeing one another at the Commonwealth Finance Ministers' meeting in Barbados at the end of September, and I should be delighted to arrange a bilateral talk then.

As you know, the United Kingdom Government remains very anxious to help Nigeria through its current economic difficulties. I was very glad that it proved possible to announce the resumption of ECGD cover, which took place on 28 July. We much appreciate the close cooperation which has developed among our officials, and we continue to attach great importance to hearing your analysis of recent developments.

In this connection, I was concerned about recent changes in the foreign exchange system. It is important that the market should be left to work flexibly and freely to ensure the efficient use of Nigeria's foreign exchange inflows. And I was also somewhat worried to hear about the size of the public sector deficit. No doubt another important concern in your own mind at this time is finding a way forward in reaching an early settlement with the uninsured creditors, and in reaching a final agreement with the commercial banks. All this is relevant to the discussion in the IMF Executive Board in September following the recent visit of an IMF Article IV Mission. It is important that significant progress will have been made, to enable the UK Executive Director to give his full support to the programme both then and at the first review of the current Stand By Agreement. This in turn will help with your

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approach to the Paris Club for the next round of rescheduling of official debt.

I hope we can also discuss your suggestion of a consultative group in some detail when we meet. The usual practice, as you know, is for the IBRD to take the lead in arranging such groups, and I am sure your best course is to discuss the idea with them. However, you can be sure that the United Kingdom would wish to play a constructive part in such a group, and we would be pleased to discuss the arrangements for such a meeting with your own people and of the staff of the World Bank. For such a meeting to be a success it will be important to demonstrate that the present Nigerian recovery programme has the backing of the international financial institutions.

With warm personal good wishes.

A handwritten signature in black ink, appearing to read 'Nigel Lawson', written in a cursive style.

NIGEL LAWSON

CONFIDENTIAL

CONFIDENTIAL

FM LAGOS

TO IMMEDIATE FCO

TELNO 809

OF 040855Z AUGUST 87

INFO IMMEDIATE HM TREASURY, DTI, BANK OF ENGLAND, ODA, ECGD

INFO PRIORITY UKDEL IMF/IBRD WASHINGTON

Chy X below. I imagine you
will still want to delay any
meeting until CFM. 25 5/3

DMP

CH/EXCHEQUE	
REC.	- 5 AUG 1987
ACTION	MR MOUNTFIELD
COPIES TO	MR SERG. LITNER MR PITCAIRN

YOUR TELNOS 520 AND 521: OKONGWU

SUMMARY

1. OKONGWU STILL ANXIOUS TO MEET THE CHANCELLOR AND PRESS THE CASE FOR A CONSULTATIVE GROUP. BELIEVES THAT NIGERIA MEETS THE CRITERIA AND THAT HE HAS WORLD BANK SUPPORT. INSISTS THAT (APART ONLY FROM THE QUESTION OF PETROLEUM SUBSIDIES) NIGERIA IS ON COURSE WITH IMF AND THAT THEIR REQUIREMENTS WILL BE MET.

DETAIL

2. I CALLED ON OKONGWU THIS MORNING (3 AUGUST). I GAVE HIM THE CHANCELLOR'S LETTER AND HAD OVER AN HOUR'S DISCUSSION WITH HIM. THE FOLLOWING IS THE UPSHOT.

3. CONSULTATIVE GROUP. OKONGWU CLEARLY HAS THE WIND IN HIS TAIL AND WISHES TO PRESS AHEAD. HE HAD (AS WE KNEW: MY TELNO 802) DISCUSSED THE QUESTION WITH CONABLE. THE LATTER HAD AGREED THAT NIGERIA MET THE WORLD BANK'S CRITERIA (WHICH OKONGWU SPELT OUT: MY TELNO 802 PARA 1(B)) AND HAD ASSURED HIM OF HIS SUPPORT. CONABLE HAD, HOWEVER, SUGGESTED THAT IT MIGHT BE BETTER FOR NIGERIA TO GET BRITAIN TO TAKE THE INITIATIVE. OKONGWU SAID THAT NIGERIA CONTINUED TO LOOK TO BRITAIN AS HER KEY SUPPORTER, AND THAT HE HOPED VERY MUCH THAT THE CHANCELLOR WOULD MEET HIM IN LONDON AS SOON AS HE GOT BACK FROM HOLIDAY; HE WAS MOST ANXIOUS TO 'KEEP UP THE MOMENTUM'. HE WOULD BE MOST GRATEFUL IF THE CHANCELLOR COULD OFFER HIM A TIME FOR A MEETING. COMMENT. I DO NOT THINK THAT IT IS ANY ACCIDENT THAT OKONGWU AND HUSEIN (MY TELNO 802) USED VERY MUCH THE SAME LANGUAGE IN PUTTING THE CASE FOR A CONSULTATIVE GROUP. MY SUSPICION IS THAT HUSEIN, WHO IS NOTHING IF NOT AN ACTIVIST, HAS THOUGHT UP THIS PROPOSAL AS HIS SWAN SONG ON LEAVING NIGERIA, AND HAS SOLD IT BOTH TO CONABLE AND TO THE NIGERIANS.

4. THE NIGERIAN ECONOMY AND THE IMF. I WENT OVER THE POINTS IN YOUR TELNO 520, PARAGRAPH 4. OKONGWU INSISTED THAT, EXCEPT IN ONE PARTICULAR, THE NIGERIAN GOVERNMENT WERE ON SIDE WITH THE IMF. HE AGREED WITH YOUR POINT ABOUT THE FLEXIBILITY OF THE FOREIGN EXCHANGE MARKET AND HAD PUT HIS WEIGHT (NOT ALTOGETHER SUCCESSFULLY) BEHIND THE PROPOSITION THAT IT SHOULD NOT BE INTERFERED WITH. HE THOUGHT THAT HE HAD NOW GOT HIS WAY.

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SEE MY TELNO 808). HE DID NOT (NOT) ACCEPT THE POINT ABOUT THE DEFICIT, EXCEPT INsofar AS THE QUESTION OF THE PETROLEUM SUBSIDY WAS RELEVANT. THE GOVERNMENT HAD IN FACT ABOLISHED THE SUBSIDY LAST YEAR, BUT HAD OMITTED TO PUT IN PLACE A PERMENENT MECHANISM FOR KEEPING IT THAT WAY. THE DEVALUATION OF THE NAIRA HAD THEREFORE CAUSED IT TO BE REVIVED (NIGERIA IMPORTS MANY OF HER FINISHED PETROLEUM PRODUCTS). THE ABOLITION OF THE SUBSIDY WAS A POLITICAL HOT POTATO, BUT HE WAS CONFIDENT THAT THE GOVERNMENT WOULD VERY SOON GRASP IT. OTHERWISE DISCIPLINE WAS TIGHT AND INFLATION LOW.

5. UNINSURED CREDITORS AND THE BANKS. AGAIN, HE HAD BEEN DOING HIS BEST. NIGERIA WOULD NOT RENEGE ON HER OBLIGATIONS. DISCUSSIONS WITH THE LONDON CLUB WERE CURRENTLY TAKING PLACE.

6. ECGD LINE OF CREDIT. OKONGWU SAID THAT THE PRESIDENT HAD BEEN 'THRILLED' AT THE ANNOUNCEMENT. HE LOOKED FORWARD TO THE ECGD VISIT TO FIRM UP THE DETAILS. I EMPHASISED THE IMPORTANCE OF HIS MINISTRYS PLAYING THEIR ROLE EXPEDITIOUSLY AND EFFICIENTLY.

7. INVESTMENT. WE ENDED WITH A LONG DISCUSSION OF THE INVESTMENT CLIMATE. I TOLD HIM FRANKLY THAT THERE WAS MUCH CURRENT SCEPTICISM AND WENT OVER THE STANDARD GROUND OF THE VARIOUS DISINCENTIVES, INCLUDING LACK OF ASSURANCES OF CONTINUITY OF POLICY, PROBLMES OF EXPATRIATE EMPLOYMENT ETC. HE TOOK IT WELL, AND AGAIN INSISTED THAT HE PERSONALLY WAS ON THE SIDE OF THE ANGELS AND WAS BATTLING HARD FOR POSITIVE GOVERNMENTAL ATTITUDES. HE AGREED THAT IT WAS ALL-IMPORTANT TO RESTORE A RELIABLE TRACK RECORD.

8. COMMENT. OUR DISCUSSION SHOWED THAT OKONGWU WAS FULLY AWARE OF THE IMF REQUIREMENTS AND OF THE TIMETABLE. HE INSISTED (AND I BELIVE HIM) THAT HE HAS THE BACKING OF THE PRESIDENT IN MEETING THEM. WE WILL KEEP IN TOUCH WITH THE VISITING IMF STAFF.

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LAHPAN 2584

MONETARY
WAD
MR MUNRO
MR REEVE

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CONFIDENTIAL

GRS 851
CONFIDENTIAL

CONFIDENTIAL
FM LAGOS
TO IMMEDIATE FCO
TELNO 809

mpf

CH/EXCHG	
REC.	- 5 AUG 1987
100000	MR MOUNTFIELD
TO	MR G. LITTLE
	MR PITCAIRN

OF 040855Z AUGUST 87
INFO IMMEDIATE HM TREASURY, DTI, BANK OF ENGLAND, ODA, ECGD
INFO PRIORITY UKDEL IMF/IBRD WASHINGTON

IPS/Chancellor
We are replying,
offering a
meeting with
Sir G Little
in early Sept
2. Mr Pitcairn.

YOUR TELNOS 520 AND 521: OKONGWU

SUMMARY

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1. OKONGWU STILL ANXIOUS TO MEET THE CHANCELLOR AND PRESS THE CASE FOR A CONSULTATIVE GROUP. BELIEVES THAT NIGERIA MEETS THE CRITERIA AND THAT HE HAS WORLD BANK SUPPORT. INSISTS THAT (APART ONLY FROM THE QUESTION OF PETROLEUM SUBSIDIES) NIGERIA IS ON COURSE WITH IMF AND THAT THEIR REQUIREMENTS WILL BE MET.

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LAHPAN 2584

MONETARY
WAD
MR MUNRO
MR REEVE

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CONFIDENTIAL

Alex
Paper
PSE
Prup

FROM: AMANDA HIGGINS
DATE: 21 August 1987

SIR G LITTLER

cc PS/Chancellor
Mr Mountfield o/r
Mrs Case
Mr Pitcairn

PROPOSED CALL BY OKONGWU IN EARLY SEPTEMBER

The Foreign Office has informed me that Okongwu will not now be visiting London in early September and that instead he is likely to request a meeting with the Chancellor in Barbados or Washington later in the month.

Amanda Higgins

AMANDA HIGGINS

*1. 2/2 to grant/commence of
for Mrs. POM. Whether or not
can be done - all the cases
I am not sure
of work on it
have
Cassell (a serious
her) follow this
S. Middle
for provide.*

FROM: P MOUNTFIELD
DATE: 16 September 1987

CHANCELLOR OF THE EXCHEQUER

cc Sir P Middleton
Sir G Littler
Mr Cassell

THREAT TO NIGERIAN BANK ACCOUNT IN LONDON

(The Bank of England have asked us to restrict circulation of this note to those named above: please do not copy without further reference.)

The Bank have warned us of the risk that legal action may be taken to seize funds held in an account which they operate on behalf of the Nigerian Central Bank. The risk is probably not immediate. But there is very little we can do to avert it. It could be highly embarrassing if it happened.

2. Background.

a. Paris Club.

Under the terms of the Paris Club agreement signed last December, Nigeria has been making monthly payments since April into a special account held at the Bank of England. The total so far amounts to \$350m. This money is held by the Bank for disbursement to Paris Club creditors, as and when they sign bilateral agreements implementing the Paris Club deal. So far, only three (including ECGD) have signed. ECGD is already owed sums totalling £30m. But the Bank of England cannot make payments from the account without the authority of the Central Bank of Nigeria, who are required to give 15 days notice. The Bank of England is required to notify the Secretary of the Paris Club of all such disbursements (in order to maintain parity of treatment between creditors) but he has no power to veto them. Similarly, since this is not an escrow account, the Bank of England cannot refuse a legal

instruction from the CBN to pay the money to another bank in another country, outside British jurisdiction.

b. The Trust Deed.

In parallel with the Paris Club operation, Nigeria reached separate settlements with the commercial banks and with the uninsured trade creditors. Promissory notes have been issued to some of the latter group, whose debts have been recognised by the Nigerian authorities. Others have outstanding claims which are still in dispute.

3. Those creditors who have already received promissory notes and are signatories to the agreement have certain rights under a Trust Deed, the trustees of which are the Law Debenture Trust Company. Their representative (Mr David Murison) has been negotiating on their behalf, because Nigeria now wishes to defer still further the due payments under the promissory notes - in effect, to re-reschedule them. The account at the Bank of England would normally be covered by sovereign immunity. But under the terms of the Trust Deed, Nigeria signed away its rights and granted a waiver in favour of the holders of promissory notes. That group, acting collectively (or individual creditors acting on their own, if LDTC fails after a certain time to take action on their behalf and at their request) are apparently the only group of creditors who could legally threaten the sums held by the Bank of England. If the current negotiations with the promissory note holders break down, there is a danger that this would happen quite quickly. Since the total claims of the creditors concerned already total over \$3.5 billion this would wipe out at a stroke the money held by the Bank.

4. Implications.

The Bank do not believe the immediate threat is all that great, but the situation could deteriorate rapidly if the negotiations fail. The sequence would be that a group of aggrieved creditors,

no less than 25% of the present total, would ask for a meeting. They would ask LDTC to take legal action, initially to freeze the account at the Bank of England and then to attach it. The action would take the form of an interim injunction. If Murison failed to act, it would be open to an individual creditor to proceed independently. Once it was public knowledge that such an interim injunction had been granted, even though it were appealed by the Bank, the rush would be on to seize all other Nigerian assets, wherever situated. There has already been one such attempt, in the Italian courts, to attach some Nigerian ships: this has been settled out of court in a way we do not yet understand. The Bank of England are concerned lest this pattern be repeated.

5. The threat is threefold:

a. Such action would greatly sour our relations with the Nigerian authorities, and wreck any chance of reasonable debt settlement in the immediate future.

b. It would damage the credibility of the Bank of England, as a safe haven for the funds of other central banks (although the Bank believe that they would not be liable to reimburse the Nigerian authorities).

c. It would severely damage the UK in its relations with other creditor governments, who would see funds which they believed belonged to them paid out to another group of creditors.

6. Possible Defensive Action.

We have looked at ways of averting this threat. The most obvious one would be to distribute the present funds to the creditors. However, there is no way of doing this, without an instruction from the Nigerian government. And to alert them would probably lead them to move the funds immediately to another country. The Bank are satisfied (on legal advice) that they have no duty of

care to their Nigerian clients to warn them of the risk. The most we can do - and are doing - is to remind the Nigerians at frequent intervals that they already owe substantial sums to ECGD from this account, and they should authorise early payment. But, at a meeting at ECGD yesterday, the Nigerians made a derisory offer, of some £10 million against £30m which ECGD claim is due. (Much larger sums are, of course, due later this year: but those are not yet deposited in the special account.) In any case, special action by ECGD would risk accusation from the other two creditors who have signed their bilaterals, that we were trying to steal an unfair advantage over them. The Bank advise that you should not raise this with Okongwu when you see him in Washington.

7. The Bank's view, which I fear I share, is that we can do nothing about this. The Bank however, were very anxious that you should be aware of the risk, so that your instructions could be taken in a hurry if things go wrong.

8. One final complication. One of the smaller holders of promissory notes is Minorities Finance, the ex-JMB subsidiary still partly owned by the Bank of England. However, we are assured that this will not be among the first to take action.

R1

P MOUNTFIELD



BF 18/9

FROM: J M G TAYLOR

DATE: 17 September 1987

PS/SIR P MIDDLETON

THREAT TO NIGERIAN BANK ACCOUNT IN LONDON

The Chancellor has seen Mr Mountfield's minute of 16 September. He would be grateful for Sir Peter Middleton's comments as soon as possible.

2. He has commented that whether or not anything can be done - and in the circumstances he is not at all sure that it would not be a good thing to alert the Nigerians - it looks as if the Bank have been excessively careless (or someone has) to allow this situation to be possible.

A handwritten signature in dark ink, appearing to be 'JMG'.


J M G TAYLOR

PERSONAL AND CONFIDENTIAL

- (b) The Nigerians might withdraw the money from the account. This would be rather eccentric behaviour. It compounds their bad faith in negotiating one deal while failing to disclose another. In any event they would be in the dog house, not us.
- (c) The Paris Club agreement might fail because of (a) or (b) above or because the Governments were no longer willing to proceed unless the position of the Trust Deed is sorted out. This would just have to be faced.

4. My guess is that the Paris Club would assume the risk of action by the debenture holders was small and would wish to continue with the arrangements, possibly seeking assurances from the Nigerians. But this would be better than what would look like a conspiracy of silence if things go wrong. As we know from the tin affair, this sort of thing brings moral and maybe legal claims.

5. I gather that the FCO have been told by the Bank as well as ourselves. There is a Paris Club meeting on Thursday. We need to decide what to do in the near future. Would you like to discuss? Or would you like me to take the matter up with the Deputy Governor while you are away?



P E MIDDLETON

CONFIDENTIAL



FROM: A C S ALLAN
DATE: 22 September 1987

*pm
(rest of papers
→ Balhale)*

SIR P MIDDLETON

THREAT TO NIGERIAN BANK ACCOUNT IN LONDON

The Chancellor discussed your minute of 21 September with you at your bilateral this morning.

2. The Chancellor said he very much agreed with your views, and thought we should inform the Paris Club. But there were some awkwardnesses about this, and it would be worthwhile finding out before Thursday's meeting some more about the commercial creditors: are most of them British? and how difficult will it be for them if they do not get the money? You said you planned to discuss this and other points with the Deputy Governor. You would also consider whether it was more appropriate for the Bank of England or the Treasury to inform the Paris Club.

ACSA

A C S ALLAN



Permanent Secretary
H M TREASURY

[Handwritten signature in red ink]

Chancellor,

You will
wish to see how
we dealt with this
I do not think the
Bank can really be
blamed for taking
on the account - though
they will be more
careful in future. They
had no reason to
think that sovereign
immunity had been waived
for the debenture holders -
and the Nigerian Central
Bank, which was a party
to both transactions,

P.S. p/1.

FROM: P MOUNTFIELD
DATE: 25 September 1987

SIR P MIDDLETON

cc Mr Cassell
Sir G Littler o/r
Mr Mayes Bank of England

THREAT TO NIGERIAN BANK ACCOUNT IN LONDON

As agreed at your meeting with the Deputy Governor on 23 September, I made a very low-key statement at the Paris Club yesterday. The text of the relevant part, as you approved it, with some minor re-ordering suggested by Mr Loehnis, is attached. I buried this away within a longer speech about the state of play on the Nigerian IMF programme, our own bilateral negotiations, and the negotiations with the banks. I included in this the thought that creditor governments should accelerate, so far as possible, their bilateral negotiations with Nigeria (which are due to be completed by the end of the year) in order to clear the ground for the 1988 multilateral operation, which will probably start early in the new year. (The sooner that they do so, and are thus entitled to payments out of the Special Account, the less there will be for private creditors to try and get hold of, though of course I didn't say so.)

2. The statement went down quietly and no one asked any questions. I left the text of the Central Bank announcement, and of this bit of my speaking notes, with the Secretariat for circulation, on the ground that the position was highly technical and delegations might like to be reminded of what I said. (No formal record of these meetings is ever circulated.)

3. We have thus done what you asked: put up a clear marker, so that those who run may read. I doubt if they will; but at least we have put something on record to which we can refer in future if there are ever charges of bad faith levelled against us.

4. ECGD gave independently tumbled to the risk of attachment, and have been asking questions. I have arranged with Mr Mayes to speak to them and explain part of the position privately.

5. Mr Mayes tells me this morning that there has been virtually no reaction to the Nigerian statement, and all is quiet.

R1

P MOUNTFIELD

- Q. Offer to Noteholders - implications for Paris Club Creditors?
- A. - Have seen report in FT 23 September (read cut CBN press notice).
- Not a matter for HMG but will help by reporting what information we have.
 - Nigerians have reached agreement on terms of what they say is a final offer, which will now have to be submitted to noteholders for approval.
 - Notes are issued under a Trust Deed, which defines holders' rights and nominates LDTC as Trustee. Trustee in turn has appointed an 'adviser' to negotiate for them. Believe he has been in touch with some of you. He has negotiated the offer which is about to be put to noteholders.
 - Some of your ECAs already hold Pro Notes and will no doubt have seen all documentation. Others could get access via existing noteholders in their countries, or approach LDTC direct.
 - Two problems: existing noteholders, and those whose claims not yet reconciled
 - First group will not like terms on offer, but up to them to decide whether to accept them.
 - Second group will be very dissatisfied. Already British companies protesting to our Ministers - you too, no doubt. But little we can do to help. They chose not to insure themselves with our ECA.
 - Effects on PC members are governed by December 1986 Paris Club Agreed Minute which overtakes terms of earlier Pro Notes, some of which were issued to ECAs.
 - Note that terms offered to Pro Note holders considerably worse than we got.
 - Will upset those commercial banks who are holders of Pro Notes. Could further delay finalisation of banking agreement reached this summer. Will have to be sorted out before new IMF programme can be settled.

FINANCIAL TIMES

Wednesday September 23 1987

Nigeria disowns disputed debts

By Michael Holman

NIGERIA INTENDS to repudiate some \$2bn (£1.2bn) of disputed trade debts which form part of arrears exceeding \$5bn owed to companies around the world.

The move announced yesterday by the Central Bank of Nigeria is an apparent condition to the rescheduling of over \$3bn worth of promissory notes for the balance of the arrears whose validity has been accepted by the Government.

Creditors in Europe, the US and Japan responded to the terms with a mixture of anger, frustration and resignation. However, the terms offered for the rescheduling of the promissory notes are an improvement on a deal proposed by Nigeria last month and the creditors' main adviser has recommended acceptance.

This would bring to an end the dispute over the debt which began when Nigeria's oil revenues plummeted in the early 1980s and both insured and uninsured trade arrears soared.

Holders of the promissory notes are due to discuss the Nigerian proposals at a meeting to be convened next month by the London-based Law Debenture Trust. The trust has been representing the noteholders' interests in negotiations with the Nigerian Government, which last October announced that it could not meet the terms on which the notes were originally issued.

The main points of the Nigerian proposals, set out in a press statement by the Central Bank, include capitalisation of overdue interest on notes already issued at a rate of 1 per cent above the London Interbank Offered Rate, eight fixed quarterly payments of 1.25 per cent of the amount beginning in April 1988, and 80 fixed quarterly payments of 2 per cent thereafter, with the final payment in January, 2010.

The value of notes already issued is \$3.25bn. The proposals make allowance for claims which have been accepted by the Central Bank but against which notes have not yet been issued.

These new notes likely to total some \$500,000 will be sent out by the end of this year, says the statement.

However, the provision that has outraged many creditors, and which in some cases will lead to bankruptcy, reads in part: "Claims presently unmatched will not be approved or the subject of any further reconciliation by the Central Bank."

This refers to the protracted process whereby suppliers making claims for promissory notes have to get their documentation matched with documents held by the Nigerian authorities.



FROM: J M G TAYLOR
DATE: 2 October 1987

SIR PETER MIDDLETON

THREAT TO NIGERIAN BANK ACCOUNT IN LONDON

The Chancellor has seen and was most grateful for your manuscript note, covering Mr Mountfield's minute of 25 September. He has commented: "Good".

J M G TAYLOR