

PO-CH/NL/0349

PART A

Part. A.

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notify REGISTRY of movement)

Begins: 4/12/86

Ends: 22/12/87.



PO -CH /NL/0349



PART A

Chancellor's (Lawson) Papers:

ECONOMIC PROBLEMS IN
EGYPT

DD's: 25 Year

Phillips

22/11/95.

NL/0349

-CH

PO

PART A

Ch

Tim Lankester needs
instructions by 2.00pm
(cut time)

CHANCELLOR

FROM: P MOUNTFIELD
DATE: 4 December 1986

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mr Walsh
Mrs Case
Mr P Davis
Mr Pitcairn

*I am contact UK
with Mr. M's
formula & comment
how for it.*

EGYPT: IMF, RESCHEDULING, ETC

Issue:

Should the UK hold out, in isolation, for a viable IMF programme; or should it join the Americans, French and Germans in fudging the issue?

Background

2. We have known for some time (and warned you in the Lavelle Group reports) that the Egyptian debt problem was coming to the boil. An IMF team has recently returned from Egypt, following negotiations with the new (and harder-line) Finance Minister, Sidqi. Its initial reaction is that it cannot recommend an SBA on the basis of proposed Egyptian economic policies, and see no chance that the present Egyptian government is prepared to compromise. But the programme - as the Staff admit - will not establish balance of payments viability in the medium-term: ie there is little chance of the IMF or other creditors getting their money back. And it sends appalling signals to other debtors.

3. President Mubarak has meanwhile sent to all main creditor governments a demand, which includes a softer IMF programme, more bilateral aid, forgiveness of military debt, long-term

and generous debt rescheduling, and emergency food aid. This is being urgently studied. But it is already clear that there is an enormous financing gap for Egypt (put at \$1.5bn in the next 18 months, and getting worse, not better, even after the proposed IMF programme).

4. We were therefore faced with three options:

(i) To hold out for a tougher and more realistic IMF programme with a reasonable prospect of viability;

(ii) To join the others in urging the Fund to compromise (or at least, to acquiesce in this) with the distinct risk that the UK would have to join the others in financing the programme;

(iii) To sit tight and let the situation develop, so that shortage of funds would force the Egyptians back to the negotiating table.

5. The third of these (our and the Bank's preferred option) does not now seem to be politically-feasible. The question is whether the first has any chance of success, faced with the attitude of the other main creditors.

6. The danger of this course is that those who support it will be required to finance it. It is not just a matter of a harder or softer IMF programme, but of significant additional resources, as well as generous rescheduling.

7. The attached telegram (UKDEL 372) sets out the latest news, and suggests two alternative lines. The first of these (the hard line) is unacceptable to the FCO, for the obvious political reasons: they do not wish to be isolated, and do not think it will do any good. Simply to strike an attitude without chance of success is pointless.

8. The second seems to us much too soft. It implies that we are willing to go along with a programme which is doomed to failure.

9. A further approach, which we recommend, would be to throw the ball back to the Managing Director. I attach a revised formula for the UK intervention, which we have discussed with the Bank and the FCO. It is still subject to final clearance at senior level in the FCO, but I think I can get them to accept it. (X)

10. I fear Mr Lankester needs instruction by 2pm our time. Are you content with this formula please?

PM

P MOUNTFIELD

(X) I have now negotiated with the FCO the changes shown in manuscript. I recommend acceptance as amended.

PROPOSED UK INTERVENTION

"My authorities remain convinced that agreement on ^{an} ~~our~~ appropriate programme with the IMF remains essential to the solution of Egypt's problems and believe that this could unlock doors to new resources which might ease Egypt's transition to a more sustainable position. We welcome the progress reported today by Fund Staff and the adjustment measures already taken by Egypt. We cannot claim to have analysed fully the points set out by the Fund and the Egyptian authorities. We note the Staff's view (page 3) that corrections are required in the pricing, interest rate and exchange rate areas. How do staff assess Egyptian intentions? Any IMF programme will need further financial support. The paper itself says (para X) "this will require extraordinary assistance". Where does Staff think this would come from in present circumstances? We see in these papers ~~some~~ progress in the right direction. But we urge Staff and Egyptians to resolve these outstanding questions quickly, ~~in ways which will restore creditor and donor confidence, and safeguard the revolving character of Fund resources."~~

A number of aspects of a possible agreement, however, clearly remain to be analysed and quantified further, and questionmarks remain over the prospects for Egypt's eventual balance of payments viability.

and to work for an early agreement which meets Egypt's needs - which include the restoration of creditor and donor confidence - as well as safeguarding the revolving character of the Fund's resources.

DO NOT UNDERESTIMATE THE EGYPTIANS ARE STILL NOT PREPARED TO MOVE FAST ENOUGH OR FAR ENOUGH ON INTEREST RATES, THE EXCHANGE RATE OR THE FISCAL DEFICIT TO GIVE ANY REAL PROSPECT OF BALANCE OF PAYMENTS VIABILITY OVER THE MEDIUM TERM. A POSSIBLE FORM OF WORDS FOR US AT TOMORROW'S MEETING, WHICH WOULD BE CONSISTENT WITH THE PRIME MINISTER'S LETTER TO MUBARAK (FCO TELNO 365 OF 26 SEPT), IS GIVEN IN PARA. 5 BELOW. HOWEVER, SUCH A LINE IS LIKELY TO EXPOSE US TO THE FULL FORCE OF EGYPTIAN DISPLEASURE. A "SOFTER" VERSION WHICH WOULD PUT US CLOSE TO THE FRENCH IS THEREFORE OFFERED IN PARA. 6.

OPTION 1

5 "MY AUTHORITIES REMAIN CONVINCED THAT AGREEMENT ON AN APPROPRIATE PROGRAMME WITH THE IMF REMAINS ESSENTIAL TO THE SOLUTION OF EGYPT'S PROBLEMS AND BELIEVE THAT THIS COULD UNLOCK DOORS TO NEW RESOURCES WHICH MIGHT EASE EGYPT'S TRANSITION TO A MORE SUSTAINABLE POSITION. (NB THIS FOLLOWS THE PRIME MINISTER'S LETTER ALMOST WORD FOR WORD.) WE WELCOME THE PROGRESS REPORTED TODAY BY FUND STAFF AND THE ADJUSTMENT MEASURES ALREADY TAKEN BY EGYPT. A NUMBER OF ASPECTS OF A POSSIBLE AGREEMENT, HOWEVER, CLEARLY REMAIN TO BE ANALYSED AND QUANTIFIED FURTHER AND QUESTIONMARKS REMAIN OVER THE PROSPECTS FOR EGYPT'S EVENTUAL BALANCE OF PAYMENTS VIABILITY. WE URGE BOTH SIDES TO CONTINUE THE CONSTRUCTIVE DIALOGUE WHICH HAS BEGUN AND WORK TO AN EARLY RESOLUTION OF THESE ISSUES".

OPTION 2

6 FIRST AND SECOND SENTENCES AS OPTION 1. THEN:
"WE CANNOT CLAIM TO HAVE FULLY ANALYSED THE POINTS SET OUT BY THE FUND AND THE EGYPTIAN AUTHORITIES, NOR THE COMPLEX ISSUES OF FINANCING WHICH A FUND PROGRAMME ALONG THESE LINES WOULD RAISE. BUT BASED ON WHAT WE HAVE IN THE PAPERS BEFORE US, WE SEE THE CLEAR PROSPECT OF AN EARLY AGREEMENT."

NEXT STEP

7 THE G5 MEETS AGAIN AT 10 AM WASHINGTON TIME, THURSDAY. YOUR COMMENTS SHOULD REACH US BEFORE THEN.

8 FCO PLEASE ADVANCE TO MOUNTFIELD AND WALSH (HMT), WARE (BOE), BRAITHWAITE AND DRUMMOND (FCO) AND WOOTTEN (ODA).

LANKESTER

YYYY

ORWBAN 8205

DESKBY 04 0800Z

ADVANCE COPY

HD / ERD
HD / 30 NENAD

0-700, ZAX
M

IMMEDIATE

ZCZC
WBLNAN 3610
CONFIDENTIAL
DD 040800Z FCOLN
PP CAIRO
FM WADEL TO FCOLN
032300Z DEC
GRS 950

MR BRAITHWAITE
MR DRUMMOND, ERD

X-8

Mr MOUNTFIELD } HM TREASURY
Mr WALSH }
Mr WARE, BANK OF ENGLAND
Mr WOOTTEN ODA

BY
HSM

CONFIDENTIAL
FROM UKDEL IMF/IBRD, WASHINGTON
TO DESKBY 040800Z FCO
TELNO 372
OF 032300Z DECEMBER 86
AND TO PRIORITY CAIRO

RC

IMF: EGYPT - FCO TELNO 258

SUMMARY

1 AT LAROSHERE'S INFORMAL MEETING TOMORROW (THURSDAY) THE FRENCH AND GERMANS HAVE INSTRUCTIONS FROM THE HIGHEST LEVEL TO PRESS THE FUND TO REACH AGREEMENT WITH EGYPT ON AN SBA. THE US HAVE ALSO DECIDED NOT (REPEAT NOT) TO PUSH THE EGYPTIANS MUCH FURTHER. THE JAPANESE WILL PROBABLY FOLLOW SUIT. IF WE TAKE THE LINE IN PARA.3 OF TUR WE SHALL NOT BE ABLE (PARA.4 OF TUR) 'TO REMAIN IN THE CENTRE OF THE PACK'.

DETAIL

2 AT A G5 MEETING TODAY, THE FRENCH AND GERMANS MADE CLEAR THAT INTERVENTION AT THE HIGHEST LEVEL HAD LEFT THEM WITH FIRM INSTRUCTIONS TO PRESS THE FUND FOR EARLY AGREEMENT ON AN SBA WITH EGYPT. THE FRENCH WOULD TRY TO COUCH THIS IN LANGUAGE WHICH IMPLIED THAT BOTH SIDES HAD TO GIVE A LITTLE MORE. BUT THE REALITY WOULD BE - AND FINANISH, THE DIRECTOR REPRESENTING EGYPT WOULD BE QUICK TO SEE IT - THAT THEIR AUTHORITIES WERE PREPARED TO ACCEPT WHAT THE EGYPTIANS WERE CURRENTLY OFFERING AS THE BASIS FOR THE SBA. THE US LATER TOLD US THAT THEY TOO HAVE DECIDED TO BE BASICALLY SUPPORTIVE OF THE EGYPTIANS, THOUGH THEY WON'T GO QUITE AS FAR AS SUGGESTING THAT WHAT IS ON THE TABLE IS ENOUGH. THE JAPANESE SAID THEIR LINE WOULD BE SIMILAR.

3 ASKED THE US, FRENCH AND GERMANS WHETHER A TOUGHER POSITION BY THE UK (ALONG THE LINES OF TUR) WOULD INFLUENCE THEIR POSITION. THE ANSWER WAS UNEQUIVOCALLY NOT.

HOW TO PROCEED

4 UKDEL'S VIEW IS THAT THE FACTS CURRENTLY AVAILABLE FULLY SUPPORT THE LINE SUGGESTED IN PARA.3 OF YOUR TUR. NOTWITHSTANDING THE DOMESTIC POLITICAL CONSIDERATIONS WHICH DO NOT UNDERESTIMATE, THE EGYPTIANS ARE STILL NOT PREPARED TO

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FROM: A W KUCZYS

DATE: 4 December 1986

MR MOUNTFIELD

cc: Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mr Walsh
Mrs Case
Mr P Davis
Mr Pitcairn

EGYPT: IMF RESCHEDULING ETC

As I told Mr Pitcairn, the Chancellor was content with your formula, which he found commendable.

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

A W KUCZYS

GRS 325

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FM CAIRO

TO FLASH FCO

TELNO 754

OF 041242Z DECEMBER 86

AND TO FLASH UKDEL IMF IBRD, WASHINGTON

YOUR TELNO 258 TO UKDEL IMF/IBRD AND UKDEL IMF/IBRD 372:

EGYPT/IMF

1. I STRONGLY AGREE WITH THE VIEW EXPRESSED IN UKDEL IMF TUR PARAGRAPH 4 AND THE ALTERNATIVE WORDING GIVEN IN THEIR OPTION 2.

2. INDEED IN THE LIGHT OF THE REPORTED INSTRUCTIONS TO THE FRENCH AND THE GERMANS, ADOPTION OF THE LANGUAGE SUGGESTED AT OPTION 2 WOULD SEEM THE ONLY CHANCE WE HAVE OF REMAINING IN THE CENTRE OF THE PACK. THE EGYPTIANS ARE IN A HYPERSENSITIVE FRAME OF MIND AT THE MOMENT (MY US COLLEAGUE IS BEING LOBBIED INCESSANTLY BY DIFFERENT MINISTERS) AND WOULD BE BITTERLY RESENTFUL OF ANY ATTEMPT BY THE UK, (A RELATIVELY MODEST AID GIVER AND CREDITOR IN COMPARISON WITH THE US, JAPAN AND OUR MAJOR EUROPEAN PARTNERS) IF WE WERE SEEN TO BE HANGING SACK WHILE THE OTHERS TOOK A MORE HELPFUL AND CONSTRUCTIVE ATTITUDE.

3. ON THE SPECIFIC POINTS RAISED IN PARAGRAPH 5 OF FCO TUR:
 - A. EGYPT'S MILITARY DEBT. THE LATEST POSITION, GIVEN ME BY MY US COLLEAGUE TODAY, IS THAT THE PROBLEM OF EGYPT'S FMS DEBT WOULD BE TACKLED IN 2 STAGES. THE FIRST STEP WOULD BE A REDUCTION IN THE RATE OF INTEREST, WHILE THE SECOND STAGE WOULD DEAL WITH THE PROBLEM OF ARREARS BY INCLUDING FMS DEBT IN THE PARIS CLUB RESCHEDULING EXERCISE. A PAPER SETTING OUT THESE PROPOSALS IS APPARENTLY ON PRESIDENT REAGAN'S DESK BUT HAS NOT YET BEEN SIGNED.

 - B. BRIDGING FINANCE. ACCORDING TO WISNER, THE EGYPTIANS HAD REQUESTED US DOLLARS 500 MILLION IN BRIDGING SUPPORT (THIS WOULD BE IN CASH RATHER THAN BEING ALLOCATED TO PROJECTS AND WOULD NOT REPRESENT ADDITIONAL AID). WISNER DID NOT, HOWEVER, SAY WHETHER THIS HAD YET BEEN AGREED BY THE AMERICANS.

URWICK

CCHPAN 6668

MONETARY
NENAD

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START BRINGING PRIVATE FOREIGN CURRENCY HOLDINGS BACK INTO LOCAL CURRENCY.

5 STAFF EMPHASISED THAT, WHILE THERE WERE STILL THESE IMPORTANT DIFFERENCES, THE EGYPTIAN AUTHORITIES HAD SHOWN A MUCH GREATER WILLINGNESS TO ADJUST THAN HITHERTO.

6 STAFF WENT ON TO SAY THAT THERE WAS AN UNFILLED FINANCING GAP (DETAILS AS IN OUR TELNO 368 OF 2 DECEMBER) FOR THE 18 MONTHS OF ANY PROSPECTIVE SBA AND THAT THE BALANCE OF PAYMENTS OVER THE MEDIUM TERM BASED ON THE PROJECTIONS THEY HAD DONE DID NOT LOOK VIABLE (SEE PARA. 12 BELOW).

7 THE US QUICKLY MADE CLEAR THAT THEY TOOK FULL ACCOUNT OF EGYPTIAN POLITICAL AND ECONOMIC DIFFICULTIES. THE MOMENTUM OF NEGOTIATIONS FOR AN SBA SHOULD BE MAINTAINED AND A POSITIVE OUTCOME REACHED SOON. THE US WOULD SUPPORT MULTILATERAL RESCHEDULING OF EGYPT'S OFFICIAL DEBTS AND WOULD INCREASE THE CASH COMPONENT OF ITS OWN ASSISTANCE.

8 THE GERMANS FAVOURED AN SBA WHICH REPRESENTED 'A WELL-BALANCED FAIR POSITION' WHICH PAID DUE REGARD TO EGYPT'S POLITICAL AND ECONOMIC PROBLEMS. THE WAY HAD 'BEEN PAVED TOWARDS REACHING AGREEMENT WITH THE FUND IN THE NEAR FUTURE'. THE FRENCH ECHOED THESE SENTIMENTS. HE SPOKE NEXT.

9 THE JAPANESE HOPED THAT COMMON GROUND WOULD BE FOUND WHICH WOULD LEAD TO AN SBA. THE CANADIANS SPOKE IN SIMILAR TERMS BUT EMPHASISED THE IMPORTANCE OF BEING ABLE TO SUSTAIN THE ADJUSTMENT PROCESS TO OBTAIN MEDIUM-TERM VIABILITY. THEY WOULD CONSIDER INCREASING THEIR AID.

10 THE SAUDIS WERE THE MOST VISIBLY PRO-EGYPTIAN. THE DIFFERENCES BETWEEN THE TWO SIDES WERE SMALL AND AGREEMENT SHOULD NOW BE REACHED. THE FUND SHOULD BE FLEXIBLE IN INTERPRETING THE NEED FOR MEDIUM-TERM VIABILITY.

11 THE DANE (WHICH ESTABLISHED AFTERWARDS THAT HE HAD NOT HAD INSTRUCTIONS) WAS MUCH LESS ACCOMMODATING. THE NORDICS WOULD EXPECT TO SUPPORT AN SBA PROVIDED IT WAS APPROVED BY MANAGEMENT. HE HOPED ANY AGREEMENT WOULD BE CLOSER TO THE FUND'S PROPOSALS THAN TO THE EGYPTIANS'.

12 LAROSIERE SUMMED UP THE SENSE (IF NOT ALWAYS THE WORDS USED) AS BEING THAT HE HAD BEEN URGED TO 'STEP INTO AN AGREEMENT'. HOWEVER, THE BOARD HAD PREVIOUSLY EXPRESSED CONCERN OVER BEING PRESENTED WITH PROGRAMMES WHERE THE CHANCES OF THE FUND BEING REPAYED WERE NOT CLEARLY GOOD. IN HIS VIEW, THE HANCES IN THIS CASE WERE POOR UNLESS THE PARIS CLUB AND OTHER CREDITORS ACCEPTED FROM THE OUTSET THAT DEBT RESCHEDULING WOULD HAVE TO BE BOTH EXTRAORDINARILY GENEROUS AND LONG-TERM. THE FUND HAD DONE SOME FURTHER FINANCING GAP PROJECTIONS BASED ON EVEN MORE GENEROUS ASSUMPTIONS THAN THOSE IN THE DOCUMENT OF 2 DECEMBER (THIS TIME 100 PER CENT RESCHEDULING OF ARREARS, CURRENT DEBT SERVICE INTEREST AND PRINCIPAL ETC) AND THE FINANCING GAPS FOR THE PERIOD AFTER 1991 WERE STILL HORRENDOUS. (THE SUPPORTING TABLES AND ASSUMPTIONS ARE BEING FAXED TO LONDON.)

13 ANOTHER INFORMAL MEETING WAS FIXED FOR 22 DECEMBER, AT WHICH LAROSIERE HOPED TO HEAR THE RESPONSE OF CREDITORS TO

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FROM UKDEL IMF/IBRD, WASHINGTON

TO DESKBY 050800Z FCO

TELNO 376

OF 042300Z DECEMBER 86

AND TO PRIORITY CAIRO

IMF: EGYPT

SUMMARY

1 LAROS HERE TOOK THE SENSE OF TODAY'S INFORMAL MEETING AS BEING AN INSTRUCTION TO AGREE A STAND-BY ARRANGEMENT ON TERMS CLOSE TO THOSE NOW BEING OFFERED BY THE EGYPTIANS. HOWEVER, HE STRESSED THAT SUCH A PROGRAMME LACKED MEDIUM-TERM BALANCE OF PAYMENTS VIABILITY AND WANTED COMFORT FROM EGYPT'S CREDITORS - BEFORE HE COULD BRING THE SBA TO THE BOARD - THAT THERE WOULD BE EXTRAORDINARILY GENEROUS AND LONG-TERM RESCHEDULING OF OFFICIAL DEBT. OF THE DIRECTORS WHO SPOKE, THE NORDICS WERE THE LEAST SYMPATHETIC TO THE EGYPTIAN POSITION. SAUDI ARABIA, THE US, GERMANY, FRANCE, JAPAN AND CANADA WERE ALL (IN DESCENDING ORDER) SUPPORTIVE OF THE EGYPTIANS. HE SPOKE EXACTLY TO YOUR TELNO 261. WE MUST HAVE SOUNDED SLIGHTLY FIRMER THAN THE LAST TWO BUT LESS FIRM THAN THE NORDICS.

DETAIL

2 14 DIRECTORS WERE PRESENT - THOSE IDENTIFIED IN PARA.1 PLUS THE AUSTRALIAN, ITALIAN, IRANIAN, DUTCH, MEXICAN CONSTITUENCIES AND FINNISH (LIBYA, REPRESENTING EGYPT) - AT THE MD'S INFORMAL MEETING.

3 FUND STAFF BEGAN WITH A PRESENTATION ON PROGRESS IN THE NEGOTIATIONS WITH EGYPT BASED ON THE MATERIAL FAXED TO LONDON 2 DECEMBER: THEY MADE CLEAR THAT THEY STILL FOUND INADEQUATE THE EGYPTIAN PROPOSALS ON THE EXCHANGE RATE, INTEREST RATES AND PRICING POLICY. THE EXCHANGE RATE CHANGES PROPOSED BY THE EGYPTIANS WERE CRITICISED FOR:

(i) FAILING TO TACKLE THE PROBLEM QUICKLY ENOUGH, DISCOURAGING ECONOMIC ADJUSTMENT AND ENCOURAGING ADVERSE SPECULATION (EG THROUGH ADVERSE LEADS AND LAGS):

(ii) BEING ADMINISTRATIVELY CUMBERSOME AND FOR LEAVING MANY IMPORTANT COMMODITIES AT THE COMMERCIAL BANK RATHER THAN FREE MARKET EXCHANGE RATE UNTIL LATE IN THE PROGRAMME:

(iii) NOT PRODUCING ANY MOVEMENT OF THE CENTRAL BANK RATE TO THE FREE MARKET RATE, THUS (TOGETHER WITH THE PRICING PROPOSALS) LEAVING MANY AGRICULTURAL PRODUCER PRICES MUCH TOO LOW TO STIMULATE DOMESTIC OUTPUT.

4 ON INTEREST RATES, THE STAFF STRESSED THAT WITH INTEREST RATES CURRENTLY FIXED AT A MAXIMUM OF 13 1/4 PER CENT AND INFLATION APPROACHING 30 PER CENT, A MAJOR RISE IN INTEREST RATES WAS NEEDED TO ALLOCATE RESOURCES MORE EFFICIENTLY AND WAS A NECESSARY BUT NOT SUFFICIENT CONDITION TO

/START

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HIS CONCERNS OVER MEDIUM-TERM VIABILITY.

14 FCO PLEASE ADVANCE TO MOUNTFIELD AND WALSH (HMT),
WARE (BOE), BRAITHWAITE AND DRUMMOND (FCO) AND WOOTTEN (ODA).

LANKESTER

YYYY

ORWBAN 8239

MONETARY

NONAD

ADVANCED AS REQUESTED

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Ch

1. You may want to follow up 'x' on Monday. - I will try & remember to do so. (?? lunch)

FROM: MRS A F CASE
DATE: 5 December 1986

CHANCELLOR

2. Rather than sending the draft PS letter to No. 10, wd it be better to raise this with the PM at your bilateral next week?

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mr Walsh
Mr Mountfield
Mr P Davis
Mr Pitcairn

DKK 5/12 - I agree. A copy sent - inform, psr.

PS. X is done with.

EGYPT : IMF RESCHEDULING ETC

This note reports the latest position after yesterday's informal meeting of Executive Directors in Washington. The UK was isolated within G5 even on the basis of the relatively soft formula we adopted and an SBA that overtly does not lead to viability, or a fudge, is now firmly on the cards. Creditors have been asked to consider before 22 December what financing support they can give.

2. You may want to report the situation to the Prime Minister and, if opportunity arises, to raise the issues with the French and Germans in the margins of ECOFIN. (Sir G Littler might like to take parallel action in the Special Monetary Committee Meeting).

Washington discussion

3. The latest telegram UKDEL IMF 376 reports that at the Managing Director's meeting the staff made it clear that the Egyptian programme was inadequate on exchange rates, interest rates and pricing policy. There was an unfilled financing gap for the 18 months of any prospective SBA and the balance of payments over the medium term did not look viable. Even on more generous assumptions eg 100% rescheduling of everything (arrears, current debt service interest principal) the financing gaps for the period after 1991 were still horrendous.

below

4. In discussion the US, France, Germany, Japan and Canada all spoke in favour of an early agreement on an SBA maintaining the momentum of negotiations reaching a solution which paid due regard to Egypt's political and economic problems etc. The US and Canada both offered to increase their aid.

5. The Managing Director took this as an instruction to agree a standby arrangement on terms close to those now being offered by the Egyptians. However, given that the programme lacked medium term balance of payments viability, he sought assurances from the creditors of financing support and fixed another meeting for 22 December to hear creditors' offers.

6. Although it is disappointing that the UK was so isolated, Mr Lankester's intervention was well worthwhile. It has focussed attention on the unrealism of the programme and the need to decide how it should be financed. We need to use the time up to 22 December to urge others to think more seriously about them.

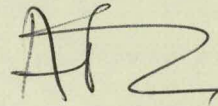
Next steps

X | 7. We clearly need to think carefully about our line and to re-examine the further financing calculations and the earlier proposals from Mubarak. It is unlikely that we can find much to offer on top of a generous rescheduling (which costs us little since we would not be paid anyway). We also need to consider the signals that this will send to other creditors. We will report further in the light of interdepartmental discussion. In the meantime you and Sir Geoffrey Littler might like to speak to the French and Germans next week to make clear our disappointment with the way events are shaping and our concern about the financial implications. We understand from the press that President Mubarak will visit France next week. I attach a speaking note.

8. I also understand that the Prime Minister, when she saw the original telegram, preferred the "soft option"

ch
Charles
Powell told
me this
today
JWK

which we advised you to reject. But she did not, of course, know the whole story. I therefore attach a short draft letter which we might send to No 10 before the weekend.

A handwritten signature in black ink, appearing to be 'AFZ', written in a cursive style.

MRS A F CASE

CONQUEROR

III

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SPEAKING NOTE

We welcome the progress which has been made in discussion between the Fund and the Egyptian authorities. We fully share others' concern about the Egyptians political and economic problem. However, we are seriously worried by the possibility that the Fund will agree a programme lacking medium term balance of payments viability. This can only give the wrong signal to other debtors; increase significantly the Fund's own arrears problem and lead to unacceptable demands for further funds from each of our countries.

2. We accept the need for very generous rescheduling and will play our full part in that. However, even with a generous contribution from the US, the Egyptian need for finance will remain "extraordinary". Must make it clear now that UK Government has no new funds to contribute.

3. We are not convinced that the way things are moving will lead to a solution which is in all our interests.

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DRAFT PS LETTER TO NO 10

cc FCO
Bank of England

We have known for some time, and warned in the regular reports on the international debt scene, that the Egyptian debt problem was coming to the boil. An IMF team has recently returned from Egypt, following negotiations with the new Finance Minister. Its initial reaction is that it cannot recommend a standby agreement on the basis of proposed Egyptian economic policies and see no chance that the present Egyptian Government is prepared to compromise. In the meantime President Mubarak has sent to all main creditor governments a demand, including a softer IMF programme, more bilateral aid, forgiveness of military debt, long term and generous debt rescheduling and emergency food aid. This is being urgently studied. But it is clear that there is an enormous financing gap for Egypt (put at \$1.5 billion in the next 18 months, and getting worse not better, even after the proposed IMF programme).

2. In the light of this, the Managing Director called an informal meeting of creditors this week at which the Staff's initial assessment was confirmed. The programme was considered

weak on exchange rates, interest rates and pricing policy. Even with 100% rescheduling, enormous financing gaps remained in the period after 1991.

3. Before that meeting it was clear that many other countries, including the US, France and Germany were willing to see the Fund compromise in a weak programme. I understand that the Prime Minister saw Mr Lankester's telegram (UKDEL IMF No 372). She favoured the second and softer "line to take". However by the time we knew her view, the Chancellor had already agreed a somewhat firmer line (agreed at official level between Treasury, Bank and FCO) intended to place responsibility on the Managing Director to look for a viable programme. I attach the text to which Mr Lankester spoke. But as expected, the US/French/German acquiescence in a softer programme was confirmed. The Managing Director seems therefore prepared to accept an instruction to agree a standby arrangement on terms close to those offered by the Egyptians but lacking medium term viability. He has however asked creditors to consider what additional resources they could provide. This is helpful, because it focusses attention on the unrealism of the programme and requires the others, notably the US, to think again about whether it can be afforded.

4. We shall be considering the UK line further in the light of President Mubarak's request and will report further. But the way in which events are moving raises serious questions in terms of the additional resources we shall be asked to provide on top of very generous rescheduling, of the Fund's own financial position and in terms of the appalling signals such an agreement would send to other debtors.

PROPOSED UK INTERVENTION

"My authorities remain convinced that agreement on an appropriate programme with the IMF remains essential to the solution of Egypt's problems and believe that this could unlock doors to new resources which might ease Egypt's transition to a more sustainable position. We welcome the progress reported today by Fund Staff and the adjustment measures already taken by Egypt. We cannot claim to have analysed fully the points set out by the Fund and the Egyptian authorities. A number of aspects of a possible agreement, however, clearly remain to be analysed and quantified further and questionmarks remain over the prospects for Egypt's eventual balance of payments viability. We note the Staff's view (page 3) that corrections are required in the pricing, interest rate and exchange rate areas. How do staff assess Egyptian intentions? Any IMF programme will need further financial support. The paper itself says (para X) "this will require extraordinary assistance". Where does Staff think this would come from in present circumstances? We see in these papers progress in the right direction. But we urge Staff and Egyptians to resolve these outstanding questions quickly, and to work for an early agreement which meets Egypt's needs - which include the restoration of creditor and donor confidence - as well as safeguarding the revolving character of the Fund's resources.

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16/12 PM Bilateral

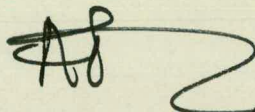
FROM: MRS A F CASE
DATE: 8 December 1986

CHANCELLOR

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mr Walsh
Mr Mountfield
Mr P Davis
Mr Pitcairn

EGYPT : IMF RESCHEDULING ETC

I attach a brief aide memoire designed to enable you to mention this to the Prime Minister on Wednesday.



MRS A F CASE

CONFIDENTIAL

EGYPT : AIDE MEMOIRE

Handling the Egyptian debt problem over the next few weeks will raise difficult issues. The Egyptians have been lobbying for special treatment. Until recently G5 response mirrored ours ie understanding of Egyptians economic and political problems but IMF agreed reform programme essential for prospect of viability [PM's words to Lufti in September.]

2. An IMF team has recently returned from Egypt following negotiations with the new Finance Minister. Its initial reaction is that proposed Egyptian economic policies remain inadequate (weak on exchange rates, interest rates and pricing policy). After generous rescheduling enormous financing gap remains (\$1.5 billion in the next 18 months and getting worse not better thereafter). In parallel Mubarak has sent all main creditor governments a demand for softer IMF programme, more bilateral aid, forgiveness of military debt, long term and generous debt rescheduling and emergency food aid.

3. Larosiere called an informal meeting to discuss way forward last week. Before that meeting it became clear that a number of other countries, including the US, France and Germany were willing to see the Fund compromise in a weak programme. This was confirmed at the meeting. The UK line was somewhat firmer. We welcomed progress and sought to place responsibility on the Managing Director to look for a viable programme.

4. The Managing Director took the views expressed as an instruction to agree a Standby Arrangement on terms close to those offered by the Egyptians even though the programme would lack medium term viability. He has asked creditors to consider before 22 December what additional resources they could provide.

5. Larosiere's request is helpful because it focusses attention on the unrealism of the programme and requires

Ch
Charles
Powell
phoned me
the day
after the
meeting at
the Fund, to
say that
PM would have
preferred
the "soft
option"
in Tim
Lankester's
telegram
AJK
9/12

the others, notably the US, to think again about whether it can be afforded. We are unlikely to be able to offer much on top of a generous rescheduling. (But we are not major creditors: British-owned banks exposure \$0.2 billion; ECGD exposure \$1 billion, including undisbursed loans.) Outcome now on cards would be serious for the Fund's own financial position and the appalling signal sent to other debtors.



FROM: CATHY RYDING

DATE: 8 December 1986

MRS A F CASE

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mr Walsh
Mr Mountfield
Mr P Davis
Mr Pitcairn

EGYPT: IMF RESCHEDULING ETC

The Chancellor was grateful for your minute of 5 December.

2. The Chancellor will raise the issue with the French and Germans in the margins of ECOFIN if an opportunity arises. The Chancellor would also like to report the situation to the Prime Minister* as you suggest, and would be grateful for a brief aide memoire.

3. On your paragraph 7, the Chancellor thinks that you are clearly right in saying that it is unlikely that we can find much to offer on top of a generous rescheduling.

*next opportunity is on Wednesday.

C. R

CATHY RYDING

CONFIDENTIAL



FROM: A W KUCZYS

DATE: 9 December 1986

MRS A F CASE

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr H P Evans
Mr Walsh
Mr Mountfield
Mr P Davies
Mr Pitcairn

EGYPT: IMF RESCHEDULING ETC

Further to Cathy Ryding's note of 8 December, the Chancellor was not in fact able to raise this subject at ECOFIN. Neither Stoltenberg nor Balladur were present in Brussels.

2. As Mrs Ryding's note also explained, the Chancellor would prefer to report orally to the Prime Minister on Wednesday, rather than sending the draft minute which you provided. Please could we have a brief aide memoire by close today (Tuesday)?

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

A W KUCZYS

CONFIDENTIAL

B. THEY SAW THE NEXT IMF INFORMAL MEETING IN WASHINGTON ON 22 DECEMBER AS OF CRUCIAL IMPORTANCE FOR EGYPT AND HOPED THAT THE PAPER OF 25 NOVEMBER WHICH EGYPT HAD SUBMITTED TO THE IMF WOULD PROVIDE AN ADEQUATE BASIS FOR A STANDBY ARRANGEMENT;

C. THEY WISHED TO AVOID THE PARIS CLUB LABEL FOR THE RESCHEDULING EXERCISE AND HOPED THAT AGREEMENT ON RESCHEDULING MIGHT THEREFORE BE REACHED IN WASHINGTON OR SOMEWHERE ELSE OTHER THAN PARIS. MAKHLOUF SAID THIS WAS A POINT TO WHICH PRESIDENT MUBARAK HIMSELF ATTACHED PARTICULAR IMPORTANCE.

D. I NATURALLY UNDERTOOK TO PUT THESE POINTS TO YOU. I ALSO RECALLED TO MAKHLOUF THAT THE NEW EGYPTIAN PRIME MINISTER, WHEN I FIRST CALLED ON HIM, HAD STRESSED TO ME THE IMPORTANCE HE ATTACHED TO ACHIEVING LONG-TERM SOLUTIONS FOR EGYPT'S PROBLEMS. IT WOULD REPRESENT A MAJOR SET-BACK TO EGYPT'S HOPES OF ECONOMIC RECOVERY IF WE HAD TO GO THROUGH THE SAME PROCESS IN 2 YEARS' TIME. THIS WAS WHY WE ATTACHED IMPORTANCE TO AGREEMENT BEING REACHED BETWEEN EGYPT AND THE IMF ON OUTSTANDING QUESTIONS. MAKHLOUF DID NOT DEMUR.

URWICK

YYYY

FCO PLEASE PASS SAVING PARIS AND BONN

CCN PARA W 2

CLEAR THAT THE ETC

PARA E 3 BETWEEN 15 AND OQXXXX 19
DECEMBER OF OECD ETC

MONETARY
NENAD
PS/MR RENTON
SIR DMIEDS

COPIES TO:-
ES/ODA
MR L F T SMITH, BANK
OF ENGLAND

(REPEATED AS REQUESTED)

-2-
CONFIDENTIAL

CONFIDENTIAL

CONFIDENTIAL

FM CAIRO

TO PRIORITY FCO

TELNO 775

OF 101155Z DECEMBER 86

INFO PRIORITY TREASURY, ODA, ECGD, DTI, BANK OF ENGLAND

INFO PRIORITY UKDEL IMF/IBRD, WASHINGTONX

INFO SAVING PARIS, BONN

UKDEL IMF/IBRD TELNO 376: IMF AND EGYPT

SUMMARY

1. THE EGYPTIANS PUT A NUMBER OF SPECIFIC REQUESTS FOR SPECIALLY FAVOURABLE TREATMENT, WHEN EGYPT'S CARE IS DISCUSSED BY CREDITOR COUNTRIES IN PARIS ON 18 DECEMBER. THEY HAVE SO FAR SHOWN NO DISPOSITION TO CRITICISE THE LINE TAKEN BY THE BRITISH REPRESENTATIVE AT THE 4 DECEMBER IMF MEETING IN WASHINGTON.

DETAIL

2. WHEN I SAW ASSISTANT FOREIGN MINISTER MAKHLOUF ON 10 DECEMBER AT HIS REQUEST (HE WAS ALSO SEEING SEPARATELY THE AMBASSADORS OF OTHER CREDITOR COUNTRIES: THE FOREIGN MINISTER HAD INTENDED SEEING US AS A GROUP YESTERDAY, BUT COULD NOT FIT IT IN BEFORE HE LEFT FOR PARIS). MAKHLOUF EXPRESSED EGYPT'S THANKS FOR THE POSITION ADOPTED BY HER PRINCIPAL CREDITORS AT THE 4 DECEMBER IMF MEETING IN WASHINGTON. HE SHOWED NO TENDENCY TO CRITICISE THE POSITION TAKEN BY THE BRITISH EXECUTIVE DIRECTOR AND MADE CT CGEAR THEU THE EGYPTIANS WERE IN GENERAL WELL SATISFIED WITH THE OUTCOME (AS INDEED THEY HAD GOOD REASON TO BE).

3. MAKHLOUF WENT ON TO SAY THAT THE EGYPTIANS UNDERSTOOD THERE WERE TO BE INFORMAL MEETINGS IN PARIS BETWEEN 15 END RO
BER OF OECD COUNTRIES AND THAT ON 18 DECEMBER
SHA'ALAN FOR THE IMF WOULD INITIATE A DISCUSSION ON EGYPT.

12 DECEM

4. IN THIS CONNECTION, THE EGYPTIANS HAD THREE SPECIFIC REQUESTS TO PUT TO US:

A. THAT WE SHOULD BE AS GENEROUS AS POSSIBLE OVER RESCHEDULING. THE EGYPTIANS WERE LOOKING FOR A GRACE PERIOD OF 7 YEARS WITH EFFECT FROM 1 JULY 1987 (THE BEGINNING OF EGYPT'S FINANCIAL YEAR AND ALSO OF HER NEXT 5-YEAR PLAN) AND THAT REPAYMENT OF PRINCIPAL AND INTEREST SHOULD BE SPREAD OVER 10 YEARS FROM THAT DATE:

CONFIDENTIAL

1B

FROM: P MOUNTFIELD
DATE: 10 December 1986

CHANCELLOR

Ch
Draft minute is
very long.
OK to issue?

PS
See also telegram
from Cairo, below.

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr H P Evans
Mr A Edwards
Mr Robson
Mrs Case
Mr Walsh
Mr P Davis
Mr Pitcairn

AWK
11/12

no multilateral
cut to
half no
push -
ok min.

EGYPT: FINANCIAL PROBLEMS

I understand you did not have a chance to speak to the Prime Minister about this on Wednesday. But the time has now come, I believe, when you should write to other colleagues too, to warn them of the developing problems, and to make sure that they all agree with the line we are taking. The problem is very complicated, both financially and politically. I attach a draft letter.

2. If you feel you should warn the Prime Minister first (given her past involvement) you might like to use the draft as a speaking note.

3. There are two deadlines: an informal discussion in the Paris Club on 19 December and a further informal meeting of the Executive Board of the IMF on 22 December. So it would be helpful to despatch this letter before the weekend.

RM

P MOUNTFIELD

DRAFT ^{MINUTE} [LETTER] TO THE FOREIGN AND COMMONWEALTH SECRETARY

cc Secretary
of State for
Trade and Industry
Secretary of State
for Defence
Prime Minister
Sir Robert Armstrong

EGYPT: FINANCIAL PROBLEMS

We have known for some time, from the reports of the Interdepartmental Debt Group, that the Egyptian debt problem was coming to the boil. Important decisions are needed in the next few days, at the IMF and in the Paris Club, which will commit us to the first stage of a programme of economic support for Egypt. But that stage by itself is unlikely to be successful. If we take it, together with our partners, we are in effect committing ourselves to going on with support for Egypt for a good many years. We shall come under great political pressure to take part, and I do not see much chance of stopping the bandwagon which is already rolling. But I must warn that the operation is likely to be a very expensive one before it is over.

2. An IMF team has recently returned from Egypt, following negotiations with the new Finance Minister. Its initial reaction was that it could not recommend

a standby agreement with the Fund on the basis of current and proposed Egyptian economic policies, and it saw no chance that the present Egyptian government is prepared to compromise. Meanwhile, President Mubarak has sent to all main creditor governments a demand, including a softer IMF programme, more bilateral aid, forgiveness of military debt, long-term and generous debt rescheduling, and emergency food aid. This demand is, no doubt, being urgently studied in all Western capitals. But it is clear that there is an enormous financing gap for Egypt. The Fund have put this at \$1.5bn for the next 18 months, even after rescheduling; and is projected to get worse not better, even after the proposed IMF programme. (There is some doubt about the Fund's figures; we are urgently trying to clarify them. But it is clear that on any showing the gap is very wide.)

3. In the light of this, the Managing Director of the IMF called an informal meeting of creditors last week, at which the Staff's initial assessment was confirmed. The programme was considered to be weak on exchange rates, interest rates and pricing policy. Even with 100% rescheduling of arrears and of new maturities of debt, enormous financing gaps continued even in the period after 1991.

4. Before that meeting it was clear that many other countries, including the US, France and Germany were

willing to see the Fund compromise in a weak programme. I authorised the UK Executive Director to take a reasonably firm line at the meeting, criticising the content of the programme and also drawing attention to the financing gaps. The objective was to place responsibility on the Managing Director to seek for a more viable programme. But, rather as we feared, the US/French/German acquiescence in a softer programme was confirmed. The Managing Director postponed a decision until 22 December, but seems ready to accept a Board instruction to negotiate a Stand-By Arrangement on terms close to those offered by the Egyptians, even though it would leave the Egyptian balancing ^E~~ing~~ of payments (on his staff's own showing) non-viable in the medium term. But he has asked creditors to consider what additional resources they could provide. This is helpful, because it focuses attention on the unrealism of the programme, and requires the others, notably the US, to think again about the problem of how funding can be provided on the large scale required.

5. I remain reluctant to go along with an IMF programme which is unlikely to succeed. I believe much firmer measures will be needed in the end, notwithstanding the unpopularity of the necessary measures in Egypt. Events will finally force the Egyptian Government to take them. There is a real danger, particularly in the "lame duck" period before

Monsieur de Larosiere's successor arrives, that the IMF will "go soft" on the major debtors. (We have seen similar signs on Brazil.) For that reason, I think we should be right to go on encouraging the Staff to take a firmer line, and avoid sending the wrong signals to the other debtors. But, short of an absolute veto, I do not believe we can persuade the rest of the Board. [However,] I do not expect final decisions to be taken at the Board on 22 December, for which no staff paper has been circulated.

6. [However,] If the programme does go ahead as proposed, it has to be supported by considerable additional finance (on top of the money which the IMF itself will provide). There are several sets of estimates circulating in Washington, but it seems clear that the immediate need is for somewhere between \$1.2 and \$1.5bn, even after rescheduling. Some of this may come from the IBRD; some from the USA; but there will still be a gap (of at least \$350m, on the last figures we have seen).

7. A major rescheduling of all Egyptian debt, from now until the early 1990s, seems inevitable. If it is not formally rescheduled, it will not be paid. [However,] This is a most unwelcome further addition to the burden of debt upon ECGD. It will require them to borrow about another £75-80m from the Exchequer next year, and more thereafter (not all of which is

allowed for in current forecasts). (However,) I think we shall have to join in this operation on conventional terms. I believe we should resist Egyptian demands for concessional interest rates and excessively-long repayment periods. They also want to avoid the label of 'Paris Club'; this can no doubt be accepted.

8. The Egyptians have also asked to be "forgiven" all military debt. Most of this is owed to the USA, and we believe they are planning to meet the request in part if not in whole. We ourselves have virtually no debt owed to MOD; but there is a big new ECGD-guaranteed loan, committed but not yet drawn down, which would be caught by the Paris Club rescheduling. Clearly we should resist any suggestion that this debt be "forgiven".

9. Egypt has not asked for a rescheduling of unguaranteed debt to commercial banks. There is only about \$5 billion of this, most of it short-term; and the UK share is very small.

10. We shall no doubt be asked to contribute direct bilateral aid as well. I believe ODA officials will be putting some suggestions to you shortly, but I cannot see that the UK can make more than a token effort here.

11. Further export credit, even if we were prepared to provide it, would not help much. It will already have been allowed for in the calculations of the financing gap (along with the imports which it would finance). However, as a matter of record, it is worth remembering that there is still about £140m of credit to be drawn down for the big Cairo Waste Water project, and further sums for other ECGD project business, as well as £150m on the defence sales memorandum mentioned above. Much of this will be liable to be rescheduled. Although obviously we must honour existing commitments (including the money already committed for the phase 1 of the Waste Water scheme) I do not believe that ECGD should accept further commitments in this market, except for minor expenditure necessary to finish off existing British projects. ECGD will, I understand, be preparing detailed proposals shortly including the position on continued short-term cover.

12. Egypt has also asked for substantial food aid. There is already a provision of about 34 mecu in the European Budget for this purpose. We shall need to be careful that the Commission, under French or German pressure, does not add substantially to this bill. The Egyptians have asked whether this aid can be accelerated, but we must await proposals from the Commission on this point. There are no specific proposals for other Community aid at present.

13. These are all short-term measures. As I undicated above, the size of the problem now facing Egypt means that further help will be needed right through to the 1990s (Egyptian economic crises seem to go in seven-year cycles, for which there is good biblical precedent). It is therefore particularly important that we should not accept new commitments in any of these areas which might become the thin ends of very large wedges.

14. No fresh Ministerial decisions are needed on any of these questions at present (apart from the matter of bilateral aid, on which your own officials are consulting you); but I thought it right that you and [my] other colleagues should know the full extent of the problems we now face.

15. I am sending copies of this [letter] ^{minute} to the Prime Minister, ^{Paul Channon and George Younger;} [and to the Secretaries of State for Trade and Industry and for Defence] and ^{to} Sir Robert Armstrong.

N.L.

Cathy

Can you get
the minute below
typed asap +
signed by Ch;
and the amendments
to the note by officials
done with sno-palce on
the top copy enclosed
Thanks

T.

DRAFT LETTER TO THE FOREIGN AND COMMONWEALTH
SECRETARY

cc Secretary
of State for
Trade and Industry
Secretary of State
for Defence
Prime Minister
Sir Robert Armstrong

EGYPT: FINANCIAL PROBLEMS

We have known for some time, from the reports of the Interdepartmental Debt Group, that the Egyptian debt problem was coming to the boil. Important decisions are needed in the next few days, at the IMF and in the Paris Club, which will commit us to the first stage of a programme of economic support for Egypt. But that stage by itself is unlikely to be successful. If we take it, together with our partners, we are in effect committing ourselves to going on with support for Egypt for a good many years. We shall come under great political pressure to take part, and I do not see much chance of stopping the bandwagon which is already rolling. But I must warn that the operation is likely to be a very expensive one before it is over. I attach a note by my officials, following a discussion with other departments and the Bank of England, which sets out the main problems.

ES

FROM: P MOUNTFIELD
DATE: 12 December 1986

PS/CHANCELLOR

EGYPT: FINANCIAL PROBLEMS

I have redrafted the letter, as you asked, in the form of a short covering letter from the Chancellor, followed by a 'Note by Officials'.

R1

CONFIDENTIAL

P MOUNTFIELD

No fresh Ministerial decisions are needed on any of these questions at present (apart from the matter of bilateral aid) on which your own officials are consulting you; but I thought it right that you and my colleagues should know the full extent of the problems we now face.

I am sending copies of this letter to the Prime Minister; and to the Secretaries of State for Trade and Industry and Defence and Sir Robert Armstrong.

MINUTE

DRAFT ~~LETTER~~ TO THE FOREIGN AND COMMONWEALTH
SECRETARY

~~cc~~ Secretary
of State for
Trade and Industry
Secretary of State
for Defence
Prime Minister
Sir Robert Armstrong

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agreed by mt.

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DATE: 12 December 1986

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I have redrafted the letter, as you asked, in the form of a short covering letter from the Chancellor, followed by a 'Note by Officials'.

R1

P MOUNTFIELD

ch

Peter Mountfield insisted that
colleagues did need all this detail.
But he has re-done as a short
covering note plus a paper by
officials. Content on this basis?

Yes; but I have made
a few changes to the
draft letter → no one will.
12/12

No fresh Ministerial decisions are needed on any of these questions at present (apart from the matter of bilateral aid) on which ^{(un) (sh)} your own officials are consulting you), but I thought it right that you and ^{my} my colleagues should know the full extent of the problems we now face.

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N.L.

EGYPT: FINANCIAL PROBLEMS

Note by the Treasury.

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2. In the light of this, the Managing Director of the IMF called an informal meeting of creditors last week, at which the Staff's initial assessment was confirmed. The programme was considered to be weak

on exchange rates, interest rates and pricing policy. Even with 100% rescheduling of arrears and of new maturities of debt, enormous financing gaps continued even in the period after 1991.

3. Before that meeting it was clear that many other countries, including the US, France and Germany were willing to see the Fund compromise in a weak programme. The Chancellor authorised the UK Executive Director to take a reasonably firm line at the meeting, criticising the content of the programme and also drawing attention to the financing gaps. The objective was to place responsibility on the Managing Director to seek for a more viable programme. But, rather as we feared, the US/French/German acquiescence in a softer programme was confirmed. The Managing Director postponed a decision until 22 December, but seems ready to accept a Board instruction to negotiate a Stand-By Arrangement on terms close to those offered by the Egyptians, even though it would leave the Egyptian balance of payments (on his staff's own showing) non-viable in the medium term. But he has asked creditors to consider what additional resources they could provide. This is helpful, because it focuses attention on the unrealism of the programme, and requires the others, notably the US, to think again about the problem of how funding can be provided on the large scale required.

4. The Treasury remains reluctant to go along with an IMF programme which is unlikely to succeed. It believes much firmer measures will be needed in the end, notwithstanding the unpopularity of the necessary measures in Egypt. Events will finally force the Egyptian Government to take them. There is a real danger, particularly in the "lame duck" period before ~~Monsieur~~ de Larosiere's successor arrives, that the IMF will "go soft" on the major debtors. (There have been similar signs on Brazil.) For that reason, it seems right to go on encouraging the Staff to take a firmer line, and avoid sending the wrong signals to the other debtors. But, short of an absolute veto, it will be almost impossible to persuade the rest of the Board. However, it is unlikely that final decisions to be taken at the Board on 22 December, for which no staff paper has been circulated.

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cc Chief Secretary
 Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Lavelle
 Mr Mountfield
 Mr H P Evans
 Mr A Edwards
 Mr Robson
 Mrs Case
 Mr Walsh
 Mr P Davies
 Mr Pitcairn



28

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

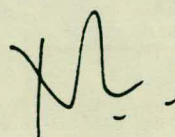
THE FOREIGN AND COMMONWEALTH SECRETARY

EGYPT: FINANCIAL PROBLEMS

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I am sending copies of this minute to the Prime Minister, George Younger, and Paul Channon, and to Sir Robert Armstrong.


 N.L.

15 December 1986

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on exchange rates, interest rates and pricing policy. Even with 100% rescheduling of arrears and of new maturities of debt, enormous financing gaps continued even in the period after 1991.

3. Before that meeting it was clear that many other countries, including the US, France and Germany were willing to see the Fund compromise in a weak programme. The Chancellor authorised the UK Executive Director to take a reasonably firm line at the meeting, criticising the content of the programme and also drawing attention to the financing gaps. The objective was to place responsibility on the Managing Director to seek for a more viable programme. But, rather as we feared, the US/French/German acquiescence in a softer programme was confirmed. The Managing Director postponed a decision until 22 December, but seems ready to accept a Board instruction to negotiate a Stand-By Arrangement on terms close to those offered by the Egyptians, even though it would leave the Egyptian balance of payments (on his staff's own showing) non-viable in the medium term. But he has asked creditors to consider what additional resources they could provide. This is helpful, because it focuses attention on the unrealism of the programme, and requires the others, notably the US, to think again about the problem of how funding can be provided on the large scale required.

4. The Treasury remains reluctant to go along with an IMF programme which is unlikely to succeed. It believes much firmer measures will be needed in the end, notwithstanding the unpopularity of the necessary measures in Egypt. Events will finally force the Egyptian Government to take them. There is a real danger, particularly in the "lame duck" period before Larosière's successor arrives, that the IMF will "go soft" on the major debtors. (There have been similar signs on Brazil.) For that reason, it seems right to go on encouraging the Staff to take a firmer line, and avoid sending the wrong signals to the other debtors. But, short of an absolute veto, it will be almost impossible to persuade the rest of the Board. However, it is unlikely that final decisions to be taken at the Board on 22 December, for which no staff paper has been circulated.

5. However, if the programme does go ahead as proposed, it will have to be supported by considerable additional finance (on top of the money which the IMF itself will provide). There are several sets of estimates circulating in Washington, but it seems clear that the immediate need is for somewhere between \$1.2 bn and \$1.5 bn, even after rescheduling. Some of this may come from the IBRD; some from the USA; but there will still be a gap (of at least \$350 m, on the last figures we have seen).

6. A major rescheduling of all Egyptian debt, from now until the early 1990s, seems inevitable. If it is not formally rescheduled, it will not be paid. However, this is a most unwelcome further addition to the burden of debt upon ECGD. It will require them to borrow about another £75-80m from the Exchequer next year, and more thereafter (not all of which is allowed for in current forecasts). The US will certainly have to join in this operation on conventional terms. But it is proposed to resist Egyptian demands for concessional interest rates and excessively-long repayment periods. They also want to avoid the label of 'Paris Club'; this can no doubt be accepted.

7. The Egyptians have also asked to be "forgiven" all military debt. Most of this is owed to the USA, and we believe they are planning to meet the request in part if not in whole. The UK have virtually no debt owed to MOD; but there is a big new ECGD-guaranteed defence loan, committed but not yet drawn down, which would be caught by the Paris Club rescheduling. Clearly we should resist any suggestion that this debt be "forgiven".

8. Egypt has not asked for a rescheduling of unguaranteed debt to commercial banks. There is only about \$5 billion of this, most of it short-term; and the UK share is very small.

9. We shall no doubt be asked to contribute direct bilateral aid as well. ODA officials will be putting proposals to the Foreign Secretary shortly, but *we* cannot see that the UK can make more than a token effort here.

10. Further export credit, even if we were prepared to provide it, would not help much. It will already have been allowed for in the calculations of the financing gap (along with the imports which it would finance). However, as a matter of record, it is worth remembering that there is still about £140m of credit to be drawn down for the big Cairo Waste Water project, and further sums for other ECGD project business, as well as £150m on the defence sales memorandum mentioned above. Much of this will be liable to be rescheduled. Although obviously we must honour existing commitments (including the money already committed for the phase 1 of the Waste Water scheme) ECGD will not accept further commitments in this market, except for minor expenditure necessary to finish off existing British projects. ECGD will be preparing detailed

proposals shortly including the position on continued short-term cover.

11. Egypt has also asked for substantial food aid. There is already a provision of about 34 mecu in the European Budget for this purpose. We shall need to be careful that the Commission, under French or German pressure, does not add substantially to this bill. The Egyptians have asked whether this aid can be accelerated, but we must await proposals from the Commission on this point. There are no specific proposals for other Community aid at present.

12. These are all short-term measures. As indicated above, the size of the problem now facing Egypt means that further help will be needed right through to the 1990s (Egyptian economic crises seem to go in seven-year cycles, for which there is good biblical precedent). It is therefore particularly important that we should not accept new commitments in any of these areas which might become the thin ends of very large wedges.

15

EGYPT: FINANCIAL PROBLEMS

Note by the Treasury.

An IMF team has recently returned from Egypt, following negotiations with the new Finance Minister. Its initial reaction was that it could not recommend a standby agreement with the Fund on the basis of current and proposed Egyptian economic policies, and it saw no chance that the present Egyptian government is prepared to compromise. Meanwhile, President Mubarak has sent to all main creditor governments a demand, including a softer IMF programme, more bilateral aid, forgiveness of military debt, long-term and generous debt rescheduling, and emergency food aid. This demand is, no doubt, being urgently studied in all Western capitals. But it is clear that there is an enormous financing gap for Egypt. The Fund have put this at \$1.5bn for the next 18 months, even after rescheduling; and is projected to get worse not better, even after the proposed IMF programme. (There is some doubt about the Fund's figures; we are urgently trying to clarify them. But it is clear that on any showing the gap is very wide.)

2. In the light of this, the Managing Director of the IMF called an informal meeting of creditors last week, at which the Staff's initial assessment was confirmed. The programme was considered to be weak

on exchange rates, interest rates and pricing policy. Even with 100% rescheduling of arrears and of new maturities of debt, enormous financing gaps continued even in the period after 1991.

3. Before that meeting it was clear that many other countries, including the US, France and Germany were willing to see the Fund compromise in a weak programme. The Chancellor authorised the UK Executive Director to take a reasonably firm line at the meeting, criticising the content of the programme and also drawing attention to the financing gaps. The objective was to place responsibility on the Managing Director to seek for a more viable programme. But, rather as we feared, the US/French/German acquiescence in a softer programme was confirmed. The Managing Director postponed a decision until 22 December, but seems ready to accept a Board instruction to negotiate a Stand-By Arrangement on terms close to those offered by the Egyptians, even though it would leave the Egyptian balance of payments (on his staff's own showing) non-viable in the medium term. But he has asked creditors to consider what additional resources they could provide. This is helpful, because it focuses attention on the unrealism of the programme, and requires the others, notably the US, to think again about the problem of how funding can be provided on the large scale required.

4. The Treasury remains reluctant to go along with an IMF programme which is unlikely to succeed. It believes much firmer measures will be needed in the end, notwithstanding the unpopularity of the necessary measures in Egypt. Events will finally force the Egyptian Government to take them. There is a real danger, particularly in the "lame duck" period before Larosière's successor arrives, that the IMF will "go soft" on the major debtors. (There have been similar signs on Brazil.) For that reason, it seems right to go on encouraging the Staff to take a firmer line, and avoid sending the wrong signals to the other debtors. But, short of an absolute veto, it will be almost impossible to persuade the rest of the Board. However, it is unlikely that final decisions to be taken at the Board on 22 December, for which no staff paper has been circulated.

5. However, if the programme does go ahead as proposed, it will have to be supported by considerable additional finance (on top of the money which the IMF itself will provide). There are several sets of estimates circulating in Washington, but it seems clear that the immediate need is for somewhere between \$1.2 bn and \$1.5 bn, even after rescheduling. Some of this may come from the IBRD; some from the USA; but there will still be a gap (of at least \$350 m, on the last figures we have seen).

6. A major rescheduling of all Egyptian debt, from now until the early 1990s, seems inevitable. If it is not formally rescheduled, it will not be paid. However, this is a most unwelcome further addition to the burden of debt upon ECGD. It will require them to borrow about another £75-80m from the Exchequer next year, and more thereafter (not all of which is allowed for in current forecasts). The US will certainly have to join in this operation on conventional terms. But it is proposed to resist Egyptian demands for concessional interest rates and excessively-long repayment periods. They also want to avoid the label of 'Paris Club'; this can no doubt be accepted.

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9. We shall no doubt be asked to contribute direct bilateral aid as well. ODA officials will be putting proposals to the Foreign Secretary shortly, but *we* cannot see that the UK can make more than a token effort here.

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proposals shortly including the position on continued short-term cover.

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FCS/86/306

CHANCELLOR OF THE EXCHEQUER

*The letter to will need
Pg No 10 will need
of the:*

CONFIDENTIAL

18/12/86

CH/EXCHEQUER	
REC.	18 DEC 1986
ACTION	MR MOUNTFIELD 18/12
COPIES TO	CST, EST
	SIR P. MIDDLETON
	SIR G. LITTLER
	MR LAVELLE

MR H. P. EVANS
MR A. EDWARDS
MR ROBSON
MRS CASE
MR WALSH
MR P. PAULS
MR PITCAIRN

Egypt: Financial Problems

1. Thank you for your minute of 15 December.
2. I share many of your concerns about the weakness of the current IMF proposals for a programme for Egypt. They do not provide a good basis for the solution of Egypt's problems in the medium term, and will be expensive to implement. But, as you say, there is not much we can do about it. We shall not change the minds of our G5 colleagues, and to stand out in isolation will only irritate both them and the Egyptians for no practical gain, particularly as we have less at stake than other donors and creditors.
3. I do not think we should assume that all is lost. Like many other debtors, Egypt will need a long-term relationship with the IMF. There will be a chance in subsequent programmes to toughen up the measures included in the initial one. As so often, the decision to go to the IMF has been politically difficult. Once that bridge has been crossed, and assuming the relationship gets closer, it should be easier to build on. Donor countries confronted with expensive long-term commitments will also want to see genuine economic reforms in place, and we should find them more responsive to our concerns as time goes on.



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4. Although long-term support for Egypt will be expensive, the other options are not attractive. The current alternatives to Mubarak are all worse. Our remaining economic interests in Egypt would be damaged. The potential costs to the West of an unstable Egypt, in an already highly volatile Middle East, are enormous. We have seen in Zambia and Brazil in recent weeks how quickly unpopular economic measures can get the mob on to the streets. In our judgement the potential for disruption and political instability in Egypt is considerably greater than in either of these. A breach with the IMF at this stage would only encourage Egypt's strong fundamentalist opposition and other opponents of Egypt's pro-Western orientation.

5. You rightly note that we shall be called upon to help fill the financing gap. I recognise that both our economic interests in Egypt and our enthusiasm for the proposed programme are smaller than those of the US, FRG and France. I believe that we should only do what is necessary to retain our credibility in the eyes of the Egyptians, and of our G5 colleagues whose support we may need to enlist for other countries in trouble. It is relevant here that our support for the Mexican package probably made it easier for us to enlist US help over Nigeria. We should make all we can of what we are already doing through new credits, bilateral aid, EC food aid and financial support, and the Paris Club.

6. I have agreed that we should offer an additional £10 million quick-disbursing financial aid on grant terms, on condition that agreement is reached between Egypt and the IMF on a programme of economic reform, and provided also that other donors between them agree to make available sufficient funds to fill the financing gap, and that the

/Paris Club

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Paris Club agrees upon an appropriate rescheduling arrangement. I should be happy for our Executive Director at the IMF to announce this at M. Larosiere's Board meeting on 22 December, and propose that we should follow this up with a high-level message to the Egyptians. I must add, however, that financial constraints on the aid programme mean that we have no more than this to offer, and I cannot pretend that £10 million will be seen by the Egyptians (or the IMF) as an adequate response to Egypt's plight.

7. I can understand your reluctance to commit further export credits, but I am surprised that you say that new export credits would not help much. I believe that a continued limited flow of new credits, if properly targetted with IBRD's help, would help to keep Egypt and the IMF together, would encourage the prospect of a tougher programme next time, would keep our foot in a market which, if it has little medium term potential, still has some in the long-term, would help us politically with both the G5 and the Egyptians, and would share the burden around Whitehall (we have already given Egypt Retrospective Terms Adjustment). I have in mind doing no more than maintaining our existing very restrictive cover, which is considerably less than we have done for Nigeria and Mexico. As you know ECGD cover is an area in which Egyptian misconceptions in the recent past about our attitude have proved hard to correct. I hope therefore that we can avoid falling behind the credit-insurer pack, which we would if we adopt new restrictions that would be regarded as a vote of no confidence by the Egyptians and which would have damaging knock-on effects on our ATP and trade efforts.



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8. I am copying this minute to the Prime Minister,
George Younger, Paul Channon and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

GEOFFREY HOWE

Foreign & Commonwealth Office
18 December 1986

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3052/38

FROM: H G WALSH

DATE: 18 December 1986

CHANCELLOR

Ch
Content with line
to take?
OK to send it
to No. 10 for clearance?

cc: Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Evans
Mrs Case
Mr Pitcairn
Mr Milligan

*OK (P) / Gush
2 or 3 paras.
Make clear that
Tom L shd be
from disambig
to mention N
Flow as x
with L
under 197
useful go on*

EGYPT: LINE TO TAKE: IMF INFORMAL BOARD MEETING ON 22 DECEMBER

You will have seen from Cairo telegram number 785 (attached) that it has been reported that President Mubarak has asked that his disappointment with the line taken by the UK Executive Director at the last informal meeting of the IMF Board on Egypt should be conveyed to the Prime Minister. He has also expressed the hope that the Prime Minister will issue instructions to ensure that Britain is more supportive of Egypt at the meeting on Monday.

2. The Egyptians are using their usual tactics to soften us up. We need to establish a line to take for Mr Lankester at Monday's meeting that does not leave us exposed within G5, but retains some pressure for the objective of balance of payments viability to at least be recognised. The proposed IMF programme remains inadequate to achieve viability, even in the medium term. A financing gap remains.

3. The outcome of the discussion at the Paris Club today was basically leading towards generous re-financing terms for Egypt provided that an IMF programme is agreed. The Overseas Development Administration have also now agreed that an additional £10 million of bilateral aid might be made available, but to mention this relatively low sum in the line to take might be counter-productive. But we shall give Mr Lankester discretion to mention it, if he feels that it would be useful.*

4. The attached line to take has been agreed with AEF, the

* *Ch*
See minute from Foreign Sec. in blue folder enclosed:
Sir G Howe seems to expect that Tim Lankester shd
announce this on Monday. *awk*

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FCO, ODA and the Bank of England. If you agree, your office might also agree it with No 10 early tomorrow. It could then be incorporated in a telegram of instructions to Mr Lankester later in the day.

H.W.

H G WALSH

Mr Maude - FCO
Mr Hudson - ODA
Mr Ware - Bank of England

Line to take

My authorities welcome the progress made so far in continuing efforts to reach agreement on a suitable programme for Egypt within the international institutions and also welcome policy reforms proposed by Egypt as a substantial step towards the necessary adjustment. The UK is very ready to assist in this process and has joined with other creditors in the Paris Club in recognising the need for a generous rescheduling of officially guaranteed debt over a period of years once a programme has been agreed. Substantial European Community assistance, to which the UK makes a substantial contribution, is also being made available. UK is keeping open existing undrawn export credit commitments worth over \$500 million and is ready to contribute towards Egypt's special needs within the limited resources of the UK aid programme. The achievement of balance of payments viability for Egypt in conditions of political and social stability is an important concern of HMG. But we recognise that this will be possible only in the medium term and stress importance of working towards IMF programmes sufficient to achieve this objective and to protect the Fund's resources.



FROM: A W KUCZYS

DATE: 19 December 1986

MR WALSH

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr H P Evans
Mrs Case
Mr Pitcairn
Mr Milligan

EGYPT: IMF INFORMAL BOARD MEETING ON 22 DECEMBER

The Chancellor has seen your minute of 18 December. As I have already told Mr Milligan, he is content with the line for Mr Lankester to take, except that (for the purposes of clearing it with the Prime Minister) it should be broken into two or three paragraphs. We should also make clear that Mr Lankester is being given discretion to mention the £10 million financial aid as and when he considers it useful to do so.

2. As I also mentioned to Mr Milligan, I would be very grateful for a short covering letter to No.10, which will need to take account of the Foreign Secretary's minute of yesterday to the Chancellor.

A handwritten signature in black ink, appearing to be 'AWK'.

A W KUCZYS

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6872 - 1

AND ALSO WELCOME POLICY REFORMS PROPOSED BY EGYPT AS A SUBSTANTIAL STEP TOWARDS THE NECESSARY ADJUSTMENT. THE UK IS VERY READY TO ASSIST IN THIS PROCESS AND HAS JOINED WITH OTHER CREDITORS IN THE PARIS CLUB IN RECOGNISING THE NEED FOR A MULTILATERAL RESCHEDULING OF OFFICIALLY GUARANTEED DEBT OVER A PERIOD OF YEARS ONCE A STANDBY HAS BEEN AGREED. SUBSTANTIAL EUROPEAN COMMUNITY ASSISTANCE, TO WHICH THE UK MAKES A SUBSTANTIAL CONTRIBUTION IS ALSO BEING MADE AVAILABLE. UK IS KEEPING OPEN EXISTING UNDRAWN EXPORT CREDIT COMMITMENTS WORTH OVER DOLLARS 500 MILLION AND IS READY TO CONTRIBUTE TOWARDS EGYPT'S SPECIAL NEEDS WITHIN THE LIMITED RESOURCES OF THE UK AID PROGRAMME. THE ACHIEVEMENT OF BALANCE OF PAYMENTS VIABILITY FOR EGYPT IN CONDITIONS OF POLITICAL AND SOCIAL STABILITY IS AN IMPORTANT CONCERN OF HMG. BUT WE RECOGNISE THAT THIS WILL BE POSSIBLE ONLY IN THE MEDIUM TERM AND STRESS IMPORTANCE OF WORKING TOWARDS IMF PROGRAMMES SUFFICIENT TO ACHIEVE THIS OBJECTIVE AND TO PROTECT THE FUND'S RESOURCES.

5. ODA HAVE NOW AGREED THAT SOME BILATERAL AID CAN BE MADE AVAILABLE TO EGYPT. YOU HAVE FULL DISCRETION TO MENTION THIS IN THE DISCUSSION IF YOU CONSIDER IT HELPFUL. OUR SUGGESTED LINE IS: UK HAS AGREED TO OFFER AN ADDITIONAL POUNDS 10 MILLION QUICK DISBURSING FINANCIAL AID ON GRANT TERMS FOR BRITISH GOODS AND SERVICES, ON CONDITION THAT AGREEMENT IS REACHED BETWEEN EGYPT AND THE IMF ON A PROGRAMME OF ECONOMIC REFORMS, AND PROVIDED ALSO THAT OTHER DONORS BETWEEN THEM AGREE TO MAKE AVAILABLE SUFFICIENT FUNDS TO FILL THE FINANCING GAP, AND THAT THE PARIS CLUB AGREES UPON AN APPROPRIATE RESCHEDULING ARRANGEMENT.

OVERALL ASSESSMENT

6. IT IS CLEAR FROM INFORMAL EB MEETING ON 4 DECEMBER AND YOUR SUBSEQUENT REPORTS THAT IMF IS BEING PLACED IN DIFFICULT POSITION. ON THE ONE HAND, OTHER G5 AND ITALY ARE CONTENT FOR VERY WEAK PROGRAMME TO PROCEED. ON THE OTHER, PROPOSED ADJUSTMENT MEASURES APPEAR INSUFFICIENT,

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*Nigel
PWP (my
letter to Charles
Powell, etc) fl*

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T.

OCCIAN 6872
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DD 191900Z WADEL
FM FCOLN TO WADEL
191100Z DEC
GRS 1118

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FM FCO
TO DESKBY 191900Z UKDEL IMF/IBRD WASHINGTON
TELNO 275
OF 191100Z DECEMBER 1986
INFO PRIORITY CAIRO

IMF: EGYPT

OBJECTIVE

1. INTERVENE LATE AND LOW KEY IN INFORMAL DISCUSSIONS TO ENDORSE PROPOSED PROGRAMME WITH RESERVATIONS - SEE FOLLOWING LINE TO TAKE. YOUR MAIN INTERVENTION SHOULD BE EXACTLY IN TERMS OF LINE TO TAKE BELOW. ANY SUBSEQUENT INTERVENTIONS NEED NOT SPECIFICALLY ECHO US/GERMAN/FRENCH SENTIMENTS BUT NEITHER SHOULD YOU BE ISOLATED WITHIN G5 - SEE SENSITIVITIES.
SENSITIVITIES
2. MUBARAK HAS WRITTEN TO PM CRITICISING LAST UK INTERVENTION AT EB - SEE TELNO 785 OF 18 DECEMBER.
LINE TO TAKE
3. THE FOLLOWING LINE TO TAKE HAS BEEN AGREED WITH THE CHANCELLOR AND IS BEING CLEARED WITH PM OVER WEEKEND - WE WILL CONFIRM ANY CHANGES ORALLY.
4. LINE TO TAKE
MY AUTHORITIES WELCOME THE PROGRESS MADE SO FAR IN CONTINUING EFFORTS TO REACH AGREEMENT ON A SUITABLE PROGRAMME FOR EGYPT WITHIN THE INTERNATIONAL INSTITUTIONS.

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ECGD CREDITS

9. THE AVAILABILITY OF NEW EXPORTS CREDITS WILL DEPEND ON THE NATURE OF THE RESCHEDULING PROPOSALS. IN ACCORDANCE WITH OUR NORMAL POLICIES, ECGD WOULD BE PREPARED TO CONTINUE TO MAKE SHORT TERM CREDIT AVAILABLE, PROVIDED EGYPT DOES NOT RESCHEDULE SHORT TERM DEBT. SO FAR AS MEDIUM AND LONG TERM DEBT IS CONCERNED, EGYPT WOULD IN PRINCIPLE BE ELIGIBLE FOR OUR SO CALLED DX FACILITY (UNDER WHICH COVER IS RESTORED EARLY FOR COUNTRIES WITH A GOOD ADJUSTMENT RECORD IN SUPPORT OF THEIR ADJUSTMENT PROGRAMME) THOUGH THE TIMING OF ANY RESUMPTION OF COVER WOULD DEPEND ON THE ADEQUACY OF THAT EFFORT. (FOR YOUR INFORMATION ONLY, EARLY RESUMPTION OF COVER FOR EGYPT LOOKS SOME WAY OFF GIVEN THE PRESENT IMF PROGRAMME). BUT WHITEHALL DISCUSSIONS ARE CONTINUING.

10. FIGURE OF DOLLARS 500 MILLION IS MADE UP OF UNDRAWN BALANCES ON SIGNED LOAN AGREEMENTS ON CIVIL BUSINESS OF POUNDS 208 MILLION, AND ON MILITARY BUSINESS DEFENCE LINES OF CREDIT OF POUNDS 150 MILLION.

EC POSITION

11. AS FAR AS THE EUROPEAN COMMUNITY IS CONCERNED UNDISBURSED MONIES UNDER THE SECOND PROTOCOL AT THE END OF AUGUST AMOUNTED TO 102 MECU FOR EIB LOANS AND 112 MECU FOR PROJECT AID. WE WOULD EXPECT THESE SUMS TO BE DISBURSED OVER THE NEXT TWO YEARS. UNDER THE THIRD MEDITERRANEAN PROTOCOL WE WOULD EXPECT EGYPT TO BE ELIGIBLE FOR AT LEAST THE SAME LEVEL AS THEY ENJOYED UNDER THE SECOND PROTOCOL, NAMELY 276 MECU. THE LIKELY DISBURSEMENT PERIOD IS 1988-1992. UNDER FOOD AID PROVISIONS EGYPT WILL HAVE RECEIVED ABOUT 34 MECU THIS YEAR AND IT WOULD BE REASONABLE TO ASSUME ROUGHLY THE SAME LEVEL FOR THE NEXT TWO CALENDAR YEARS. THERE IS NO AID DEBT. AS FAR AS WE ARE CONCERNED EGYPT WAS BROUGHT UNDER THE RTA ARRANGEMENTS FOR SOME YEARS AGO.

12. PLEASE CONFIRM TEXT OF YOUR INTERVENTION(S) DESKBY TO CAIRO SO THAT THEY CAN TELL EGYPTIANS EXACTLY WHAT

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AUTHORITIES LONG TERM COMMITMENT TO REFORM REMAINS UNCERTAIN, FINANCING GAP OVER LIFETIME OF PROGRAMME REMAINS LARGE ON LATEST DATA (DOLLAR 350 MILLION AFTER IBRD LOANS AND SPEEDING UP AID DISBURSEMENTS - CF SHAALAN'S MEMORANDUM OF 4 DECEMBER) AND STAFF SEE NO PROSPECT ON CURRENT ADJUSTMENT MEASURES OF MEDIUM TERM BOP VIABILITY BEING ATTAINED (YOUR TELNO 368 OF 2 DECEMBER, PARA 8). OUR WORRIES THAT PROGRAMME CONTAINS TOO MUCH FINANCING AND TOO LITTLE ADJUSTMENT WERE CONFIRMED BY PARIS CLUB DISCUSSIONS - SEE BELOW. ONLY CONCLUSION IS THAT EGYPTIAN SBA MAY WELL FACE SERIES OF BREAKDOWNS REQUIRING GENEROUS WAIVERS AND EXTRA FINANCE FROM CREDITORS IF IT IS TO BE COMPLETED. WE FULLY AGREE WITH PARA 4 OF YOUR TELNO 394 OF 18 DECEMBER THAT FUND'S CREDIBILITY IS BEING DAMAGED.

7. MOMENTUM AND POLITICAL PRESSURE ON CREDITORS IS SUCH THAT WE SEE NO PROSPECT, EVEN UNDER NEW MD, OF BETTER REQUEST FOR SBA BEING PUT TO EB - ON CURRENT TIMETABLE IN SECOND HALF OF MARCH AFTER FURTHER FUND MISSION EXPECTED TO VISIT CAIRO IN MID-JANUARY TO FINALISE PROGRAMME.
BACKGROUND - PARIS CLUB

8. TELNO 1338 OF 18 DECEMBER FROM PARIS REPORTS PARIS CLUB DISCUSSION ON EGYPT AND IMF TABLES HAVE BEEN FAXED TO YOU. EVIDENT FROM SHAALAN'S HARD-HITTING PRESENTATION THAT ON BASIS OF CURRENT PROPOSALS ONLY A WEAK ECONOMIC/FINANCIAL CASE EXISTS FOR FUND TO SUPPORT EGYPT. ALTHOUGH AUTHORITIES ARE, AT LAST, ADDRESSING PROBLEMS SERIOUSLY AND RECENT FISCAL MEASURES GO IN THE RIGHT DIRECTION, MAJOR UNCERTAINTIES REMAIN ON POLICY. NO MEETING OF MINDS BETWEEN EGYPT AND FUND ON EXCHANGE RATE UNIFICATION AND TOTAL DISAGREEMENT ON INTEREST RATE POLICY. SIMILARLY, AUTHORITIES HAVE YET TO SORT OUT WITH WORLD BANK IMPORTANT DETAILS CONCERNING PROPOSED INCREASES IN ENERGY PRICES AND LEVEL AND COMPOSITION OF THE FIVE-YEAR PUBLIC INVESTMENT PLAN. RESPONSE FROM CREDITORS WAS FAIRLY MUTED AND MOST MADE SYMPATHETIC NOISES, BUT DUTCH WERE BRUTALLY HONEST.

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YOU SAID TO AVOID MISUNDERSTANDINGS.

HOWE

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DISTRIBUTION

MONETARY

NENAD

covering CONFIDENTIAL

3052/41

FROM: H G WALSH

DATE: 19 December 1986

MR KUCZYS

cc: Mr Mountfield
Mr Evans
Mr Milligan

IMF: EGYPT

As you requested I attach a draft letter for you to send this afternoon to Charles Powell at No 10, covering the proposed line for Mr Lankester to take in the IMF discussion on Monday.

2. In two small respects the recommended line to take differs from that which the Chancellor cleared this morning, to bring it into line with the common line agreed by the Paris Club. In the second line of the second paragraph, the penultimate word has been changed from "generous" to "multilateral" and in the third line the word "programme" has been changed to "standby".

H.G.

H G WALSH

DRAFT

C Powell
10 Downing Street
LONDON SE1

EGYPT AND IMF

As you ^{may be} ~~are~~ aware, there will be an informal meeting of IMF Executive Directors on Monday to consider the proposed Fund programme for Egypt. I attach a line to take for Tim Lankester, ^{in Treasury, FCO and the Bank} which has been approved by the Chancellor, and agreed by officials. It is in line with the Chairman of the Paris Club's summing up on 17 December (Paris telno 1338), and takes account of the additional UK aid for Egypt mentioned in paragraph 6 of the Foreign and Commonwealth Secretary's minute of 18 December to the Chancellor ~~of the Exchequer~~.

2. In addition, the FCO have agreed that Mr Lankester has complete discretion to announce the UK's offer of £10 million bilateral aid to Egypt, if it would be useful in the discussion. I should be grateful for your approval of this line this afternoon if possible so that it can be transmitted to Washington before the weekend. Otherwise, we shall send it with an embargo.

A copy of this letter and attachment goes to Robert Culshaw at the FCO.

A W KUCZYS



cc Mr Mountfield
Mr Evans
Mr Milligan
Mr Walsh

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

19 December 1986

C Powell Esq
10 Downing Street
LONDON
SW1

Dear Charles

EGYPT AND IMF

... As you may be aware, there will be an informal meeting of IMF Executive Directors on Monday to consider the proposed Fund programme for Egypt. I attach a line to take for Tim Lankester, which has been approved by the Chancellor, and agreed by officials in Treasury, FCO and the Bank. It is in line with the Chairman of the Paris Club's summing up on 17 December (Paris telno 1338), and takes account of the additional UK aid for Egypt mentioned in paragraph 6 of the Foreign and Commonwealth Secretary's minute of 18 December to the Chancellor.

In addition, the FCO have agreed that Mr Lankester has complete discretion to announce the UK's offer of £10 million bilateral aid to Egypt, if it would be useful in the discussion. I should be grateful for your approval of this line this afternoon if possible so that it can be transmitted to Washington before the weekend. Otherwise, we shall send it with an embargo.

A copy of this letter and attachment goes to Robert Culshaw at the FCO.

Yours ever,

Tony

A W KUCZYS
Private Secretary

Line to take

My authorities welcome the progress made so far in continuing efforts to reach agreement on a suitable programme for Egypt within the international institutions and also welcome policy reforms proposed by Egypt as a substantial step towards the necessary adjustment.

The UK is very ready to assist in this process and has joined with other creditors in the Paris Club in recognising the need for a multilateral rescheduling of officially guaranteed debt over a period of years once a standby has been agreed. Substantial European Community assistance, to which the UK makes a substantial contribution, is also being made available. UK is keeping open existing undrawn export credit commitments worth over \$500 million and is ready to contribute towards Egypt's special needs within the limited resources of the UK aid programme.

The achievement of balance of payments viability for Egypt in conditions of political and social stability is an important concern of HMG. But we recognise that this will be possible only in the medium term and stress importance of working towards IMF programme sufficient to achieve this objective and to protect the Fund's resources.

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CH/EXCHEQUER	
REC.	22 DEC 1986
ACTION	MR WALSH ^{22/12}
COPIES TO	CST EST
	SIR P MIDDLETON
	SIR G LITTLE
	MR LAVELLE
	MR H EVANS
	MRS CASE
	MR PITCAIRN
	MR MILLIGAN

Foreign and Commonwealth Office

London SW1A 2AH

19 December 1986

Dear Charles

Egypt/IMF

I enclose a copy of Cairo telegram no 785 which reports President Mubarak's request that the Prime Minister should be informed of his disappointment with the line taken by the UK representative at the IMF on 4 December.

This approach is part of the Egyptian campaign for political support in their negotiations with the IMF (the background to the negotiations is set out in the recent exchange of minutes between the Chancellor of the Exchequer and Sir Geoffrey Howe). President Mubarak has seen President Mitterrand, Chancellor Kohl and Signor Craxi this month and has obtained pledges of new aid from Germany and Italy and of additional military supplies from France.

Our consistent aim has been to encourage the Egyptians to take realistic economic measures, whilst not appearing to be less sympathetic to their political difficulties than our rivals for influence in Egypt. The US, France and Germany now seem willing for political reasons to acquiesce in a less than adequate programme. I understand that the Treasury will be consulting you shortly about the instructions to be sent to our Executive Director at the IMF for the next meeting to discuss Egypt, probably on 22 December. These reflect consultation between the Treasury and the Foreign and Commonwealth Office.

Sir Geoffrey Howe considers that in order to reassure the Egyptians of our goodwill and our willingness to offer new aid in support of an agreement with the IMF, it would be helpful for our reply to the latest Egyptian representations to have the Prime Minister's personal endorsement. I enclose a draft telegram of instructions to Cairo along those lines.

I am copying this letter to Alex Allan (Treasury), John Howe (MOD), John Mogg (Department of Trade) and Michael Stark (Cabinet Office).

Yours ever

(R N Culshaw)
Private Secretary

C D Powell Esq.
PS/10 Downing Street

CONFIDENTIAL

CONFIDENTIAL*(Flash to Paris)*

CONFIDENTIAL
FM CAIRO
TO IMMEDIATE FCO
TELNO 785

DR

OF 171520Z DECEMBER 86
INFO IMMEDIATE TREASURY, ODA, ECGD, DTI, BANK OF ENGLAND
INFO IMMEDIATE UKDEL IMF IBRD, WASHINGTON
INFO SAVING BONN, PARIS, ROME, UKREP BRUSSELS, THE HAGUE

UKDEL IMF/IBRD TELNO 376: EGYPT/IMF

SUMMARY

1. PRESIDENT MUBARAK ASKS THAT HIS DISAPPOINTMENT WITH THE LINE TAKEN BY THE BRITISH EXECUTIVE DIRECTOR AT THE IMF MEETING IN WASHINGTON ON 4 DECEMBER SHOULD BE CONVEYED TO THE PRIME MINISTER. HE EXPRESSES THE HOPE THAT MRS THATCHER WILL ISSUE INSTRUCTIONS TO ENSURE THAT BRITAIN IS MORE SUPPORTIVE OF EGYPT AT THE NEXT IMF MEETING ON 22 DECEMBER.

DETAIL

2. WHEN I SAW DR OSAMA AL BAZ, MUBARAK'S SPECIAL POLITICAL ADVISER, ON 17 DECEMBER HE TOLD ME THAT THE PRESIDENT (FROM WHOM HE HAD JUST COME) HAD ASKED THAT I SHOULD PASS ON AN ORAL MESSAGE FROM MUBARAK TO THE PRIME MINISTER. AT THE IMF MEETING ON 4 DECEMBER THE BRITISH REPRESENTATIVE HAD BEEN AMONG THE LEAST SUPPORTIVE IN CONSIDERING EGYPTIAN REQUIREMENTS AND INDEED ONLY THE DUTCH HAD TAKEN A HARDER LINE. A FURTHER IMPORTANT MEETING OF THE PARIS CLUB WAS NOW IMMINENT AND THERE WAS TO BE A CRUCIALLY IMPORTANT IMF MEETING IN WASHINGTON ON 22 DECEMBER. MUBARAK HOPED THAT THE PRIME MINISTER WOULD ISSUE THE NECESSARY INSTRUCTIONS TO ENSURE THAT AT THE NEXT IMF MEETING THE BRITISH EXECUTIVE DIRECTOR WAS AT LEAST AS FORTHCOMING AS EGYPT'S OTHER PRINCIPAL CREDITORS. IT WOULD BE SAD, AND HARMFUL TO THE GOOD RELATIONS BETWEEN THE TWO COUNTRIES, IF BRITAIN WERE STILL SEEN TO LAG BEHIND EGYPT'S OTHER FRIENDS AT A TIME WHEN THE US AND ALL EGYPT'S OTHER PRINCIPAL CREDITORS WERE SHOWING A SUPPORTIVE ATTITUDE IN HELPING HER TO OVERCOME THE MANY DIFFICULTIES SHE FACED.

3. MAKING IT PLAIN THAT HE WAS SPEAKING PERSONALLY, AL BAZ WENT ON TO TELL ME THAT THE PRESIDENT HAD BEEN VERY UPSET AND DISAPPOINTED BY THE BRITISH ATTITUDE. HE ALSO TOLD ME THAT, IN THE CASE OF THE DUTCH, THE EGYPTIANS WERE CONSIDERING SPECIFIC REPRISALS SUCH AS CUTTING DOWN THE NUMBER OF KLM FLIGHTS TO EGYPT; BUT HE DID NOT SUGGEST THAT ANYTHING OF THIS KIND WAS CONTEMPLATED IN OUR CASE. IN REPLY TO AL BAZ I NATURALLY UNDERTOOK TO CONVEY MUBARAK'S MESSAGE. STRESSING THAT I TOO WAS SPEAKING PERSONALLY, I SAID THAT LANKESTER'S

CONFIDENTIAL*INTERVENTION*

CONFIDENTIAL

INTERVENTION COULD NOT POSSIBLY BE INTERPRETED AS UNFRIENDLY TO EGYPT. BUT BECUASE OF OUR CONCERN FOR THE IMPACT OF THE TERMS OF ANY AGREEMENT REACHED WITH EGYPT ON OTHER FUND BORROWERS, WE HAD NOT FELT ABLE TO GIVE UNEQUIVOCAL SUPPORT FOR A PROGRAMME IMPORTANT ASPECTS OF WHICH STILL REMAINED TO BE ELABORATED IN DISCUSSIONS WITH THE FUND. BUT I HOPED THAT OUR FRIENDSHIP AND SUPPORT FOR EGYPT WERE NOT IN DOUBT, AS THE EXTENSIVE BRIEFING I HAD JUST GIVEN AL BAZ ON ARAB/ISRAEL HAD SO CLEARLY DEMONSTRATED (SEE MY TELNO 788 NOT TO ALL).

4. I EXPRESSED SOME PUZZLEMENT OVER EGYPT'S DISPLEASURE WITH THE DUTCH, AS OUR REPORTING TELEGRAM (SEE TUR) HAD NOT MENTIONED THEIR INTERVENTION AT ALL. BUT AL BAZ WAS POSITIVE THAT IT WAS THE DUTCH (RATHER THAN THE DANES) WHO WERE THE PRINCIPAL CULPRITS IN EGYPT'S EYES. MY DUTCH COLLEAGUE WHOM I SAW AFTERWARDS REMAINS IN IGNORANCE, HAVING RECEIVED NO REPORT ON THE LINE TAKEN BY THE DUTCH REPRESENTATIVE AT THE IMF AND SO FAR NO REPROACHES FROM THE EGYPTIAN SIDE.

5. I AM REPORTING SEPARATELY ON EGYPTIAN BRIEFING TO EC AMBASSADORS ON THEIR DISCUSSIONS WITH MCPHERSON (HEAD OF US AID) WHO IS VISITING CAIRO.

COMMENT

6. I HAD BEEN EXPECTING AN EGYPTIAN REACTION OF THIS KIND AND INDEED HAD BEEN SURPRISED WHEN IT HAD NOT COME AT MY EARLIER MEETING WITH ASSISTANT FOREIGN MINISTER MAKHLOUF (MY TELNO 775 REFERS). THE EGYPTIANS HAVE BEEN CONDUCTING A VERY INTENSIVE AND APPARENTLY SUCCESSFUL LOBBYING OPERATION, INCLUDING MUBARAK'S MEETING WITH 4 EUROPEAN LEADERS LAST WEEK: AS A CONSEQUENCE THE ATTITUDE OF OTHER CREDITORS SEEMS TO HAVE SOFTENED CONSIDERABLY IN COMPARISON WITH OUR OWN. IF WE WISH TO AVOID DAMAGE TO ANGLO-EGYPTIAN RELATIONS (AND WE ARE NOT ONE OF EGYPT'S MAJOR CREDITORS) I CAN ONLY RECOMMEND THAT WE SHOULD GET BACK INTO THE CENTRE OF THE PACK QUICKLY, ESPECIALLY IN VIEW OF THE VERY FRIENDLY ATTITUDE BEING SHOWN BY THE AMERICANS (ON WHICH SEE ALSO MIERS' MINUTE OF 9 DECEMBER RECORDING HIS DISCUSSIONS IN LONDON ON THIS WITH AMBASSADOR WISNER).

URWICK

YYYY

FCO PLEASE PASS SAVING ADDRESSEES

(REPEATED AS REQUESTED)

CCHPAN 6908

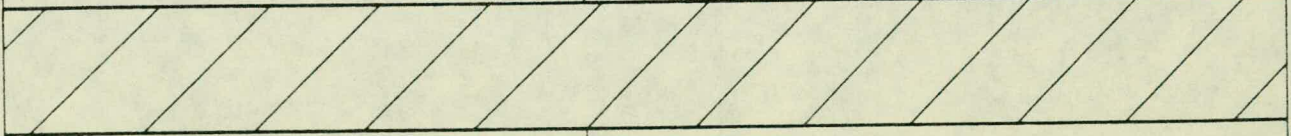
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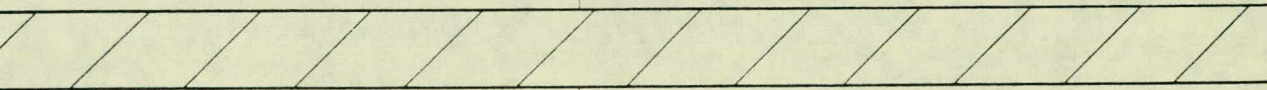
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Authorised for despatch by:		Initials	Date/time
For COD use only	Comcen reference	Telegram number	Processed by

OUT TELEGRAM (CONT)

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 residual financing gap and that the Paris Club agrees on an
 appropriate rescheduling arrangement.)
 3. You might also stress the Prime Minister's continuing
 commitment to realistic economic solutions which take adequate
 account both of the integrity of the IMF and of Egypt's special
 political circumstances.
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 MR FERGUSSON
 SIR D MIERS
 ADDITIONAL
 MR J ROBERTS, ES, ODA
 MR L F T SMITH, BANK OF
 ENGLAND
 NNNN



For distribution order see Page	Catchword:
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PPS in



10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

22 December 1986

Dear Robert,

EGYPT/IMF

You and Tony Kuczys in the Treasury both wrote to me on 19 December about the line to take at the informal meeting of IMF Executive Directors today to consider the proposed Fund programme for Egypt. Your letter also enclosed a draft telegram of instructions to Cairo.

Both the line and the draft instructions can be considered approved.

I am copying this letter to Tony Kuczys (HM Treasury), Tim Walker (Department of Trade and Industry) and to Trevor Woolley (Cabinet Office).

CH/EXCHEQUER	
REC.	23 DEC 1986 ✓ 23/12
ACTION	MR WALSH
COPIES TO	CST EST SIR P MIDDLETON SIR G LITTLE MR LAVELLE MR H EVANS MRS CASE MR PICCART MR MILLIGAN

Yours sincerely,

(CHARLES POWELL)

R. N. Culshaw, Esq.,
Foreign and Commonwealth Office.

Janet

FROM: P MOUNTFIELD
DATE: 22 December 1986

PS/CHANCELLOR

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr H P Evans
Mr A Edwards
Mr Robson
Mrs Case
Mr Walsh
Mr P Davis
Mr Pitcairn

Channon
Mr Channon will follow
Mr Mountfield
for the 20th Dec 17

EGYPT: FOREIGN SECRETARY'S MINUTE OF 18 DECEMBER

I do not think the Chancellor need react to this yet. It is a comment by the Foreign Secretary on the Chancellor's own minute. We have yet to see what Mr Channon will say - or the Prime Minister.

2. After the holiday, and after the IMF Board meeting on 22 December, we can see what further Ministerial decisions are needed. Meanwhile I might make two comments:

(i) The Foreign Secretary is quite wrong to say that British support for the Mexican package made it easier to enlist US help over Nigeria. (Para 7) The fact is that the Americans were obstructive and at one point they nearly torpedoed the Nigerian deal. We owe the Americans nothing over this.

(ii) The only issue in dispute is the provision of new export credit cover. Here Sir G Howe seems to be proposing that we should continue to make cover available (beyond that which we are already committed). If so, this is nonsense. It is already clear from the figures that we are unlikely to get any money back from Egypt until the next century. It is financially irresponsible, and quite possibly illegal, to offer fresh guarantees on loans to

*ah
There is
a report
in the
telegrams
folder
DWK
28/12

Egypt in this situation: we know very well that they would not be repaid on time. But this is an issue we can tackle when the Secretary of State for Trade and Industry reacts - as I believe he will do, negatively.

RM

P MOUNTFIELD

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FM UKDEL IMF/IBRD WASHINGTON
TO DESKBY 230800Z FCO
TELNO 397
OF 222300Z DECEMBER 86
AND TO DESKBY 230800Z CAIRO

IMF: EGYPT

SUMMARY

ERB (IMF DEPUTY MANAGING DIRECTOR) CONCLUDED FROM TODAY'S INFORMAL MEETING THAT THE FUND SHOULD MOVE QUICKLY TO A STANDBY ARRANGEMENT WITH EGYPT. A MISSION WOULD LEAVE FOR CAIRO EARLY IN THE NEW YEAR AIMED AT COMPLETING SUCH AN ARRANGEMENT, BUT THERE WOULD NEED TO BE FURTHER DISCUSSIONS ON INTEREST RATES AND THE EXCHANGE RATE. PRIOR TO THE ARRANGEMENT BEING PUT TO THE BOARD, THERE WOULD NEED TO BE A CONSULTATIVE GROUP MEETING TO ENSURE THAT THE FINANCING GAP FOR THE PERIOD OF THE PROGRAMME WAS ADEQUATELY COVERED. HE PROMISED TO CONVEY TO IBRD MANAGEMENT THE CONCERNS OF DIRECTORS ABOUT THE DELAY IN FINALISING THE IBRD ENERGY LOAN AND POSSIBLY ALSO THE IBRD INDUSTRIAL SECTOR LOAN.

2. MOST DIRECTORS WELCOMED THE OUTCOME OF THE RECENT PARIS CLUB MEETING, AND URGED A SPEEDY OUTCOME TO THE NEGOTIATIONS WITH THE FUND. I SPOKE PRECISELY TO THE TEXT IN PARA. 4 OF FCO TELNO 275 PLUS THE SUGGESTED LINE ON NEW ODA ASSISTANCE IN PARA. 5. ONLY THE SCANDINAVIANS AND THE DUTCH SAID IN TERMS THAT MORE WAS NEEDED FROM THE EGYPTIANS BEFORE AN SBA COULD BE CONCLUDED.

DETAIL

3. SHAALAN BEGAN BY REPORTING ON THE PARIS CLUB MEETING MUCH AS IN PARIS TELNO 1338. HE SAID THAT CREDITORS SEEMED QUITE SYMPATHETIC TO CONTINUED RESCHEDULING OVER THE MEDIUM-TERM, AS WAS REFLECTED IN THE PARIS CLUB'S TERMS OF REFERENCE ON EGYPT. HE MADE CLEAR THAT, IN THE FUND'S VIEW, EGYPT'S BALANCE OF PAYMENTS VIABILITY WOULD REMAIN IN QUESTION INTO THE 1990S EVEN AFTER FIVE YEARS OF ASSUMED RESCHEDULING.

4. SHAALAN HANDED ROUND A NEW TABLE ON THE FINANCING GAP. THIS SHOWS THE GAP AFTER RESCHEDULING TO BE DOLLARS 800 MILLION FOR THE 18 MONTHS JANUARY 1987 - JUNE 1988. HE EXPLAINED THAT THIS HAD BEEN REDUCED FROM DOLLARS 1.5 BILLION IN THE TABLE CIRCULATED TO DIRECTORS ON 4 DECEMBER BECAUSE THE STAFF WERE NOW ASSUMING THAT THE PARIS CLUB COULD BE PREPARED TO RESCHEDULE AN ADDITIONAL DOLLARS 700 MILLION REPRESENTING INTEREST ON AMORTISATION AND INTEREST ON ARREARS. THIS NEW TABLE SHOWS THE DOLLARS 800 MILLION GAP BEING COVERED BY DOLLARS 300 MILLION FROM IBRD LOANS FOR AGRICULTURE AND INDUSTRY TO BE NEGOTIATED IN THE FIRST HALF OF 1987 (I.E. HE ASSUMES THAT THE ENERGY LOAN WILL BE POSTPONED BECAUSE OF DELAYS IN RAISING ENERGY PRICES), DOLLARS 300 MILLION BY THE POSSIBLE CONVERSION FROM PROJECT AID TO COMMODITY AND CASH AID, AND DOLLARS 250 MILLION FROM THE SPEEDING UP OF COMMODITY

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/AID.

AID DISBURSEMENT FROM THE EXISTING PIPELINE. (ON THESE FIGURES, IN THEORY AT LEAST, FUND FINANCING IN 1987 MIGHT NOT BE NECESSARY BUT NO-ONE RAISED THIS LATTER POINT SINCE OF COURSE EGYPT REQUIRES AN SBA IF THERE IS TO BE A RESCHEDULING AND, UNLIKE NIGERIA, HAS SHOWN NO INCLINATION TO FORGO FUND MONEY).

5. IN ANSWER TO QUESTIONS FROM THE SCANDINAVIANS AND THE DUTCH, SHAALAN SAID THAT THERE WERE TWO MAIN OUTSTANDING ISSUES BETWEEN THE FUND STAFF AND EGYPT: HOW THE UNIFICATION OF THE EXCHANGE RATE WAS TO BE WORKED OUT AND THE RAISING OF INTEREST RATES WHICH EGYPT HAD ONLY PROMISED SO FAR TO REVIEW IN JUNE 1987. RAISING INTEREST RATES WAS PARTICULARLY IMPORTANT FOR THE BALANCE OF PAYMENTS SINCE HIGHER RATES WOULD ENCOURAGE CAPITAL INFLOWS AND STEM OUTFLOWS. IF THERE WAS NO MOVEMENT BY THE EGYPTIANS, HE FELT THAT THE FUND SHOULD IMPOSE A TIGHTER CREDIT REGIME TO REDUCE FURTHER THE CURRENT ACCOUNT DEFICIT (HE DID NOT SAY HOW THIS WOULD BE ACHIEVED). IN ANSWER TO HOW MUCH THE FUND MIGHT OFFER BY WAY OF ASSISTANCE, HE NOTED THAT 26 PER CENT OF QUOTA WAS THE MINIMUM IN VIEW OF EGYPT'S REQUEST FOR AN UPPER CREDIT TRANCHE SBA.

6. THERE WERE ALSO QUESTIONS ABOUT THE DELAY IN PUTTING UP ENERGY PRICES AND THE IBRD ENERGY LOAN. MOINI (IBRD) SAID THAT THE EGYPTIANS HAD REFUSED TO INCREASE ENERGY PRICES BY THE 37 PER CENT PROMISED AS FROM JANUARY 1ST 1987 AND AS A CONSEQUENCE IBRD HAD CANCELLED THE ENERGY MISSION DUE IN CAIRO EARLY IN THE NEW YEAR. IF THERE WERE TO BE CONTINUED DELAY IN ENERGY PRICES THE INDUSTRIAL SECTOR MISSION WOULD ALSO BE IN JEOPARDY (BOTH THE ENERGY AND INDUSTRIAL LOANS WERE INTENDED TO BE DOLLARS 300 MILLION EACH. THE IBRD AGRICULTURAL LOAN IS LIKELY TO BE DOLLARS 200 MILLION - 250 MILLION AND WILL GO AHEAD ANYWAY). HE EXPLAINED THE POSSIBLE DELAY IN THE ENERGY LOAN ON THE GROUNDS THAT, WITHOUT PROPER ENERGY PRICES, INDUSTRIAL POLICY WOULD CONTINUE TO BE UNSATISFACTORY. NIMATALLAH (SAUDI ARABIA) COMPLAINED THAT IBRD WAS BEING INFLEXIBLE ON ENERGY PRICES, AND HE PARTICULARLY DISLIKED THE LINKAGE TO THE INDUSTRY LOAN. DALLARA (US) SAID HE WAS CONCERNED ABOUT THE DELAY OVER THE IBRD LOANS AND HOPED THAT RAPID PROGRESS COULD BE MADE.

7. I ASKED TWO QUESTIONS. FIRSTLY, WHAT EFFECT APART FROM LOSS OF THE IBRD MONEY WOULD THE DELAY IN RAISING ENERGY PRICES HAVE ON THE BALANCE OF PAYMENTS GAP QUESTIONMARK. SHAALAN SAID THAT THE EXTRA REVENUE (POUNDS 500 MILLION IN A FULL YEAR) HAD NOT BEEN EXPLICITLY BUILT INTO THE STAFF'S CALCULATIONS. AND EVEN TAKING INTO ACCOUNT THE EXTRA PURCHASING POWER WHICH CONSUMERS WOULD HAVE IF THE PRICE RISE WAS DELAYED, HE THOUGHT THE CONSEQUENCES FOR THE FINANCING GAP WOULD BE ONLY MARGINAL. SECOND, I ASKED WHAT WAS THE BASIS FOR THE ASSUMPTION THAT THE INTEREST ON AMORTISATION AND ON INTEREST IN ARREARS COULD BE RESCHEDULED (THE TABLE TO THE ATTACHMENT TO THE PARIS CLUB TERMS OF REFERENCE DOES NOT REPEAT NOT MAKE THIS ASSUMPTION). SHAALAN SAID THAT THIS HAD NOT BEEN DISCUSSED AS SUCH BY THE PARIS CLUB BUT HE UNDERSTOOD THAT THE CLUB HAD RESCHEDULED ON THIS BASIS FOR CERTAIN CASES.

8. NIMATALLAH ARGUED THE MOST STRONGLY THAT MANAGEMENT SHOULD NOW MOVE AHEAD RAPIDLY TO AN AGREEMENT BUT OTHER DIRECTORS, INCLUDING THE US, THE GERMANS, THE FRENCH AND THE JAPANESE LOOKED FORWARD TO AN EARLY PROGRAMME AND MORE OR LESS IMPLIED THAT THE FUND SHOULD NOT (REPEAT NOT) PUSH EGYPT ANY FURTHER. APART FROM MY OWN CODED WORDS ABOUT THE "IMPORTANCE OF WORKING TOWARDS IMF PROGRAMMES SUFFICIENT TO ACHIEVE THIS OBJECTIVE (I.E. BALANCE OF PAYMENTS VIABILITY IN THE MEDIUM-TERM) AND TO PROTECT THE FUND'S RESOURCES" ONLY THE DANE AND THE DUTCH GAVE ANY REAL INDICATIONS THAT THE EGYPTIANS OUGHT TO DO MORE. THE DANE SAID HE STOOD BY HIS STATEMENT OF 4 DECEMBER. THE DUTCH, ALTHOUGH ASKING FOR FURTHER ACTION, SPOKE IN A LOW KEY. OTHER DIRECTORS WHO URGED THE FUND TO PROCEED RAPIDLY WERE THE AUSTRIAN, ITALIAN, KOREAN AND THE MEXICAN. THE LATTER SAID HE WAS HEARTENED BY THE NEW FLEXIBILITY THAT DIRECTORS NOW SEEMED TO BE SHOWING. NOTWITHSTANDING THE GENERAL SENSE OF THE MAJORITY AT THE MEETING THAT EGYPT HAS DONE ENOUGH, ERB STILL CONCLUDED THAT FURTHER DISCUSSIONS, ESPECIALLY ON INTEREST RATES AND THE EXCHANGE RATE, WOULD BE NEEDED BETWEEN THE STAFF AND THE EGYPTIANS. (BUT HE TOLD ME AFTERWARDS THAT HE WAS NOT HOPEFUL THAT MUCH MORE COULD BE ACHIEVED).

9. DALLARA SAID THAT THE US WAS CONSIDERING GENEROUS TREATMENT OF THE FMS DEBT. GOOS SAID THAT GERMANY WOULD BE PROVIDING DM 50 MILLION IN FOOD AID OVER THE NEXT 18 MONTHS AND DM 125 MILLION IN OTHER FAST DISBURSING AID. ERB SAID THAT SHAALAN WOULD BE IN TOUCH WITH OTHER DIRECTORS TO GET UP TO DATE INDICATIONS OF LIKELY NEW AID COMMITMENTS.

10. FCO PLEASE ADVANCE TO MOUNTFIELD, EVANS (HMT), WARE (BOE), BRAITHWAITE, DRUMMOND (ERD) AND WOOTTON (ODA).

LANKESTER

YYYY

ORWBAN 3574

NNNN

MONETARY
NEWAD
Ps/Mr RENTON
Sir D Miers

-3-

CONFIDENTIAL

GRS 320
CONFIDENTIAL

CONFIDENTIAL

FM CAIRO

TO DESKBY 231600Z FCO

TEL NO 802

OF 231449Z DECEMBER 86

INFO IMMEDIATE UKDEL IMF IBRD, WASHINGTON

INFO SAVING BONN, PARIS, ROME, UKPEP BRUSSELS

YOUR TELNO 481: EGYPT/IMF

1. I SAW THE EGYPTIAN FOREIGN MINISTER ON 23 DECEMBER (AL BAZ IS OUT OF CAIRO) AND SPOKE PRECISELY AS INSTRUCTED IN YOUR TUR, LEAVING WITH DR MAGID THE TEXT OF LANKESTER'S INTERVENTION AT THE IMF MEETING OF 22 DECEMBER (UKDEL IMF/IBRD TELNO 392 PARA 2). I EMPHASISED THE PRIME MINISTER'S PERSONAL CONCERN AT THE DISAPPOINTMENT EXPRESSED BY MUBARAK OVER THE LINE WE HAD TAKEN IN THE IMF ON 4 DECEMBER AND HER CONTINUING COMMITMENT TO REALISTIC ECONOMIC SOLUTIONS WHICH TOOK ACCOUNT BOTH OF THE INTEGRITY OF THE IMF AND OF EGYPT'S SPECIAL CIRCUMSTANCES.
2. MAGID SAID THAT THE EGYPTIANS HAD ALREADY RECEIVED AN ACCOUNT OF THE 22 DECEMBER MEETING AND THANKED ME FOR THE BRITISH INTERVENTION, WHICH HAD BEEN HELPFUL. HE WENT ON TO ASK WHETHER THE OFFER OF £10 MILLION ON GRANT TERMS WOULD BE AVAILABLE TO EGYPT IMMEDIATELY, AS WAS THE CASE IN THE EMERGENCY FINANCIAL ASSISTANCE BEING OFFERED BY SOME OTHER EUROPEAN COUNTRIES. I SAID THAT OUR OFFER WAS DEPENDENT ON AGREEMENT BEING REACHED ON A PROGRAMME OF ECONOMIC REFORM BETWEEN EGYPT AND THE IMF, ON OTHER DONORS JOINING WITH US TO FILL THE RESIDUAL FINANCING GAP AND ON PARIS CLUB RESCHEDULING ARRANGEMENTS. NEVERTHELESS IT WAS TO BE SEEN AS A VERY SIGNIFICANT GESTURE OF SUPPORT FOR EGYPT AT A TIME AND IN THE FORM IT WAS MOST NEEDED. THE CONDITIONS ATTACHED TO OUR OFFER WERE OF COURSE SET OUT IN THE TEXT I HAD GIVEN MAGID OF LANKESTER'S INTERVENTION, BUT I DARE SAY HE THOUGHT IT WORTH TESTING WHETHER THERE WAS ANY GIVE IN OUR POSITION.
3. AS MAGID WAS LEAVING FOR ALEXANDRIA IMMEDIATELY FOR A MEETING WITH THE JORDANIAN FOREIGN MINISTER, THE DISCUSSION WAS NECESSARILY BRIEF BUT VERY FRIENDLY.

URWICK

CCHPAN 7006

MONETARY
NENAD
PS/MR RENTON
PS/AUS
MR FERGUSSON
SIR D. MIERS

COPIES TO:
MR ROBERTS ODA
MR LFT SMITH B/ENGLAND,

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DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215 5144
GTN 215)
(Switchboard) 01-215 7877

From the Minister for Trade

Ch
You said you hoped
Mr Channon wd follow
Mr Mountfield's brother's
advice. In fact, it is
Mr Clark who has done so!

font

21/ 30 December 1986

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

See news

CH/EXCHEQUER	
REC.	31 DEC 1986 3 11/2
ACTION	Mr Mountfield
COPIES TO	EST, EST, Sir P Middleton, Sir G. Kettle, Mr Lovelle, Mr H P Evans, Mr A Edwards, Mr Robson Mrs Carr, Mr Walsh Mr P Davis Mr Pitcairn

EGYPT: FINANCIAL PROBLEMS

Thank you for copying to Paul Channon your minute of 15 December. I have now seen Geoffrey Howe's reply and, like him, I share many of your concerns about the weakness of the current IMF proposals for a programme for Egypt. However, it is clear that there is nothing to be gained from UK isolation. I too believe that an agreement with the IMF and the establishing of a long term relationship between the IMF and Egypt will best serve our long term commercial interest.

I therefore welcome Geoffrey Howe's decision to offer an additional £10 million quick-disbursing financial aid on grant terms, subject to agreement on an IMF programme of economic reform and between donors and creditors. I would hope that a fresh look at a modest increase in capital aid for Egypt would not be ruled out, once such a programme is in place, since UK industry will need some assistance in the next difficult years to maintain its traditional presence in the Egyptian market, and to avoid adverse comparison with the much bigger aid programmes of some of our main competitors.

As you know ECGD is currently reviewing its terms of cover for business with Egypt both on short term and medium term credit. As the Egyptians have not proposed the rescheduling of their short term debts and are not currently in default on them the Department proposes to recommend to its Advisory Council the maintenance of cover for this category of business. Should the Council decline consideration will be given to the provision of such cover under the Department's National Interest powers.

L03ARX



Rt Hon Nigel Lawson MP

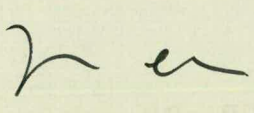
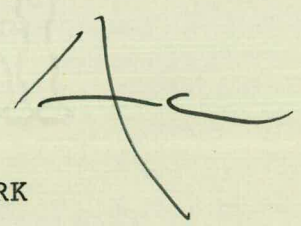
December 1986

As the Egyptians are poised to seek relief on their medium term indebtedness and as such relief is likely to be required for many years to come there is no basis for the assumption of new liabilities in this area. The Department is however, allowing existing commitments to run: these amount to some US\$500 million in respect of loans signed but not yet fully drawn down and £100 million in respect of firm offers of cover for business in negotiation. There remains approximately £50 million uncommitted under the Department's present medium term cover limit for Egypt.

There will be no basis for considering the assumption of new medium term commitments on Egypt until she has come to terms with the IMF and the Paris Club and, following the latter, concluded a bilateral agreement with the UK.

The instructions given to our IMF representative in FCO tel 275 reflect this situation.

I am copying this letter to the Prime Minister, Geoffrey Howe, George Younger and Sir Robert Armstrong.



ALAN CLARK

L03ARX



FROM: MISS J L CAMP
DATE: 31 December 1986

MR MOUNTFIELD

EGYPT: FOREIGN SECRETARY'S MINUTE OF 18 DECEMBER

The Chancellor has seen and was grateful for your minute of 22 December.

Janel Camp
MISS J L CAMP

FROM: P MOUNTFIELD 7
 DATE: 7 January 1980

CHANCELLOR

cc Chief Secretary
 Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Lavelle
 Mr H P Evans
 Mrs Case
 Mr Walsh
 Mr P Davis
 Mr Pitcairn

Meona

Thatcher
Worship

EGYPT: FINANCIAL SUPPORT

I promised a further submission after the holiday, about the Ministerial replies to your minute of 15 December, and about the IMF Board meeting on 22 December.

Ministerial Correspondence

2. The Foreign Secretary (18 December) predictably argues that the UK should not get out on a limb in opposing the Egyptian programme at the IMF, even though we know it won't work. He then goes on to say that Egypt is still a potentially-valuable long-term market, and that we should keep a foot in the door by maintaining export credit cover, this of course is nonsense: on the IMF's own figures, Egypt will be in no position to service new debt for the rest of this century. Luckily, Mr Alan Clark (30 December) makes it clear that he is not prepared to let ECGD offer any new medium-term cover (beyond existing commitments to Egypt) "until she has come to terms with the IMF and the Paris Club and, following the latter, concluded a bilateral agreement with the UK". Even then, I imagine ECGD will be very reluctant to agree to any further new cover, and we would certainly advise you to oppose it. That is a battle we can fight later. I see no need for you write again at Ministerial level now.

IMF

3. The Board discussion on 22 December went very much as we expected and feared. Mr Lankester's telegram 397 (attached) reports the outcome: a Mission will go to Cairo early in the New Year, aimed at completing a stand-by arrangement with Egypt. Despite continuing concerns about interest rates and the exchange rate, everybody expects that such an agreement will be reached. Mr Lankester spoke as instructed, and avoided isolating the UK further, but managed to get our doubts on record without causing any offence (and without attracting much support either).

4. No fresh decisions on this are needed until the Staff recommendations on the SBA are ready to put to the Board, when we will report to you again.

R1

P MOUNTFIELD

From:- MRS M. HENSON

DATE:- 8 JANUARY 1987

MR MOUNTFIELD

EGYPT: FINANCIAL SUPPORT

The Chancellor has seen and was grateful for your minute of 7 January.

Meena Henson



FROM: MRS M HENSON
DATE: 8 January 1987

Handwritten initials

MR MOUNTFIELD

EGYPT: FINANCIAL SUPPORT

The Chancellor has seen and was grateful for your minute of 7 January.

Meena Henson
MEENA HENSON

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FM BUDAPEST
TO IMMEDIATE FCO
TELNO 009
OF 121400Z JANUARY 87
INFO PRIORITY UKDEL IMF/IBRD

HUNGARY: IMF ARTICLE IV TEAM

SUMMARY

1. TEAM FINALISING REPORT FOR SUBMISSION TO BOARD IN MARCH. CURRENT ACCOUNT DEFICIT OF OVER DOLLARS ONE BILLION NOW EXPECTED. SECOND PHASE OF TOUGHER MEASURES NEEDED. RECOURSE TO IMF NOT EXCLUDED.

DETAIL

2. THE IMF ARTICLE IV TEAM WAS HERE LAST WEEK. I SAW MS JUNZ TWICE AND SHE HOPES TO SEE MOUNTFIELD (TREASURY) AND HALL (BANK OF ENGLAND) TODAY. THE TEAM'S REPORT WILL NOW BE FINALISED FOR PRESENTATION TO THE BOARD IN MARCH.
3. MS JUNZ REPORTED THAT THE 1986 CURRENT ACCOUNT DEFICIT WILL BE EVEN LARGER THAN ANTICIPATED. SHE DECLINED TO GIVE A FIGURE BUT COMMENTED THAT IT WOULD BE QUOTE WELL OVER DOLLARS ONE BILLION UNQUOTE. SHE WAS CONCERNED ABOUT THE SIZE OF THE BUDGET DEFICIT AND UNCERTAINTY ABOUT THE REAL UNDERLYING RATE OF INFLATION (PROBABLY AROUND 14 PER CENT). SHE QUESTIONED WHETHER MAROTMY WOULD HAVE THE EXPERTISE AND MEDGYESSY THE POLITICAL CLOUT (MY TELNO 284) TO PROVIDE THE NECESSARY IMPETUS TO REFORM.
4. MS JUNZ AGREED THAT A SECOND PHASE OF TOUGHER MEASURES WOULD BE NEEDED IN 1987, AND THE SOONER THE BETTER. THE ATTITUDE OF THE JAPANESE BANKS WOULD HAVE AN IMPORTANT BEARING ON THE TIME AVAILABLE TO THE HUNGARIANS. AT THE MOMENT THE JAPANESE APPEARED EAGER TO CONTINUE LENDING, AND SHE DOUBTED IF EVEN THE INCREASED CURRENT ACCOUNT WOULD PUT THEM OFF. MS JUNZ CONCLUDED THAT RECOURSE TO THE IMF LATER IN THE YEAR COULD NOT BE EXCLUDED (LANCE'S LETTER OF 12 DECEMBER) AND SHE WILL RETURN HERE IN MAY TO GIVE FURTHER ADVICE.
5. FCO PLEASE ADVANCE TO MOUNTFIELD (TREASURY) AND HALL (BANK OF ENGLAND).

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FROM UKDEL IMF/IBRD WASHINGTON
TO FCO DESKBY 130800Z
TELNO 8
OF 122300Z JANUARY 87
AND TO BUENOS AIRES

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IMF: ARGENTINA

SUMMARY

1 ARGENTINE AGREEMENT WITH IMF ALMOST ASSURED. NO MEXICAN-STYLE AUTOMATIC TRIGGERS.

DETAIL

2 LACHMAN (DIVISION CHIEF, WESTERN HEMISPHERE DEPT) CONFIRMED THAT AN OUTLINE AGREEMENT HAS BEEN REACHED BETWEEN HIS DEPARTMENT AND THE ARGENTINE MISSION DESCRIBED IN OUR TELNO 3 OF 5 JANUARY. THIS WAS FOR A 15-MONTH SBA FOR A TOTAL OF SDR 1,113 MILLION (80 PER CENT ANNUAL ACCESS) AND A CFF DRAWING OF SDR 390 MILLION BASED ON PAST DECLINES IN THE VOLUME AND PRICE OF GRAIN EXPORTS. THE AGREEMENT WAS NOW WITH IMF MANAGEMENT FOR APPROVAL BUT LACHMAN EXPECTED NO PROBLEMS.

3 LACHMAN WAS RELUCTANT TO TALK ABOUT FIGURES BUT HE AGREED THAT THE 2.5 PER CENT OF GNP QUOTED FOR THE FISCAL DEFICIT FOR 1987 IN THE LONDON FINANCIAL TIMES OF 12 JANUARY WAS BROADLY CORRECT. HE ALSO SAID THAT, DESPITE STRONG ARGENTINE PRESSURE FOR MEXICAN-STYLE TRIGGERS, THE OUTLINE AGREEMENT PROVIDED ONLY THAT THE COUNTRY'S GROWTH PERFORMANCE AND TERMS OF TRADE WOULD BE "TAKEN INTO ACCOUNT" IN SETTING FUTURE PERFORMANCE CRITERIA AT REVIEWS OF THE PROGRAM. IT ALSO ALLOWED FOR AN ADDITIONAL CFF DURING THE COURSE OF THE PROGRAM IF ARGENTINA'S TERMS OF TRADE FALL FURTHER AND IF THE NORMAL RULES OF THIS FACILITY ALLOWED THE DRAWING. (DURING 1987, ARGENTINA WILL REPAY ROUGHLY SDR 260 MILLION FROM PAST CFF DRAWINGS, CREATING A LIKE AMOUNT OF NEW BORROWING CAPACITY.)

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4 THE ONLY OTHER AREA WHERE LACHMAN WAS SPECIFIC WAS OVER THE NEW MONEY ARGENTINA WOULD NEED IN 1987. HE SAID THAT THE AUTHORITIES WOULD ASK THE BANKS FOR AT LEAST DOLLARS 1.5 BILLION. BUT HE ADDED THAT THIS ALLOWED FOR A SIZEABLE AND NOT WHOLLY NECESSARY REBUILDING OF RESERVES, SO THE 'REAL' FINANCING GAP WAS CONSIDERABLY SMALLER.

5. LACHMAN SAID THAT THE PROGRAM WOULD BE BROUGHT TO THE BOARD AS QUICKLY AS POSSIBLE (ROUGHLY MID-FEBRUARY) FOR AGREEMENT IN PRINCIPLE.

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

LANKESTER

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ORWBAN 8852

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FID

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FM BRASILIA

TO IMMEDIATE FCO

TELNO 9

OF 121245Z JANUARY 87.

INFO IMMEDIATE UKDEL IMF/IBRD WASHINGTON

INFO PRIORITY WASHINGTON

INFO ROUTINE RIO DE JANEIRO

INFO SAVING SAO PAULO

BRAZILIAN FOREIGN DEBT AND ECONOMY

1. THE PRESIDENT IS HOLDING A MUCH ADVERTISED MEETING WITH ECONOMIC MINISTERS TODAY TO CONSIDER A REALIGNMENT OF PRICES AND OTHER ASPECTS OF THE ECONOMIC CRISIS HERE. HE HAS ACCUSED BUSINESSMEN OF FERMENTING ECONOMIC ANARCHY, FOLLOWING A HARD-HITTING LETTER TO HIM FROM THE CONFEDERATION OF INDUSTRY.

2. WE SHALL AWAIT REPORTS OF THIS MEETING BEFORE COMMENTING ON FUNARO'S LATEST LETTER TO TRICHET (TEXT IN CRADDOCK'S TELELETTER OF 8 JANUARY) BUT WILL LET YOU HAVE VIEWS WELL IN ADVANCE OF THE 19 JANUARY PARIS CLUB MEETING.

3. MEANWHILE CENTRAL BANK PRESIDENT BRACHER HAS LEFT FOR NEW YORK TELLING ME THAT HE HOPES TO INFLUENCE FAVOURABLY THE RESPONSE IN THE US TO FUNARO'S LETTER. HE ALSO IS LOOKING FOR "NEW MONEY" AND HAS TOLD MY WEST GERMAN COLLEAGUE HERE THAT HE WILL BE ASKING FOR AS MUCH AS US DOLLARS 4 BILLION. HE WILL DOUBTLESS POINT TO SOME SMALL IMPROVEMENTS SINCE THE NOVEMBER ECONOMIC MEASURES, SUCH AS A SLIGHT IMPROVEMENT IN THE DECEMBER TRADE FIGURES AND SOME FALL IN DOMESTIC DEMAND FOR EG CARS.

4. THE GENERAL ATMOSPHERE HOWEVER REMAINS TENSE AND DISGRUNTLED ON THE ECONOMIC FRONT HERE, WITH WIDESPREAD PROFITEERING AND STRIKES AGAINST A BACKGROUND OF GENERAL UNCERTAINTY AND FALTERING CONFIDENCE IN THE GOVERNMENT'S ABILITY TO PUT ITS HOUSE IN ORDER.

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FM CAIRO

TO ROUTINE FCO

TELNO 12

OF 121030Z JANUARY 87

INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND, TREASURY

INFO ROUTINE UKDEL IMF IBRD, WASHINGTON

INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS

MY TELNO 797: EGYPT/IMF AND IBRD

SUMMARY

1. THE EGYPTIAN MINISTER FOR CABINET AFFAIRS IS OPTIMISTIC OVER THE OUTCOME OF THE FORTHCOMING NEGOTIATIONS WITH THE IMF: BUT COMPLICATIONS OVER INCREASES IN ENERGY PRICES COULD DELAY THE CONCLUSION OF A STANDBY ARRANGEMENT.

DETAIL

2. THERE HAS BEEN EXTENSIVE AND FAIRLY ACCURATE REPORTING IN THE EGYPTIAN PRESS OF THE MEETINGS IN PARIS AND WASHINGTON ON 17 AND 22 DECEMBER (PARIS TELNO 1338 AND UKDEL IMF/IBRD TELNO 397) AND OF EGYPT'S NEGOTIATIONS WITH THE IMF (BUT VERY LITTLE ON THE WORLD BANK TALKS). I CALLED ON DR 'ATIF 'EBEID (MINISTER OF STATE FOR CABINET AFFAIRS) ON 11 JANUARY TO SEEK AN AUTHORITATIVE EGYPTIAN VIEW ON THE STATE OF PLAY PRIOR TO THE ARRIVAL IN CAIRO ON 15 JANUARY OF THE IMF MISSION.

3. 'EBEID CLAIMED THERE WERE SEVERAL REASONS FOR OPTIMISM OVER THE NEGOTIATIONS WITH THE IMF. THE STATISTICAL INFORMATION AVAILABLE TO THE IMF TEAM HAD BEEN GREATLY IMPROVED AND THERE WAS NOW A MUCH MORE UNIFIED POSITION WITHIN THE EGYPTIAN GOVERNMENT ON THE MEASURES WHICH NEEDED TO BE TAKEN. THERE WAS ALSO BROAD AGREEMENT THAT THE FREEING OF THE ECONOMY WAS THE RIGHT COURSE FOR EGYPT. ALTHOUGH THE REFORMS REQUIRED TO RESTRUCTURE THE ECONOMY WOULD BE CARRIED OUT GRADUALLY, THIS GRADUALISM WAS ESSENTIAL IF THE DESIRED OBJECTIVE WERE TO BE ACHIEVED IN CONDITIONS OF POLITICAL STABILITY. STEPS ALREADY TAKEN HAD RESULTED IN A SHARP RISE IN PRICES, BUT BECAUSE THESE HAD HAPPENED GRADUALLY AND THE NEED FOR THEM WAS GENERALLY UNDERSTOOD, THEY HAD NOT AROUSED PROTEST.

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4. 'EBEID SAID THAT THE DISCUSSIONS WITH THE IMF WOULD START ON 17 JANUARY: HE EXPECTED THAT THE TEAM'S VISIT WOULD NOT LAST MORE THAN ABOUT 10 DAYS. THE EGYPTIAN AUTHORITIES WERE NOW DRAFTING A PAPER TO PRESENT TO THE TEAM ON ARRIVAL, SETTING OUT THE EGYPTIAN POSITION ON IMPLEMENTATION OF THEIR PROPOSALS ON EXCHANGE RATES, INTEREST RATES AND ENERGY PRICES. 'EBEID EXPECTED THAT APPROVAL BY THE IMF BOARD WOULD BE ACHIEVED EITHER IN LATE FEBRUARY OR EARLY MARCH, WITH RESCHEDULING OF EGYPT'S DEBTS BEING ARRANGED AS SOON AS PRACTICABLE THEREFORE. 'EBEID WENT ON TO ASK THAT EGYPT'S FRIENDS SHOULD PRESS FOR A MEETING OF THE IMF BOARD AS SOON AS POSSIBLE AND ALSO SHOULD SUPPORT EGYPT'S REQUEST FOR A GREATER ALLOCATION OF FOOD AID FROM THE EUROPEAN COMMUNITY.

COMMENT

5. WHILE 'EBEID WAS OPTIMISTIC ABOUT THE FORTHCOMING NEGOTIATIONS, THEY MAY NOT BE AS STRAIGHTFORWARD AS HE SEEMS TO EXPECT. FOR EXAMPLE, IT IS NOT CLEAR HOW FAR THE EGYPTIANS ARE STICKING TO THEIR OWN TIMETABLE. ALTHOUGH 'EBEID SAID THAT THE PROBLEM WOULD BE ADDRESSED IN THE PAPER TO BE PRESENTED TO THE IMF MISSION, THERE IS AS YET NO SIGN OF THE ESTABLISHMENT OF THE STRUCTURE TO ENABLE ALL REGISTERED COMMERCIAL BANKS TO DEAL FREELY IN THE FOREIGN EXCHANGE MARKET: NOR OF THE ARRIVAL OF THE EXPERT FROM THE BANK OF FRANCE WHO WAS TO ADVISE ON THE ESTABLISHMENT OF SUCH A STRUCTURE (SEE PARA 10 OF MY TELNO 751). THE CENTRAL BANK HAVE SAID TO US THAT HE IS LIKELY TO ARRIVE AT THE BEGINNING OF FEBRUARY.

6. MORE SIGNIFICANTLY IT IS UNCERTAIN WHAT IMPACT THE EGYPTIAN AUTHORITIES' DECISION TO POSTPONE INCREASES IN ENERGY PRICES UNTIL 1 APRIL WILL HAVE ON THE OVERALL TIMING FOR THE CONCLUSION OF A STANDBY ARRANGEMENT (SEE MY TELNO 795). ACCORDING TO USAID STAFF, THE IBRD HAVE NOW INFORMED THE EGYPTIAN AUTHORITIES THAT THE ENERGY PRICE INCREASE MUST BE GREATER THAN ORIGINALLY PLANNED IN ORDER TO MAKE UP FOR THE SHORTFALL IN REVENUE AS A RESULT OF THE THREE MONTHS DELAY. UNLESS THESE INCREASES ARE ACTUALLY IMPLEMENTED, THE INRD CANNOT PUT ITS IMPRIMATUR ON A STANDBY ARRANGEMENT. THE LOCAL IMF REPRESENTATIVE HAS SAID TO US THAT AN INCREASE IN ENERGY PRICES WILL BE A PRE-CONDITION OF THE STANDBY ARRANGEMENT. (THIS VIEW APPEARS TO BE CONFIRMED BY UKDEL IMF/IBRD TELNO 1.) WHEN I ASKED 'EBEID ABOUT THE DECISION TO DELAY INCREASES IN ENERGY PRICES, HE SOUGHT TO DISMISS THIS AS A RELATIVELY MINOR TECHNICAL MATTER, AND SAID THAT IN ANY CASE DECISION ON TIMING WAS ONE WHICH MUST BE LEFT TO THE EGYPTIAN GOVERNMENT.

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7. THERE HAS, HOWEVER, BEEN ONE FAVOURABLE DEVELOPMENT IN THE LAST MONTH. THE IMF ESTIMATE OF EGYPT'S EXPORT REVENUES WAS BASED ON AN AVERAGE OIL PRICE OF DOLLARS 12 PER BARREL DURING 1986/87. THIS IS OBVIOUSLY NOW TOO LOW AND SHOULD MARGINALLY REDUCE THE SIZE OF THE GAP WHICH NEEDS TO BE FINANCED OVER THE NEXT 18 MONTHS.

URWICK

YYYY

FCO PSE PASS SAVING ADDRESSEES

CCHPAN 7175

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MR J ROBERTS, ES/PPA

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FM CAIRO

TO ROUTINE FCO

TELNO 48

OF 271500Z JANUARY 87

INFO ROUTINE ODA, ECGD, BANK OF ENGLAND, TREASURY, DTW

INFO ROUTINE MODUK, TEL AVIV, WASHINGTON

INFO SAVING PARIS

DTW (OT4)

MOD (DTW ROW2)

PRENTICE'S TELELETTER OF 23 JANUARY TO ROBERTS (NOT TO ALL):
EGYPT'S FMS DEBT

SUMMARY

1. EGYPT'S FMS DEBT WILL BE INCLUDED IN THE PARIS CLUB
RESCHEDULING OF A BILATERAL SOLUTION IS NOT FOUND. SUCH
AN OUTCOME WOULD NOT BE ECONOMICALLY ATTRACTIVE TO THE
EGYPTIANS THOUGH IT MIGHT AVOID CONTINUING EMBARRASSMENT.

DETAIL

2. THE PROBLEM OF FMS DEBT PAYMENTS IS INDEED THE MAJOR
PRE-OCCUPATION OF US/EGYPTIAN RELATIONS. ACCORDING TO
THE FRENCH AMBASSADOR, MUBARAK WAS OBSESSED WITH THIS
QUESTION DURING HIS MEETING WITH RAYMOND NOIR, THE FRENCH
MINISTER OF FOREIGN TRADE, ON 11 JANUARY AND SPOKE ABOUT
ALMOST NOTHING ELSE.

3. THE US EMBASSY HAVE TOLD US THAT EGYPT'S FMS DEBT
WILL BE INCLUDED IN THE OVERALL PARIS CLUB DEBT RESCHEDULING
EXERCISE IF A BILATERAL SOLUTION HAS NOT BEEN AGREED BY
THE TIME THE PARIS CLUB MEETS. SUCH AN OUTCOME WILL NOT
BE ADVANTAGEOUS TO THE EGYPTIANS: THE RESCHEDULING WILL
BE CARRIED OUT AT THE EXISTING AVERAGE INTEREST RATE OF
11.8% AND WILL ULTIMATELY INVOLVE NO DEBT RELIEF. THE
CURRENT US OFFER, BY CONTRAST, IS FOR A REDUCTION OF THE
INTEREST RATE TO 7.2%. THE PARIS CLUB ALTERNATIVE WOULD,
HOWEVER, HAVE THE BENEFICIAL EFFECT OF TEMPORARILY REMOVING
THIS DIFFICULT PROBLEM FROM THE US/EGYPTIAN AGENDA. (THE
US EMBASSY WERE ALSO MILDLY OPTIMISTIC ABOUT LEGISLATION
CURRENTLY GOING THROUGH CONGRESS WHICH MIGHT HAVE THE EFFECT
OF QUOTE DELINKING UNQUOTE US FARMERS AND THUS ENABLE THE
QUESTION OF DOMESTIC AND FOREIGN DEBT RELIEF. THIS MIGHT
ENABLE SOME FLEXIBILITY IN THE US POSITION.)

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4. THE EGYPTIAN AUTHORITIES MADE THE MOST RECENT PAYMENT OF DOLLARS 16 MILLION IN MID-JANUARY; THE NEXT TWO INSTALLMENTS ARE FOR DOLLARS 16.1 MILLION AT THE END OF JANUARY AND DOLLARS 90.4 MILLION ON 3 MARCH. THESE PAYMENTS MUST BE MADE TO AVOID INVOKING THE BROOKE AMENDMENT. THE EGYPTIANS HAVE TRIED TO LINK THEIR FMS PAYMENTS TO THE US PROPOSALS TO CONVERT A PROPORTION OF THEIR PROGRAMME TO CASH (SEE OUR TELNO 795 ON THE VISIT OF MCPHERSON), BUT THE US ARE REFUSING TO CONSIDER THIS UNTIL AN EGYPTIAN LETTER OF INTENT WITH THE IMF IS IN PLACE.

HARRIS

YYYY
FCO PSE PASS SAVING PARIS

CCHPAN 7496

MONETARY

NENAD.

(REPEATED AS REQUESTED)

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FM CAIRO

TO ROUTINE FCO

TELNO 50


OF 011125Z FEBRUARY 87

INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND, TREASURY

INFO ROUTINE UKDEL IMF/IBRD, WASHINGTON

INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS

INFO SAVING HMG ALEXANDRIA - ACTIONED



OUR TELNO 12: THE EGYPTIAN ECONOMY

SUMMARY

1. SOME SIGNS OF MOVEMENT TOWARDS MORE UNIFIED EXCHANGE RATES EVIDENT. RELATIVELY ENCOURAGING DEVELOPMENTS IN OTHER SECTORS.

DETAIL

2. PUBLIC SECTOR COMPANIES ARE NOW INCREASINGLY HAVING TO OPEN LETTER OF CREDIT AT EITHER THE GULF RATE (170 PIASTRES TO THE DOLLAR) OR AT THE FREE MARKET RATE (CURRENTLY 196 PIASTRES) DUE TO A LACK OF FOREIGN CURRENCY IN THE OFFICIAL GOVERNMENT POOL, FOR WHICH THE RATE IS 135 PIASTRES. THE ONLY SOURCES OF FOREIGN EXCHANGE AVAILABLE TO THE GOVERNMENT POOL ARE THE MANDATORY DOLLARS 150 THAT TOURISTS HAVE TO CHANGE ON ARRIVAL IN EGYPT AND THE COST OF HOTEL ACCOMMODATION FOR THOSE TOURISTS NOT ON PACKAGES: OFFICIAL EMBASSY TRANSACTIONS: AND WORKERS' REMITTANCES IN CASH. THE TOTAL VOLUME OF FOREIGN EXCHANGE FROM THESE SOURCES IS ONLY ABOUT DOLLARS 500 MILLION.

3. HOWEVER, THERE STILL EXISTS SOME CONFUSION ABOUT WHETHER THIS PURCHASE OF FOREIGN EXCHANGE ON THE FREE MARKET BY PUBLIC SECTOR COMPANIES IS OFFICIALLY SANCTIONED. THE MINISTRY OF MILITARY PRODUCTION HAD INFORMED US THAT THEY HAD BEEN GIVEN AUTHORITY TO PURCHASE FOREIGN EXCHANGE ON THE FREE MARKET TO MEET THE £9-10 MILLION DOWN-PAYMENT ON THE PLESSEY AND OTHER CONTRACTS WHICH ARE BEING COVERED UNDER THE DOLLARS 150 MILLION ECGD DEFENCE RESERVATION. THIS AUTHORITY NOW SEEMS TO HAVE BEEN SPECIFICALLY OVER-RULED BY THE MINISTER OF ECONOMY, ALTHOUGH THE MINISTRY OF MILITARY PRODUCTION HAVE SAID THAT THEY WILL APPEAL DIRECT TO THE PRIME MINISTER.

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4. THE USE OF THE GULF RATE BY THE EGYPTIAN PUBLIC SECTOR BANKS IS A RELATIVELY RECENT PHENOMENON. ALL THE MAJOR MONEY CHANGERS IN THE GULF HAVE OFFICES IN CAIRO AND THE PUBLIC SECTOR BANKS HAVE BEEN PURCHASING FOREIGN EXCHANGE (AT A FIVE TO TEN PIASTRE PREMIUM) FOR DISTRIBUTION TO THE PUBLIC SECTOR. THE AMOUNTS INVOLVED DO NOT APPEAR THAT LARGE (APPROXIMATELY DOLLARS 300 - 500 MILLION), AND THE GULF RATE IS STILL MUCH LESS IMPORTANT THAN THE CAIRO/PORT SAID FREE MARKET RATE WHICH, ACCORDING TO THE IMF, ACCOUNTED FOR TRANSACTIONS AMOUNTING TO SOME DOLLARS 3 - 4 BILLION DURING EGYPTIAN FISCAL YEAR 1985/6.

5. THE LATEST OFFICIAL PRICE STATISTICS SHOW A SLOWING IN WHAT WAS A HIGH ANNUAL RATE OF INFLATION. BETWEEN AUGUST AND SEPTEMBER, INFLATION WAS RUNNING AT AN ANNUALISED RATE OF 30%: FOR THE SIX MONTHS TO DECEMBER INFLATION (AS MEASURED BY THE OFFICIAL CONSUMER PRICE INDEX) WAS ONLY 16%. (IT IS DIFFICULT TO TELL WHETHER THIS REPRESENTS A REAL TREND OR SIMPLY THE VOLATILITY AND UN-RELIABILITY OF OFFICIAL STATISTICS.)

6. THERE HAVE BEEN SOME PROMISING DEVELOPMENTS IN OTHER AREAS. INCREASED AGRICULTURAL PROCUREMENT PRICES HAVE BEEN ANNOUNCED FOR COTTON AND SUGARCANE, WHICH IN THE FORMER CASE WILL HAVE THE EFFECT OF STABILISING THE OUTPUT OF COTTON. FOR THE FIRST TIME IN 1986, THE NUMBER OF TOURIST ARRIVALS IN DECEMBER EXCEEDED ARRIVALS IN THE SAME MONTH OF 1985: WHILE THE EFFECT OF INCREASED INTERNATIONAL OIL PRICES ARE BEGINNING TO BE FELT.

7. WE HAVE NOT YET BEEN ABLE TO DISCUSS THESE DEVELOPMENTS AND PROGRESS IN THEIR NEGOTIATIONS WITH THE VISITING IMF TEAM, BUT WE HOPE TO DO SO THIS WEEK. TO A CERTAIN EXTENT THE SHORTAGE OF FOREIGN EXCHANGE HAS PUSHED THE EGYPTIAN AUTHORITIES RATHER FURTHER THAN THEY MIGHT LIKE TOWARDS THE IMF OBJECTIVE OF AN ACTUAL UNIFICATION OF EXCHANGE RATES.

HARRIS

FCO PSE PASS SAVING ADDRESSEES

CCHPAN 7555

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FM CAIRO

TO PRIORITY FCO

TELNO 106

OF 030730Z FEBRUARY 87

AND TO PRIORITY UKDEL IMF/IBRD WASHINGTON

INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND, H M TREASURY

INFO ROUTINE WASHINGTON

INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS

INFO SAVING HMCG ALEXANDRIA ACTIONED

MY TELNO 084 AND UKDEL IMF/IBRD TELNO 047: EGYPT/IMF

SUMMARY

1. SHA'ALAN HAS TAKEN BACK TO WASHINGTON THE SIGNED EGYPTIAN LETTER OF INTENT, A SECRET ANNEX TO THE LETTER COVERING ENERGY PRICES AND THE OFFICIAL EGYPTIAN REQUEST FOR A STANDBY ARRANGEMENT. THE LATEST IMF FORECAST OF THE BALANCE OF PAYMENTS SHOWS THAT, EVEN TAKING INTO ACCOUNT GENEROUS RESCHEDULING, THERE WILL BE A CONTINUING NEED FOR SUBSTANTIAL BALANCE OF PAYMENT SUPPORT FOR EGYPT OVER THE NEXT FIVE YEARS.

DETAIL

2. DAVIS RECENTLY SAW GRONLIE, THE RESIDENT IMF REPRESENTATIVE, TO DISCUSS THE VISIT OF SHA'ALAN WHO LEFT CAIRO ON 25 FEBRUARY AFTER 5 DAYS OF DISCUSSIONS. GRONLIE SAID THAT NOTHING NEW HAD EMERGED FROM THESE DISCUSSIONS. HOWEVER, SHA'ALAN HAD TAKEN BACK 3 DOCUMENTS WITH HIM TO WASHINGTON:

A. THE EGYPTIAN LETTER OF INTENT, WHICH HAD BEEN SIGNED BY THE GOVERNOR OF THE CENTRAL BANK, SALAH HAMID, AND THE MINISTER OF FINANCE, MUHAMMAD EL-RAZAZ:

B. A SECRET ANNEX WHICH INCLUDES DETAILS OF THE INCREASES IN ENERGY PRICES:

C. AN OFFICIAL EGYPTIAN REQUEST FOR A STANDBY ARRANGEMENT.

3. THERE HAD BEEN SOME CHANGES TO THE DOCUMENTATION TAKEN BACK BY THE IMF STAFF ON 13 FEBRUARY, BUT ACCORDING TO GRONLIE THESE HAD NOT BEEN SUBSTANTIVE. THE FIGURES IN THE IMF DRAFT TECHNICAL MEMORANDUM ATTACHED TO THE LETTER OF INTENT (SEE PARA 4 OF MY TUR) HAD ALSO NOW BEEN LARGELY FILLED IN, EXCEPT FOR THE DETAILS OF THE FORTHCOMING EGYPTIAN BUDGET: IMF STAFF WOULD RETURN TO CAIRO AROUND THE THIRD WEEK OF MARCH TO DISCUSS THESE WITH THE EGYPTIAN AUTHORITIES. GRONLIE THEREFORE THOUGHT THAT THE TIMETABLE FOR SUBMISSION TO THE BOARD HAD PROBABLY NOW SLIPPED BY A MONTH AND THAT, GIVEN THE NEED TO LOOK AT THE BUDGET IN MORE DETAIL, THE ORIGINAL IDEA OF SUBMISSION OF THE EGYPTIAN LETTER OF INTENT TO THE BOARD ON 7 APRIL (THE DAY AFTER THE ELECTIONS) WAS NOW IMPRACTICABLE. THE BOARD COULD STILL WAIVE THE REQUIREMENT FOR ONE MONTH'S NOTICE BETWEEN THE SUBMISSION AND THEIR

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/CONSIDERATION

CONSIDERATION OF PAPERS: IF THIS HAPPENED, IT WOULD SHORTEN THE PROWESS BY A WEEK OR TWO.

4. IT HAD BECOME OBVIOUS FROM THE LATEST ROUND OF DISCUSSIONS THAT EGYPT WOULD REQUIRE INCREASING SUMS OF NEW MONEY OVER THE NEXT FIVE YEARS TO MEET ANTICIPATED FINANCING GAPS IN THE BALANCE OF PAYMENTS. GRONLIE SAID HE HAD BEEN ASKED BY THE EGYPTIAN AUTHORITIES NOT TO REVEAL DETAILS OF THE LATEST FORECAST BY THE IMF OF THE EGYPTIAN BALANCE OF PAYMENTS, BUT HE THOUGHT THAT, EVEN WITH GENEROUS ANNUAL RESCHEDULING OF EGYPT'S DEBTS OVER THE NEXT FIVE YEARS, THE FINANCING GAP DURING THE CURRENT AND NEXT EGYPTIAN FISCAL YEARS (IE 1986/87 AND 1987/88) WOULD BE DOLLARS 625 MILLION AND THAT THIS WOULD RISE TO ABOUT DOLLARS 1.4 BILLION IN 1991/92. IT WAS FOR THIS REASON THAT DE LA ROSIERE HAD INSISTED THAT MEMBER COUNTRIES OF THE IMF SHOULD GUARANTEE THE REPAYMENT OF ANY IMF LOAN TO EGYPT (SEE PARA 4 OF MY TUR): IT WOULD BE USEFUL TO KNOW WHAT VIEW CAMDESSUS IS LIKELY TO TAKE ON THIS ISSUE.

5. GRONLIE THOUGHT THAT THE EGYPTIANS WERE NO LONGER LOOKING FOR FOOD FUND PLEDGES BY DONORS (SEE PARA 6 OF UKDEL IMF/IBRD'S TUR). HOWEVER, THE EGYPTIANS CONTINUED TO HOPE FOR FOREIGN EXCHANGE OF DOLLARS 500 MILLION, WHICH WOULD BE NEEDED TO NEUTRALISE ANY ACTION BY MONEY-CHANGERS DESIGNED TO SABOTAGE THE PROPOSED EXCHANGE REFORM: THEY HOPED TO GET MOST, IF NOT ALL OF THIS AMOUNT FROM THE CONVERSION BY THE US OF PROJECT LOANS INTO CASH. THE US EMBASSY HAVE SINCE CONFIRMED THAT WITHIN THE NEXT FEW DAYS THEY WOULD BE RELEASING DOLLARS 115 MILLION IN CASH WHICH HAD BEEN PROMISED BY MACPHERSON, THE HEAD OF USAID, IN DECEMBER 1986 (SEE PARA 11 OF MY TUR): THIS IS SEPARATE FROM ANYTHING THAT THEY MIGHT CONTRIBUTE TOWARDS THE DOLLARS 500 MILLION.

6. DAVIS AND I ALSO CALLED ON GANZOURY, DEPUTY PRIME MINISTER AND MINISTER OF PLANNING, ON 2 MARCH. HE CONFIRMED THAT THE PROVISION OF NEW MONEY BY FRIENDLY COUNTRIES WAS ESSENTIAL TO ENABLE EGYPT TO EMBARK ON AN IMF PROGRAMME. GANZOURY WAS ALSO CONCERNED ABOUT THE EFFECTS OF THE PROPOSED EXCHANGE RATES REFORM ON POORER EGYPTIANS: COMMODITIES DEFINED AS NECESSITIES WOULD THEREFORE BE THE LAST TO BE TRANSFERRED TO THE FREE MARKET RATE (IE PROBABLY NOT UNTIL JUNE 1988). GANZOURY GAVE A VERY POSITIVE ACCOUNT OF SHA'ALAN'S VISIT AND CONSIDERED THAT THERE WERE NOW NO SUBSTANTIVE DIFFERENCES BETWEEN EGYPT AND THE IMF: HE WAS ALSO RATHER MORE OPTIMISTIC ABOUT THE TIMETABLE FOR IMF BOARD APPROVAL AND PARIS CLUB RESCHEDULING THAN GRONLIE (SEE PARA 3 ABOVE).

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/COMMENT

COMMENT

7. THE US AMBASSADOR PRIOR TO HIS RECENT DEPARTURE FOR WASHINGTON ALSO GAVE ME AN UP-BEAT ACCOUNT OF SHA'ALAN'S VISIT AND OF HIS SUCCESS (PRESUMABLY WITH SOME HELP FROM THE AMERICANS) IN OBTAINING A FIRM EGYPTIAN COMMITMENT IN WRITING TO RAISE ENERGY PRICES AT THE BEGINNING OF MAY AND IN FILLING IN THE GAPS IN THE IMF TECHNICAL MEMORANDUM. BUT US EMBASSY OFFICIALS, WITH WHOM WE HAVE GONE OVER ALL THIS IN GREATER DETAILS, CONTINUE TO EXPRESS RESERVATIONS PARTICULARLY ON WHETHER THE EGYPTIANS WILL PROVE ABLE TO CARRY OUT THE COMPLEX PROCEDURES REQUIRED BOTH TO FULFIL THEIR UNDERTAKINGS TO THE IMF AND TO RESCHEDULE THEIR DEBTS.

8. THE FINANCIAL GAPS IN THE BALANCE OF PAYMENTS ARE AN INEVITABLE RESULT OF THE SHORT-COMINGS IN THE PROPOSED EGYPTIAN ECONOMIC REFORM PROGRAMME MORE OR LESS ENDORSED BY THE IMF BOARD ON 22 DECEMBER 1986: MOREOVER THE TIMING OF ITS IMPLEMENTATION HAS NOW SLIPPED SINCE THEN. ALTHOUGH THE IBRD WILL PROVIDE SOME OF THE FUNDS REQUIRED, WE UNDERSTAND FROM GRONLIE THAT THERE IS A LIMIT TO HOW MUCH THEY ARE ALLOWED TO LEND IN BALANCE OF PAYMENTS ASSISTANCE TO ANY ONE COUNTRY. FRIENDLY CREDITOR COUNTRIES WILL THEREFORE BE REQUIRED TO DISBURSE RELATIVELY LARGE SUMS OF BALANCE OF PAYMENTS SUPPORT FOR AT LEAST THE NEXT 5 YEARS ON CURRENT FORECASTS IF THE PROPOSED PROGRAMME IS TO BE IMPLEMENTED SUCCESSFULLY. THE ONLY WAYS IN WHICH EGYPTIAN FINANCIAL REQUIREMENTS OVER THIS PERIOD COULD BE LESSENERD WOULD BE THROUGH EITHER A REDUCTION IN EGYPTIAN IMPORTS (WITH A CORRESPONDINGLY ADVERSE EFFECT ON GROWTH PROSPECTS) OR IMPLEMENTATION OF MUCH TOUGHER ECONOMIC POLICIES BY THE EGYPTIAN AUTHORITIES THAN HAVE SO FAR BEEN ENVISAGED (AND OF WHICH THERE IS NO SIGN).

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TO ROUTINE FCO

TELNO 54

OF 040945Z FEBRUARY 87

INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND, TREASURY

INFO ROUTINE UKDEL IMF HBRD, WASHINGTON

INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS

INFO SAVING ALEXANDRIA ACTIONED

OUR TELNO 50: EGYPT/IMF

SUMMARY

1. THE DISCUSSIONS BETWEEN THE IMF AND THE EGYPTIAN AUTHORITIES HAVE BEEN CONCENTRATING ON THE PRECISE SCOPE AND TIMING OF THE EGYPTIAN PROPOSALS FOR ECONOMIC REFORM: THEY ARE NOT PROVING EASY. THE EGYPTIANS MAY IN THE END DRAFT THEIR OWN LETTER OF INTENT, RATHER THAN SUBMITTING ONE NEGOTIATED WITH AND AGREED BY THE IMF TEAM TO THE EXECUTIVE BOARD.

DETAIL

2. THE IMF TEAM, WHO ARE ACCOMPANIED BY AN OFFICIAL FROM THE HBRD, HAVE NOW BEEN IN CAIRO FOR TWO WEEKS AND SEEM LIKELY TO REMAIN FOR A FURTHER TEN DAYS. ALTHOUGH THE PRESENT NEGOTIATIONS HAVE BEEN CARRIED OUT IN CONDITIONS OF MUCH GREATER SECRECY THAN PREVIOUS ROUNDS, WE HAVE OBTAINED THE FOLLOWING GENERAL IMPRESSIONS FROM OUR CONTACTS WITH MEMBERS OF THE VISITING MISSION.

3. THE IMF TEAM HAVE BEEN WORKING EXTREMELY HARD AND HAVE MADE GOOD PROGRESS WITH THE EGYPTIANS IN FILLING IN THE DETAILS OF THE MONETARY PROGRAMME, CREDIT CEILINGS AND ITEMS IN THE BUDGET APPROPRIATE TO A STANDBY ARRANGEMENT. BUT THEY ARE STILL EXPERIENCING DIFFICULTIES IN THREE AREAS WHICH HAD PREVIOUSLY PROVED CONTENTIOUS:

A. OBTAINING A PRECISE EGYPTIAN COMMITMENT TO RAISE DOMESTIC ENERGY PRICES:

B. ESTABLISHING HOW THE EGYPTIAN AUTHORITIES WILL IMPLEMENT THEIR PROPOSALS FOR THE UNIFICATION OF EXCHANGE RATES:

C. THE LEVEL AND STRUCTURE OF DOMESTIC INTEREST RATES, ON WHICH VERY LITTLE PROGRESS APPEARS TO HAVE BEEN MADE.

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4. MUCH EFFORT HAS BEEN DEVOTED BY THE TEAM TO TRYING TO PIN DOWN THE DETAILS OF THE EGYPTIANS' OWN POLICY PROPOSALS. THERE NOW SEEMS TO BE SOME DOUBT WHETHER THE EGYPTIAN AUTHORITIES ARE STILL COMMITTED TO INCREASING ENERGY PRICES ON 1 APRIL. SIMILARLY THE EXPERT FROM THE BANK OF FRANCE WHO WAS TO ADVISE ON UNIFICATION OF EXCHANGE RATES IS NOW NOT EXPECTED TO ARRIVE UNTIL THE BEGINNING OF MARCH AT THE EARLIEST AND IT THEREFORE NO LONGER LOOKS PRACTICABLE TO TRY TO ESTABLISH A FREE FOREIGN EXCHANGE MARKET IN EARLY 1987, AS THE EGYPTIANS THEMSELVES AT ONE TIME PROPOSED (SEE MY TELNO 751 OF 1 DECEMBER 1986). THE IMF TEAM ALSO NEED TO KNOW MORE FROM THE EGYPTIANS ABOUT THEIR PROPOSALS ON DOMESTIC INTEREST RATES: THEY DO NOT SHARE THE APPARENT EGYPTIAN CONVICTION THAT A DECLINE IN INFLATION WILL RENDER PRESENT INTEREST RATES POSITIVE.

5. THE PRACTICAL DIFFICULTIES OF UNIFYING EXCHANGE RATES ARE NOT UNDERESTIMATED. THE EGYPTIAN PUBLIC SECTOR BANKS CURRENTLY HAVE LARGE LIABILITIES IN FOREIGN CURRENCY BACKED BY ASSETS DENOMINATED IN EGYPTIAN POUNDS. THIS IS A RESULT OF OPENING LETTERS OF CREDIT FOR PUBLIC SECTOR COMPANIES IN THE EXPECTATION THAT FOREIGN EXCHANGE WOULD BE AVAILABLE WHEN THE LETTER OF CREDIT BECAME DUE. OVER THE LAST 12 MONTHS THIS HAS INCREASINGLY NOT BEEN THE CASE, SO MOVEMENT TO A MORE DEPRECIATED RATE FOR THE EGYPTIAN POUND WILL CAUSE THESE BANKS TO INCUR SUBSTANTIAL LOSSES. THESE LOSSES WILL BE PARTLY COUNTER-BALANCED BY WINDFALL GAINS MADE BY PUBLIC SECTOR COMPANIES WHO HAVE IMPORTED COMMODITIES AT THE OLD RATE, ASSUMING THAT THEY ARE ALLOWED TO PASS ON THE FULL COSTS OF THE NEW EXCHANGE RATE TO THEIR CUSTOMERS.

6. WHILE THE IMF TEAM BELIEVE THAT THE RECOURSE OF PUBLIC SECTOR COMPANIES TO THE FREE MARKET TO PURCHASE FOREIGN EXCHANGE FOR THEIR COMMODITY IMPORTS IS STILL EXCEPTIONAL (PARA 3 OF MY TUR), THEY THINK IT IS LIKELY TO BECOME INCREASINGLY COMMON AS FOREIGN EXCHANGE FROM THE OFFICIAL GOVERNMENT POOL DWINDLES AND PARTICULARLY IF THE NEGOTIATIONS FOR A STANDBY ARRANGEMENT AND THE RESCHEDULING OF EGYPT'S DEBTS TAKE LONGER THAN HAD PREVIOUSLY BEEN EXPECTED.

7. THE IMF TEAM HAVE HAD TWO MEETINGS SO FAR WITH THE EGYPTIAN PRIME MINISTER. SIDQI REPORTEDLY WARNED THEM THAT ANY EGYPTIAN COMMITMENT TO THE IMF PROPOSALS, PARTICULARLY ON ENERGY PRICE INCREASES, WOULD HAVE TO BE SUBMITTED TO MUBARAK: MUBARAK HIMSELF HAS BEEN ABSENT FOR A WEEK ATTENDING THE ISLAMIC SUMMIT MEETING IN KUWAIT. 'EBEID, THE MINISTER OF STATE FOR CABINET AFFAIRS WHO HAD PLAYED A LEADING PART IN THE NEGOTIATIONS WITH THE IMF TEAM, HAS ALSO BEEN AWAY IN UPPER EGYPT FOR THE LAST FIVE DAYS.

8. IF SUBSTANTIAL PROGRESS CANNOT BE MADE IN THE AREAS WHERE THERE IS STILL DIFFICULTY (SEE PARA 3 ABOVE), ONE POSSIBLE COURSE APPARENTLY BEING CONSIDERED BY THE EGYPTIANS IS FOR THE IMF TEAM TO TAKE BACK TO WASHINGTON A LETTER OF INTENT DRAFTED BY THE EGYPTIAN AUTHORITIES AND NOT NECESSARILY EITHER NEGOTIATED WITH OR AGREED BY THE VISITING IMF TEAM. IN THIS EVENT, THE EGYPTIANS WOULD HOPE THAT THE IMF EXECUTIVE BOARD MIGHT PROVE MORE ACCOMMODATING THAN THE IMF TEAM OF OFFICIALS AND BE WILLING TO ACCEPT SUCH A LETTER AS THE BASIS FOR A STANDBY ARRANGEMENT.

COMMENT

9. NEITHER THE PRIME MINISTER, WHEN SEEING LORD TREFGARNE THIS MORNING, NOR GANZOURI (DEPUTY PRIME MINISTER AND MINISTER FOR PLANNING) GAVE ANY HINT THAT THE EGYPTIANS WERE CONTEMPLATING THE COURSE OUTLINED IN THE PRECEDING PARAGRAPH. INDEED THE PRIME MINISTER THOUGHT THAT A LETTER OF INTENT WOULD BE AGREED WITH THE IMF TEAM WITHIN THE NEXT WEEK OR SO: HE MENTIONED THAT THE TEAM WERE RECEIVED BY MUBARAK ON 3 FEBRUARY. SIDQI DID, HOWEVER, SAY THAT ALL THE MEASURES BEING PROPOSED BY THE IMF WERE SHORT-TERM, WHEREAS THE EGYPTIANS WANTED TO CARRY THROUGH THE REFORMS REQUIRED BY THE IMF AS PART OF A LONGER TERM PROCESS OF DEVELOPMENT AND RESTRUCTURING OF THE ECONOMY. THE EGYPTIAN GOVERNMENT ALSO HAD TO BEAR IN MIND THAT THERE WERE 4.5 MILLION GOVERNMENT AND PUBLIC SECTOR EMPLOYEES ON FIXED SALARIES WHO WOULD BE DIRECTLY AFFECTED BY ANY INCREASE IN PRICES. AS SOON AS THE LETTER OF INTENT WAS IN PLACE, ALL EGYPT'S DEBTS (OTHER THAN THOSE TO THE SOVIET UNION, WHICH WAS NOT OF COURSE A MEMBER OF THE IMF) WOULD BE INCLUDED IN A COMPREHENSIVE RESCHEDULING. IN REPLY TO A QUESTION FROM LORD TREFGARNE, SIDQI SAID THAT THE EGYPTIANS WERE ONLY LOOKING FOR FORGIVENESS OF THEIR MILITARY DEBT FROM THE AMERICANS: THEY ENVISAGED THAT ALL OTHER MILITARY DEBTS WOULD BE INCLUDED IN THE RESCHEDULING PROCESS. SIDQI ADDED THAT THE NEGOTIATIONS WITH THE AMERICANS OVER THE FMS DEBT WERE STILL GOING ON: THE CURRENT US PROPOSAL WOULD INVOLVE REPAYMENT BY EGYPT OF AN ACCUMULATED DEBT OF USDOLLARS 24 BILLION IN THE YEARS 2009 TO 2014: THIS WAS UNACCEPTABLE.

10. I SPECIFICALLY ASKED GANZOURI LAST NIGHT ABOUT ENERGY PRICES. HE SAID THAT, WHILE THE EGYPTIANS WERE FIRMLY COMMITTED TO INCREASES IN ENERGY PRICES, THEY WOULD PURSUE THE SAME TACTICS AS THEY HAD OVER BREAD AND PETROL AND NOT ANNOUNCE THEM IN ADVANCE: IN THIS WAY THEY HOPED TO AVOID PROVIDING A FOCUS FOR OPPOSITION. BUT GANZOURI STRESSED THAT

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ENERGY PRICES WOULD BE INCREASED WITHIN THE NEXT 2 OR 3 MONTHS,
AS AGREED WITH THE WORLD BANK: HE POINTED OUT THAT THE PRICE
OF KEROSENE IN PARTICULAR HAD NOT BEEN INCREASED FOR MANY
YEARS.

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CCHPAN 7618

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MONETARY
NEWAD
Ps / MR RENTON

COMES TO:
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MR J. ROBERTSON ES, ODA.

(REPEATED AS REQUESTED)

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 FM CAIRO
 TO ROUTINE FCO
 TELNO 61

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OF 081500Z FEBRUARY 87
 INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND, TREASURY
 INFO ROUTINE UKDEL IMF WBRD, WASHINGTON
 INFO SAVING ALEXANDRIA ACTIONED

MY TELNO 54: EGYPT/IMF

1. THE RECENTLY ANNOUNCED PARLIAMENTARY ELECTIONS (MY TELNO 58) AND ALSO THE RECEIPT OF FINANCIAL ASSISTANCE FROM CERTAIN GULF COUNTRIES HAVE GIVEN RISE TO FEARS THAT THE EGYPTIANS MAY NOW SEEK TO DELAY REACHING AGREEMENT WITH THE IMF AND ALSO CARRYING OUT THE CONDITIONS NECESSARY TO OBTAIN A LETTER OF INTENT. THE US AMBASSADOR, WHOM I SAW TODAY, AND OTHER MEMBERS OF HIS STAFF HAVE BEEN VOICING SUCH FEARS IN THE LAST FEW DAYS AND SEEM VERY CONCERNED THAT THE EGYPTIANS MAY SUCCEED TO THE TEMPTATION TO DEFER DIFFICULT DECISIONS. THESE FEARS ON THE PART OF THE AMERICANS MAY BE COMPOUNDED BY THE IMPASSE NOW REACHED OVER NEGOTIATIONS ON THE FMS DEBT, WHERE THE BALL NOW LIES IN THE US COURT FOLLOWING MUBARAK'S REJECTION OF PRESIDENT REAGAN'S PROPOSALS. THIS IS AN ISSUE OF CONSIDERABLE DELICACY FOR THE AMERICANS AND HAD ALREADY LED TO THE POSTPONEMENT OF MUBARAK'S INTENDED VISIT TO THE US AT THE END OF FEBRUARY.

2. WHEN SEEING THE EGYPTIAN FOREIGN MINISTER TODAY, I ENQUIRED WHETHER IT REMAINED THE EGYPTIAN INTENTION TO AGREE THE TERMS OF A LETTER OF INTENT WITH THE VISITING IMF MISSION BEFORE THEIR DEPARTURE AND ALSO WHETHER HE THOUGHT THERE WAS ANY RISK THAT THE PARLIAMENTARY ELECTIONS MIGHT LEAD TO THE POSTPONEMENT OF DECISIONS ON CONTENTIOUS QUESTIONS SUCH AS ENERGY PRICES. EMPHASISING THAT I WAS SPEAKING PERSONALLY, I TOLD MAGID THAT I THOUGHT THE EFFECT OF FAILURE TO GET A LETTER OF INTENT INTO PLACE AND TO CARRY THROUGH THE MEASURES REQUIRED BY THE IMF, EVEN IF IN RATHER SLOWER TIME THAN HAD ORIGINALLY BEEN PLANNED, COULD HAVE A MOST HARMFUL EFFECT ON EGYPT'S STANDING WITH HER CREDITORS. MAGID SAID HE ENTIRELY AGREED, AFFIRMED THAT IT REMAINED EGYPT'S INTENTION TO GET AN AGREED LETTER OF INTENT WITH THE IMF BEFORE THE MISSION DEPARTED (HE SAID IT WAS A LONG AND COMPLICATED DOCUMENT) AND THAT HE BELIEVED THE NECESSARY MEASURES SUCH AS INCREASES IN FUEL PRICES WOULD GO THROUGH.

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3. THIS IS IN LINE WITH WHAT THE PRIME MINISTER AND DEPUTY PRIME MINISTER GANZOURI TOLD LORD TREFGARNE AND MYSELF (SEE MY TUR), BUT DOES NOT SQUARE WITH AMERICAN IMPRESSIONS. WE SHALL BE REPORTING FURTHER AS SOON AS THE IMF TEAM'S MISSION IS CONCLUDED, PROBABLY ON 12 FEBRUARY.

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CCHPAN 7672

MONETARY
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TO PRIORITY FCO

TELNO 77

OF 151140Z FEBRUARY 87

INFO ROUTINE ODA, DTI, ECGD, BANK ENGLAND, TREASURY

INFO ROUTINE UKDEL IMF IBRD, WASHINGTON

INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS

INFO SAVING HMG ALEXANDRIA ACTIONED

MY TELNO 61: EGYPT/IMF

1. THE SEMI-OFFICIAL PRESS HAS BEEN CARRYING DETAILS OF THE LETTER OF INTENT THE EGYPTIAN AUTHORITIES ARE SAID TO HAVE AGREED WITH THE IMF TEAM, WHO LEFT CAIRO ON 13 FEBRUARY. THE MOST DETAILED DESCRIPTION OF THE LETTER OF INTENT IS CARRIED BY THE WEEKLY MAGAZINE PUBLISHED BY AL-AHRAM AND DEVOTED TO ECONOMIC ISSUES.
2. THE LETTER IS REPORTED TO REFER TO AN 18-MONTH PROGRAMME STARTING IN JULY (THIS PROGRAMME HAD OF COURSE INITIALLY BEEN INTENDED TO COME INTO OPERATION AT THE BEGINNING OF 1987). THE AIMS OF THE PROGRAMME ARE DESCRIBED AS BEING TO INCREASE THE ROLE OF MARKET FACTORS AND TO CONTROL INFLATION BY REDUCING GOVERNMENT EXPENDITURE WHILE INCREASING REVENUES. THE LETTER OF INTENT ALSO APPARENTLY REFERS TO MEASURES TO INCREASE EXPORTS AND REDUCE IMPORTS, AND TO RESTRICT THE APPROVAL OF NEW FOREIGN LOANS.
3. ON EXCHANGE RATES, THE LETTER IS REPORTED TO STATE THAT THERE WILL BE MOVEMENT TOWARDS A "MORE UNIFIED" RATE, WITH A MORE ACTIVE ROLE BEING PLAYED BY COMMERCIAL BANKS. THE GOVERNMENT IS ALSO COMMITTED TO INCREASE DOMESTIC SAVINGS BY LOWERING INFLATION, REDUCE THE BUDGET DEFICIT AND GRADUALLY TO INCREASE INTEREST RATES. THE LETTER IS ALSO SAID TO COVER PLANS TO FREE AGRICULTURAL PRODUCER PRICES, EXCEPT FOR COTTON AND SUGAR CANE, AND ALSO TO INCREASE DOMESTIC ENERGY PRICES (SEE MY TELNO 75). THE BUDGET DEFICIT IS REPORTEDLY TO BE DECREASED FROM 14 PER CENT IN 1986 TO 4 PER CENT OF GDP IN 1987. THERE ARE PLANS TO DECREASE THE NUMBER OF COMMODITIES WHICH ATTRACT SUBSIDY AND TO RESTRICT THE DISTRIBUTION OF SUCH COMMODITIES TO PEOPLE WITH LIMITED INCOME. AN INCREASE IN REVENUE FROM TAXES IS ALSO PLANNED BY REFORMS IN THE EXISTING SYSTEM, AND BY TIGHTENING THE RULES ON TAX EVASION.

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4. WE HOPE TO SEE THE RESIDENT REPRESENTATIVE OF THE
IMF TOMORROW AND I AM ALSO SEEKING APPOINTMENTS WITH THE
EGYPTIAN MINISTERS MOST CLOSELY INVOLVED TO OBTAIN THEIR
ACCOUNT OF THIS LATEST ROUND OF NEGOTIATIONS WITH THE IMF.

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SAVING
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THIS TELEGRAM
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FM CAIRO

TO ROUTINE FCO

TELNO 082

OF 170648Z FEBRUARY 87

INFO ROUTINE DEPT OF ENERGY, DTI, ODA, ECGD, BANK OF ENGLAND

INFO ROUTINE UKDEL IMF//IBRD WASHINGTON TEL AVIV, WASHINGTON

INFO ROUTINE OPEC POSTS

PS, TO CHANCELLOR OF THE EXCHEQUER,
TREASURY.

MY TELNOS 026 AND 075: EGYPTIAN OIL PRICES

SUMMARY

1. EGYPT REDUCES THE PRICE OF THE SUEZ BLEND BY DOLLARS 0.35 PER BARREL. PRICES FOR OTHER BLENDS REMAIN THE SAME.

DETAIL

2. THE EGYPTIAN GENERAL PETROLEUM CORPORATION ANNOUNCED ON 15 FEBRUARY NEW PRICES FOR ITS OIL EXPORTS, EFFECTIVE UNTIL THE END OF THE MONTH. THE PRICES FOR THE MAIN BLENDS ARE SHOWN BELOW (IN DOLLARS PER BARREL):

PRICE FOR 16-28 FEB DECREASE ON PRICE FOR 16 JAN TO 15 FEB

SUEZ	17.25	0.35
RAS GHAREB	15.40	--
BELAYUN	16.65	--

COMMENT

3. THE MARGINAL REDUCTION IN PRICE OF THE SUEZ BLEND SEEMS SENSIBLE IN THE LIGHT OF THE RECENT WEAKENING OF THE INTERNATIONAL OIL MARKET. EGYPT'S TOTAL OIL PRODUCTION IN JANUARY WAS 900,000 BARRELS PER DAY (ABOVE THE FIGURE OF 870,000 BARRELS PER DAY THAT EGYPT HAS COMMITTED TO IN ORDER TO SUPPORT OPEC: SEE MY TELNO 021), BUT INDICATIONS ARE THAT PRODUCTION FOR FEBRUARY WILL BE AROUND 850,000 BARRELS PER DAY.

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TELNO 34
OF 171450Z FEBRUARY 37
AND TO IMMEDIATE UKDEL IMF IBRD
INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND, TREASURY
INFO ROUTINE WASHINGTON
INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS
INFO SAVING HMC G ALEXANDRIA ACTIONED

MY TELNO 77: EGYPT/IMF

SUMMARY

1. EGYPT AND THE IMF TEAM REACH AGREEMENT ON A LETTER OF INTENT, BUT THE DETAILS OF A TECHNICAL MEMORANDUM TO BE ATTACHED TO IT STILL REMAIN TO BE NEGOTIATED. INCREASES IN ENERGY PRICES HAVE NOW BEEN DELAYED UNTIL THE BEGINNING OF MAY: THEY ARE STILL AN ESSENTIAL PRECONDITION FOR SUBMISSION OF THE LETTER OF INTENT TO THE IMF BOARD FOR APPROVAL. THE EGYPTIANS ARE LIKELY TO REQUEST A MEETING OF THE PARIS CLUB IN MID-MAY. A LARGE FINANCING GAP HAS STILL TO BE COVERED.

DETAIL

2. I CALLED ON SALAH HAMID, GOVERNOR OF THE CENTRAL BANK OF EGYPT, ON 16 FEBRUARY TO DISCUSS THE LATEST ROUND OF NEGOTIATIONS WITH THE IMF. WE HAVE SINCE SEEN THE IMF REPRESENTATIVE AND ALSO COMPARED NOTES WITH EC AMBASSADORS AND THE US EMBASSY.
3. THE GOVERNOR OF THE CENTRAL BANK SAID THAT THE IMF TEAM HAD TAKEN BACK A LETTER OF INTENT TO WASHINGTON AND THAT THE OFFICIAL TEXT WOULD BE HANDED TO SHA'ALAN, THE DIRECTOR OF THE MIDDLE EAST DEPARTMENT OF THE IMF, WHEN HE RETURNED TO CAIRO ON EITHER 22 OR 23 FEBRUARY.
4. HOWEVER THE US EMBASSY, WHO TAKE A LESS SANGUINE VIEW THAN OUR OTHER INTERLOCUTORS, CLAIM THAT THE LETTER OF INTENT IS SUBJECT TO A FOOTNOTE ORIGINALLY INSISTED ON BY DE LA ROSIERE TO THE EFFECT THAT MEMBER COUNTRIES OF THE IMF WOULD GUARANTEE THE REPAYMENT OF ANY IMF LAON MADE TO EGYPT; BUT THAT, AS A PRIOR CONDITION OF THIS KIND WAS UNPRECEDENTED, IT WAS LIKELY TO BE OPPOSED BY THE EXECUTIVE BOARD. THE US EMBASSY ALSO SAY THAT ATTACHED TO THE LETTER OF INTENT IS A 40-PAGE TECHNICAL MEMORANDUM WRITTEN BY THE IMF, DETAILS OF WHICH HAVE STILL TO BE NEGOTIATED. SETTLING THESE DETAILS WOULD BE THE MAIN TASK

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OF THE IMF TEAM WHICH IS DUE TO VISIT EGYPT IN MARCH (SEE PARA 3 BELOW). WHILE THE EGYPTIANS DO NOT APPARENTLY FORESEE PROBLEMS, THE AMERICANS FEAR THAT THE NEGOTIATIONS COULD PROVE DIFFICULT.

5. THE GOVERNOR OF THE CENTRAL BANK OUTLINED THE PROGRAMME AGREED BETWEEN THE EGYPTIANS AND THE IMF IN THE 3 AREAS WHICH HAVE HITHERTO BEEN IN DISPUTE WITH THE FUND AND THE IBRD (SEE MY TELNO 54):

A. ON EXCHANGE RATES, ACTION WOULD BE TAKEN BY THE EGYPTIANS AT THE BEGINNING OF MAY AS SOON AS THE ELECTIONS ARE OUT OF THE WAY. IT WOULD BEGIN, AS PREVIOUSLY PLANNED, WITH THE SHIFTING OF 40% OF COMMODITIES FROM THE OFFICIAL TO THE FREE MARKET EXCHANGE RATE. AT THE SAME TIME THE COMMERCIAL BANKS WOULD BE ALLOWED TO DEAL IN FOREIGN EXCHANGE AT THE FREE MARKET RATE. THE EGYPTIAN AUTHORITIES WERE, HOWEVER, CONCERNED THAT THE EXCHANGE RATE MIGHT DEPRECIATE RAPIDLY IF THERE WERE NOT A SUFFICIENT CUSHION OF FOREIGN EXCHANGE AND ALSO THAT THE MONEY CHANGERS AND ISLAMIC INVESTMENT COMPANIES MIGHT WITHHOLD FOREIGN CURRENCY FROM THE MARKET IN AN EFFORT TO DESTABILISE IT: HE WAS THEREFORE HOPING FOR INCREASED ASSISTANCE FROM FRIENDLY COUNTRIES.

B. ON INTEREST RATES, HAMID SAID THE EGYPTIAN AUTHORITIES WERE STICKING TO THEIR ORIGINAL PROPOSALS UNDER WHICH A SEPARATE RATE, 5 PERCENTAGE POINTS ABOVE THE EXISTING 13% RATE, WOULD BE OFFERED FOR DEPOSITS IN DOLLARS WHICH ARE CONVERTED INTO EGYPTIAN POUNDS.

C. ON ENERGY PRICES TOO, ACTION WOULD BE DELAYED UNTIL THE ELECTIONS WERE OVER. HAMID CONCEDED THAT SUCH INCREASES WERE A PRECONDITION FOR APPROVAL OF THE LETTER OF INTENT BY THE IMF BOARD AND FOR A RESUMPTION OF LENDING TO THE INDUSTRIAL AND ENERGY SECTORS BY THE IBRD. BUT HE THOUGHT THE LETTER COULD NONETHELESS BE SUBMITTED TO THE IMF BOARD BY THE END OF APRIL (WITH FORMAL APPROVAL PRESUMABLY NOT BEING GIVEN UNTIL INCREASES IN ENERGY PRICES WERE ACTUALLY IMPLEMENTED).

6. HAMID SAID THAT THE IBRD HAD RECEIVED A REQUEST FROM THE EGYPTIANS TO CONVENE A CONSULTATIVE AID GROUP FOR EGYPT FOLLOWING THE APPROVAL OF EGYPT'S LETTER OF INTENT AND BEFORE THE MEETING OF THE PARIS CLUB, WHICH HE EXPECTED WOULD TAKE PLACE IN THE MIDDLE OF MAY. EGYPT DID NOT INTEND ASKING FOR A FORMAL MEETING OF THE LONDON CLUB, SINCE COMMERCIAL DEBT FORMED SO SMALL A PROPORTION OF EGYPT'S EXTERNAL DEBT.

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11. ACCORDING TO THE US EMBASSY, THE FINANCING GAP FOR THE PERIOD OF THE INITIAL STANDBY ARRANGEMENT IS NOW ESTIMATED BY THE IMF TO BE USDOLLARS 525 MILLION, AFTER TAKING ACCOUNT OF DISBURSEMENTS BY THE WORLD BANK. THE EGYPTIANS ARE ALSO EXPECTED TO REQUEST AN ADDITIONAL USDOLLARS 500 MILLION TO PROVIDE A CUSHION FOR THE EXPECTED DEPRECIATION OF THE EXCHANGE RATE. THE AMERICANS ANTICIPATE THAT THE EGYPTIANS WILL FACE DIFFICULTIES IN MOBILISING THESE SUMS. WE ASKED THE US EMBASSY WHETHER THE AMERICANS WOULD NOW BE PREPARED TO RELEASE THE SECOND TRANCHE OF USDOLLARS 115 MILLION, WHICH MACPHERSON OF USAID HAD TOLD THE EGYPTIAN WOULD BE AVAILABLE FOLLOWING AGREEMENT ON A LETTER OF INTENT WITH THE IMF (MY TELNO 795 OF 13 DECEMBER 1986). THE US EMBASSY ARE LIKELY TO RECOMMEND THIS TO WASHINGTON, BUT BEFORE DOING SO WILL WANT TO BE QUITE SURE THAT THE LATEST ROUND OF NEGOTIATIONS WITH THE IMF HAS INDEED SUCCEEDED IN CREATING THE BASIS FOR A STANDBY ARRANGEMENT.

URWICK

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FCO PLEASE PASS SAVING ADDRESSEES

MONETARY

NENAD

PS/MR RENTON

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7. THE EGYPTIAN PRIME MINISTER,³ IN SPEAKING TO CHABAN-DELMAS WHO IS VISITING EGYPT, SAID THAT THE DISCUSSIONS WITH THE IMF HAD PROVED DIFFICULT, ESPECIALLY AS SOME MINISTERS NOT DIRECTLY CONCERNED WITH ECONOMIC AFFAIRS HAD STRONGLY CONTESTED THE MORE DIFFICULT POINTS IN THE AGREEMENT AND THAT THERE HAD BEEN AN INTENSIVE AND LENGTHY INTERNAL DEBATE.

8. GRONLIE, THE RESIDENT IMF REPRESENTATIVE, HAS BROADLY CONFIRMED ALL THIS BUT TOLD US THAT THE ORIGINAL DRAFT LETTER OF INTENT PREPARED BY THE EGYPTIANS HAD BEEN SIGNIFICANTLY WEAKER THAN THE PROGRAMME CONTAINED IN THEIR OWN PAPER OF 29 NOVEMBER (MY TELNO 751 OF 1 DECEMBER 1986). THE IMF HAD SAID THEY WOULD TAKE THIS EARLIER DRAFT BACK TO WASHINGTON, BUT COULD NOT ENDORSE IT. ON THE DAY BEFORE THE IMF TEAM'S PROPOSED DEPARTURE, THE EGYPTIANS HAD PRODUCED A NEW DRAFT BROADLY ACCEPTABLE TO THE TEAM, WHO HAD THEN POSTPONED THEIR DEPARTURE BY A DAY TO ALLOW FURTHER DISCUSSION OF SOME RELATIVELY MINOR OUTSTANDING DIFFERENCES. THE IMF TEAM WILL RETURN TO CAIRO IN EARLY MARCH FOR FURTHER TECHNICAL DISCUSSIONS EXPECTED TO LAST 2 OR 3 WEEKS. THEIR AIM WILL BE TO ESTABLISH THE PERFORMANCE CRITERIA FOR THE JUNE AND SEPTEMBER QUARTERS: IN ORDER TO SET THESE CRITERIA, THE IMF NEED A MORE DETAILED KNOWLEDGE OF THE EGYPTIAN BUDGET PROPOSALS FOR THE FINANCIAL YEAR 1987/8 THAN THEY AT PRESENT POSSESS.

9. GRONLIE THOUGHT THE PAPERWORK FOR A STANDBY ARRANGEMENT SHOULD BE COMPLETED BY THE IMF TEAM BY THE BEGINNING OF APRIL AND SUBMITTED TO THE BOARD IN THE FIRST WEEK OF MAY. HE ALSO CONFIRMED THAT THE STANDBY ARRANGEMENT WOULD NOT BECOME EFFECTIVE UNTIL DOMESTIC ENERGY PRICES WERE INCREASED AND THAT THE EGYPTIANS WERE NOW COMMITTED TO RAISE THEM ON 1 MAY. THE DATES FOR THE TRANSFER IN 3 STAGES OF COMMODITIES FROM THE OFFICIAL TO THE FREE MARKET EXCHANGE RATE TO WHICH THE EGYPTIANS HAVE NOW AGREED ARE THE BEGINNING OF MAY, DECEMBER 1987 AND JUNE 1988. UNIFICATION SHOULD THUS ONLY TAKE 14 MONTHS FROM ITS INCEPTION: THE FIRST TRANCHE OF COMMODITIES AND SERVICES TO BE TRANSFERRED TO THE FREE MARKET RATE WILL INCLUDE TOURIST RECEIPTS, WORKERS' REMITTANCES AND AS YET UNSPECIFIED AGRICULTURAL AND INDUSTRIAL SECTOR PRODUCTS.

10. GRONLIE SAID THAT ONCE A STANDBY ARRANGEMENT WAS IN PLACE, IMF TEAMS WOULD VISIT EGYPT EVERY 4 MONTHS TO REVIEW EGYPTIAN POLICIES. AT THE FIRST SUCH REVIEW THE IMF WOULD ADDRESS PROBLEMS OF THE TIMETABLE FOR THE INCORPORATION OF THE CENTRAL BANK FOREIGN EXCHANGE POOL (70 PIASTRES TO THE US DOLLAR) WITH THE TWO OTHER EXCHANGE RATES AND ALSO POLICIES ON INTEREST RATES. GRONLIE DOES NOT, INCIDENTALLY, FORESEE MUCH SWITCHING OF DOLLARS INTO EGYPTIAN POUNDS RESULTING FROM THE PRESENT EGYPTIAN PROPOSAL ON INTEREST RATES (PARA 5B ABOVE.).).

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FM CAIRO

TO ROUTINE FCO

TELNO 089

OF 190830Z FEBRUARY 87

INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND, TREASURY

INFO ROUTINE UKDEL IMF/IBRD WASHINGTON, WASHINGTON

INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS

INFO SAVING HMGX ALEXANDRIA ACTIONED

MY TELNO 84: EGYPT/IMF

SUMMARY

1. THE EGYPTIAN MINISTER OF STATE FOR CABINET AFFAIRS, WHO HAS PLAYED A CENTRAL ROLE IN THE NEGOTIATIONS WITH THE IMF, BROADLY CONFIRMS THE ACCOUNT GIVEN IN MY TUR AND EXPLAINS SOME POINTS OF DOUBT. THE TECHNICAL MEMORANDUM PREPARED BY THE IMF TO BE ATTACHED TO THE LETTER OF INTENT COULD WELL RAISE MORE DIFFICULTIES THAN THE EGYPTIANS ANTICIPATE, THERE IS ALSO STILL SOME VAGUENESS ABOUT PRECISE MEASURES TO INCREASE ENERGY PRICES.

DETAIL

2. I CALLED ON DR 'ATIF 'EBEID, MINISTER OF STATE FOR CABINET AFFAIRS, ON 18 FEBRUARY, MAINLY IN ORDER TO CHECK SOME POINTS OF DOUBT CONCERNING THE LATEST ROUND OF EGYPTIAN NEGOTIATIONS WITH THE IMF IN WHICH EBEID HIMSELF HAS PLAYED A CENTRAL ROLE.

3. EBEID SAID THAT THE DRAFT LETTER OF INTENT WHICH THE IMF TEAM TOOK BACK TO WASHINGTON HAD NOT BEEN FORMALLY APPROVED BY THE PRESIDENT. HOWEVER SINCE THEIR DEPARTURE MUBARAK'S FORMAL APPROVAL HAD BEEN OBTAINED AND THE OFFICIAL TEXT OF THE LETTER WOULD BE HANDED TO SHA-ALAN WHEN HE VISITED CAIRO IN THE NEXT FEW DAYS: THERE HAD BEEN NO CHANGES FROM THE ORIGINAL DRAFT. BECAUSE THE OFFICIAL TEXT OF THE LETTER OF INTENT HAD NOT YET BEEN FORMALLY HANDED TO THE IMF, THE EGYPTIANS WERE NOT MAKING ANY ANNOUNCEMENT ON THE RESULT OF THEIR TALKS WITH THE IMF TEAM, BUT EBEID ASSURED ME THAT EVERYTHING WAS NOW IN PLACE AND PROCEEDING ACCORDING TO PLAN, ALTHOUGH HE MADE NO ATTEMPT TO CONCEAL THAT THE GOING HAD BEEN DIFFICULT.

4. THERE HAVE BEEN SUGGESTIONS HERE THAT THE LETTER OF INTENT MIGHT HAVE TO BE SUBMITTED FOR APPROVAL TO THE NEWLY ELECTED PEOPLE'S ASSEMBLY WHEN IT MEETS IN APRIL, WHICH COULD WELL HAVE IMPOSED FURTHER DELAY. BUT EBEID SAID THAT FORTUNATELY THIS WAS NOT THE CASE. THE MEASURES OUTLINED IN THE LETTER OF INTENT WERE A MATTER FOR THE EXECUTIVE TO IMPLEMENT AND DID NOT REQUIRE PARLIAMENTARY APPROVAL.

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5. EBEID CONFIRMED THE EXISTENCE OF THE TECHNICAL MEMORANDUM PREPARED BY THE IMF TEAM FOR ATTACHMENT TO THE LETTER OF INTENT (SEE PARA 4 OF MY TUR) BUT AFFIRMED THAT NEGOTIATIONS ON THE MEMORANDUM, PARTS OF WHICH STILL HAD TO BE COMPLETED, SHOULD NOT CAUSE DIFFICULTIES SINCE IT MERELY SET OUT IN GREATER DETAIL THE IMPLEMENTATION OF THE AGREED PROGRAMME IN THE LETTER OF INTENT. I WOULD GUESS EBEID IS BEING OVER-SANGUINE ABOUT THIS: NO DOUBT THE IMF WILL TRY TO USE THE MEMORANDUM TO PIN DOWN THE EGYPTIAN ON KEY DETAILS OF IMPLEMENTATION LEFT VAGUE IN THE COVERING LETTER.

6. EBEID WAS LESS THAN PRECISE IN ANSWERING MY QUESTION ON THE EGYPTIAN COMMITMENT TO INCREASING ENERGY PRICES. HE BEGAN BY SAYING THAT MUBARAK HAD TOLD THE IMF TEAM THAT EGYPT WAS FULLY COMMITTED TO INCREASING ENERGY PRICES TO INTERNATIONAL LEVELS BY THE END OF THE NEXT 5-YEAR PLAN IN 1992, BUT WOULD NOT PUBLICLY ANNOUNCE THEIR INTENTIONS. EBEID CLAIMED THE REASON AGREEMENT ON INCREASING ENERGY PRICES HAD BEEN SO DIFFICULT TO ACHIEVE WAS BECAUSE THE EGYPTIANS WERE FEARFUL OF THE KNOCK-ON EFFECT ON PRICES IN THE TRANSPORT AND INDUSTRIAL SECTORS AND ESPECIALLY OF THE TENDENCY HERE BOTH TO ANTICIPATE SUCH INCREASES AND TO TRY TO PASS ON EXCESSIVE INCREASES TO CUSTOMERS IN ORDER TO COVER HIGHER COSTS. WHEN I PRESSED EBEID ON THE GOVERNMENT'S DETAILED INTENTIONS, HE AGREED THAT THE FIRST ROUND OF ENERGY PRICE INCREASES WOULD BE PUT INTO EFFECT AT THE BEGINNING OF MAY. BUT HE REMAINED VAGUE ABOUT THE DETAILS.

7. I ASKED WHETHER THE EGYPTIAN GOVERNMENT WERE CONSIDERING BRIEFING AMBASSADORS OF COUNTRIES DIRECTLY CONCERNED ON THE OUTCOME OF THEIR LATEST NEGOTIATIONS WITH IMF, AS THEY HAD DONE IN NOVEMBER AND DECEMBER. EBEID SAID THAT THEY WERE INDEED INTENDING TO DO THIS, FOLLOWING A FORMAL REACTION FROM THE IMF IN WASHINGTON.

URWICK

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FROM UKDEL IMF/IBRD WASHINGTON
TO PRIORITY FCO
TELNO 047
OF 192300Z FEBRUARY 87
AND TO PRIORITY CAIRO

IMF: EGYPT

SUMMARY

1 FUND STILL AWAIT MUBARAK'S AND FUND MANAGEMENT'S APPROVAL OF WHAT HAS BEEN NEGOTIATED SO FAR. NONE OF THE QUANTITATIVE TARGETS FOR THE SBA HAVE YET BEEN SET. A SIZEABLE FINANCING GAP STILL REMAINS. EGYPT'S MEDIUM-TERM BALANCE OF PAYMENT LOOKS WORSE THAN BEFORE. NO FUND BOARD APPROVAL OF SBA LIKELY BEFORE MAY. US STATE OFFICIALS DISAPPOINTED BY DEVELOPMENTS.

DETAIL

2 FOLLOWING CAIRO TELNOS 50, 77 AND 89, WE TODAY SAW CHABRIER (DEPUTY DIRECTOR OF THE FUND'S MIDDLE EASTERN DEPT).

3 HE SAID THAT SHAALAN IN CAIRO, WITH WHOM THEY HAD JUST BEEN IN TOUCH, HAD STILL NOT BEEN TOLD THAT MUBARAK HAD APPROVED THE STATEMENT OF POLICIES (COMMENT: THIS STATEMENT IS MORE LIMITED AND LESS DETAILED THAN A LETTER OF INTENT) WHICH HAD BEEN LEFT IN CAIRO. FUND MANAGEMENT HAD ALSO NOT COMMENTED.

4 CHABRIER SAID THAT THE STATEMENT REPRESENTED A STEP BACKWARDS FROM EGYPT'S NOVEMBER PROPOSALS IN THAT THE TIMETABLE FOR ADJUSTMENT HAD SLIPPED AND THAT LESS ADJUSTMENT (ESPECIALLY ON INTEREST RATES) WAS CONTEMPLATED. HE ADDED THAT THE STATEMENT CONTAINED FEW SPECIFICS. IF MUBARAK AGREED IT, A FUND MISSION WOULD HAVE TO RETURN TO CAIRO TO NEGOTIATE THE FIGURES AND A DETAILED TIMETABLE FOR THE EXCHANGE RATE REFORMS. THE SETTING OF PERFORMANCE CRITERIA WOULD INVOLVE LOOKING IN DETAIL AT FISCAL PROSPECTS FOR 1987/8 WHICH, SO FAR, THE EGYPTIANS HAD NOT DISCUSSED WITH THE FUND.

5 CHABRIER SAID THAT THE FISCAL POSITION FOR 1986/7 WAS TURNING OUT ROUGHLY AS EXPECTED AND THAT THE CURRENT ACCOUNT PICTURE FOR 1987 NOW LOOKED ABOUT DOLLARS 400 MN BETTER. (THIS WAS THE RESULT OF A HIGHER OIL PRICE ASSUMPTION AND LOWER COMMODITY IMPORT PRICES, ONLY PARTLY OFFSET BY LOWER PROSPECTIVE WORKERS' REMITTANCES.) HOWEVER, WITH A REDUCED PROSPECTIVE FLOW OF WORLD BANK MONEY OVER THE LIKELY PERIOD OF THE SBA (FOLLOWING IN LARGE PART FROM THE DELAY IN ENERGY PRICE INCREASES) CHABRIER SAID THAT THERE WAS STILL A FINANCING GAP OF SOME DOLLARS 600-700 MN BEFORE FUND INVOLVEMENT. MORE WORRYINGLY, WORLD BANK STUDIES OF EGYPT'S OIL AND GAS INDUSTRIES HAD SHOWN THAT PREVIOUS FUND

/ PROJECTIONS

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PROJECTIONS FOR OUTPUT IN THESE SECTORS FOR THE NEXT FEW YEARS WERE TOO OPTIMISTIC. THUS, ALTHOUGH 1987'S CURRENT ACCOUNT POSITION LOOKED BETTER THAN BEFORE, THE PROSPECTIVE FINANCING GAPS FOR THE EARLY 1990S WERE EVEN LARGER THAN PREVIOUSLY THOUGHT.

6 CHABRIER WENT ON TO SAY THAT THE EGYPTIANS WERE STILL LOOKING FOR A NUMBER OF ASSURANCES BEFORE EMBARKING ON AN SBA:

(I) SOME FOREIGN EXCHANGE IN HAND AS A CUSHION, BEFORE STARTING REFORM OF THE FX MARKET. THE EGYPTIANS HAD ORIGINALLY SUGGESTED DOLLARS 1 BN BUT HAD BEEN TOLD THAT THIS WAS AN UNREALISTIC HOPE:

(I.I) ADDITIONAL "FOOD FUND" DONOR PLEDGES OF ABOUT DOLLARS 600-700 MN A YEAR, BRINGING TOTAL FOOD AID TO DOLLARS 1 BN A YEAR. THIS WAS TO CUSHION THE URBAN POOR FROM THE EFFECTS OF THE REFORMS. (NB IF THIS WERE FORTHCOMING IT WOULD LARGELY OR WHOLLY CLOSE THE FINANCING GAP NOTED ABOVE.):

(I.I.I) THEY WERE STILL PRESSING FOR CONVERSION OF PROJECT AID INTO CASH AID.

NEXT STEPS

7 CHABRIER EXPECTED SHAALAN TO RETURN EARLY NEXT WEEK AND THAT ANOTHER INFORMAL MEETING OF THE RELEVANT FUND DIRECTORS WOULD THEN BE CALLED. (NB GIVEN NEXT WEEK'S BANK/FUND SYMPOSIUM, THIS MIGHT WELL HAVE TO WAIT UNTIL THE WEEK BEGINNING 2 MARCH.) HE THOUGHT THAT EVEN IF A FUND MISSION RETURNED TO CAIRO SHORTLY AFTERWARDS, SO MUCH DETAILED NEGOTIATIONS AND EXAMINATION OF 1987/88 REMAINED THAT THE RELEVANT PAPERS COULD ONLY GET TO THE FUND BOARD BY EARLY MAY AT SOONEST.

OTHER REACTIONS

8 US STATE DEPARTMENT'S INITIAL RESPONSE AT OFFICIAL LEVEL IS DISAPPOINTMENT ABOUT THE LACK OF PROGRESS THE EGYPTIANS ARE MAKING IN FACING UP TO THEIR PROBLEMS. THE US OFFICE AT THE FUND (WHO HAD BRIEFED STATE) EXPRESSED A SIMILAR VIEW.

9 FCO PLEASE ADVANCE TO LAVELLE, MOUNTFIELD, WALSH (FOR LANKESTER) (HMT), WARE (BOE), T RICHARDSON (FCO) AND WOOTTON (ODA).

THIS TELEGRAM
WAS NOT
ADVANCED

FOOT
ORWRAN9737

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 FM UKDEL IMF/IBRD, WASHINGTON
 TO PRIORITY FCO
 TELNO 58
 OF 032330Z MARCH 87
 INFO ROUTINE CAIRO

IMF: EGYPT

SUMMARY

A LETTER OF INTENT NOW AGREED BETWEEN EGYPT AND THE FUND, PAVING THE WAY FOR BOARD APPROVAL EARLY MAY. HOWEVER, CAMDESSUS MAY PRESS FIRST FOR GUARANTEES FOR THE FUND FROM MAJOR SHAREHOLDERS.

DETAIL

2. SHAALAN (HEAD OF THE FUND'S MIDDLE EASTERN DEPARTMENT) TOLD US TODAY THAT THE FUND AND EGYPT HAVE NOW AGREED A LETTER OF INTENT (CAIRO TELNO 106 ARRIVED SHORTLY AFTERWARDS). THIS IS BASED ON THE STATEMENT OF POLICIES DESCRIBED IN PARAS 3 - 4 OF OUR TELNO 47 OF 19 FEBRUARY. SHAALAN DID NOT GO INTO DETAIL BUT DID SAY THAT THE EGYPTIANS HAD DROPPED THEIR DEMAND FOR A FOREIGN EXCHANGE CUSHION (OUR TUR PARA 6(1)) BEFORE STARTING TO REFORM THE FX MARKET (N.B. PARA 5 OF CAIRO TUR HOWEVER RECORDS CONTINUED EGYPTIAN HOPES IN THIS AREA). ANOTHER FUND MISSION WOULD GO TO CAIRO WITHIN 2 WEEKS TO NEGOTIATE THE DETAILED MEMORANDUM OF UNDERSTANDING BASED ON THE L.O.I. SHAALAN FORESAW NO DIFFICULTY.

3. AS TO NEXT STEPS, SHAALAN SAID HE HAD RECOMMENDED TO CAMDESSUS THAT ANOTHER INFORMAL MEETING OF RELEVANT FUND DIRECTORS BE HELD SOON. SHAALAN ADDED THAT HE HAD THE IMPRESSION THAT CAMDESSUS FAVOURED ASKING THE MAJOR SHAREHOLDERS OF THE FUND FOR SOME KIND OF GUARANTEE ON FUND MONEY ADVANCED TO EGYPT. (COMMENT: THIS WOULD BE UNPRECEDENTED. WE BELIEVE IT IS AN IDEA LAROSIERE HAD ALSO ENTERTAINED AND CAIRO TELNO 84 OF 17 FEBRUARY REPORTS THE US EMBASSY THERE AS SAYING THAT THE LOI 'IS SUBJECT TO A FOOTNOTE ORIGINALLY INSISTED ON BY LAROSIERE TO THE EFFECT THAT MEMBER COUNTRIES OF THE IMF WOULD GUARANTEE THE REPAYMENT OF ANY IMF LOAN MADE TO EGYPT'. BUT, IN WASHINGTON LAROSIERE HAD NEVER DEMANDED MORE FROM DIRECTORS THAN THAT - SEE OUR TELNO 376 OF 4 DECEMBER 1986 - PARIS CLUB CREDITORS SHOULD GIVE WHATEVER CONCESSIONS WERE NEEDED TO EGYPT TO PROTECT THE FUND'S POSITION. IT MAY BE THAT CAMDESSUS IS NOT THINKING OF MORE THAN THIS).

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4. SHAALAN ALSO SAID THAT MUBARAK WAS ASKING THAT NO FUND PAPERS SHOULD BE CIRCULATED TO THE FUND BOARD BEFORE THE APRIL 6 ELECTIONS. IN EFFECT, THIS MEANT THAT THE BOARD COULD NOT DISCUSS THE SBA UNTIL EARLY MAY, BY WHICH TIME THE FIRST ROUND OF ENERGY PRICE INCREASES WOULD HAVE HAD TO BE IMPLEMENTED.

5. WE WILL REPORT IF/AS SOON AS/ AN INFORMAL MEETING IS CALLED AND IF WE HEAR MORE ABOUT CAMDESSUS' THINKING.

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

LANKESTER

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ORWBAN 0018

(ADVANCED AS REQUESTED)

MONETARY
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MR. MUNRO
SIR. D. MIERS.

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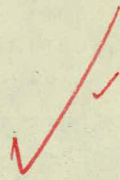
FM CAIRO

TO PRIORITY FCO

UELNO 115

OF 050830Z MARCH 87

AND TO PRIORITY UKDEL IMF/IBRD WASHINGTON
INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND
INFO ROUTINE H M TREASURY, WASHINGTON
INFO SAVING BONN, PARIS, ROME, TOKYO, UKREP BRUSSELS
INFO SAVING HMG ALEXANDRIA (ACTIONED)



MY TELNO 106 AND UKDEL IMF/IBRD TELNO 58:
EGYPT/IMF

SUMMARY

1. THE EGYPTIAN FOREIGN MINISTER CONFIRMS TO EC AMBASSADORS THAT EGYPT HAS REQUESTED A STANDBY ARRANGEMENT FROM THE IMF OF SDR 250 MILLION. THE EGYPTIANS WILL ALSO BE ASKING FRIENDLY COUNTRIES FOR AN ADDITIONAL SUM OF US DOL 300-600 MILLION AS A FOREIGN EXCHANGE CUSHION TO PROTECT THEMSELVES AGAINST A PRECIPITATE FALL IN THE EXCHANGE RATE OF THE EGYPTIAN POUND AS THEY BEGIN TO IMPLEMENT THEIR ECONOMIC PROGRAMME.

DETAIL

2. THE EGYPTIAN FOREIGN MINISTER, BRIEFING EC AMBASSADORS ON 4 MARCH, CONFIRMED THAT EGYPT HAD GIVEN SHA'ALAN A LETTER OF INTENT AND HAD ALSO FORMALLY REQUESTED A STANDBY ARRANGEMENT OF SDR 250 MILLION. IN SUBSEQUENT QUESTIONING, THE PRIME MINISTER'S ECONOMIC ADVISER, WHO WAS ALSO PRESENT, SAID THAT THE INITIAL TRANCHE OF THIS WAS LIKELY TO BE SDR 116 MILLION WITH SUBSEQUENT DRAWINGS BEING MADE QUARTERLY. MAGID ASKED FOR THE CONTINUING SUPPORT OF EC GOVERNMENTS FOR EGYPT'S APPLICATION TO THE IMF: HE BELIEVED EARLIER MISUNDERSTANDINGS BETWEEN EGYPT AND THE IMF HAD BEEN OVERCOME AND THAT THERE WAS NOW BROAD AGREEMENT ON THE NEED FOR EGYPT TO PROCEED WITH HER PROPOSED ECONOMIC REFORM PROGRAMME THE FULFILMENT OF WHICH WAS AS MUCH IN EGYPT'S OWN INTEREST AS THAT OF HER CREDITORS.

3. MAGID WENT ON TO SAY THAT THE FIRST YEAR OF ITS IMPLEMENTATION WOULD BE VERY DIFFICULT FOR EGYPT, AS MOVES TO UNIFY EXCHANGE RATES WOULD MAKE MANY COMMODITIES MORE EXPENSIVE AND STANDARDS OF LIVING WOULD INEVITABLY FALL AS A RESULT. IT WAS THEREFORE ESSENTIAL TO TRY TO PREVENT A PRECIPITATE FALL IN THE EXCHANGE RATE OF THE EGYPTIAN POUND (SEE PARA 5 OF MY TUR).

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4. REPLYING TO A QUESTION FROM THE FRENCH AMBASSADOR, MAGID CONFIRMED THAT THE EGYPTIANS WOULD ALSO BE ASKING FOR A FOREIGN EXCHANGE CUSHION TO HELP PREVENT AN EXCESSIVE OR SUDDEN FALL IN THE EXCHANGE RATE: THIS WOULD BE OVER AND ABOVE THE SDR 250 MILLION REQUESTED UNDER THE STANDBY ARRANGEMENT. THE PRIME MINISTER'S ECONOMIC ADVISER THEN EXPLAINED THAT THIS WOULD NOT, HOWEVER, BE USED TO SUPPORT AN PARTICULAR EXCHANGE RATE AND THAT THE EGYPTIANS DID NOT YET KNOW HOW MUCH THEY WOULD BE SEEKING, BUT HE ESTIMATED THAT IT WOULD BE BETWEEN DOLLARS 300 AND 600 MILLION.

5. MAGID REAFFIRMED THE EGYPTIAN GOVERNMENT'S DETERMINATION TO PROCEED WITH ITS ECONOMIC REFORM PROGRAMME AND SPOKE WARMLY OF THE UNDERSTANDING NOW BEING SHOWN BY THE US ADMINISTRATION AS WELL AS BY EC COUNTRIES. HE ALSO CONFIRMED THE EGYPTIAN COMMITMENT TO RAISE ENERGY PRICES ON 1 MAY AND STRESSED THE NEED TO MAINTAIN CONFIDENTIALITY, ESPECIALLY IN VIEW OF THE FORTHCOMING ELECTIONS.

6. MAGID SOUGHT UNDERSTANDING FROM EGYPT'S FRIENDS FOR ANY DELAYS LIKELY TO ARISE IN THE SERVICING OF THEIR DEBT IN THE COMING MONTHS: EGYPT INTENDED TO HONOUR HER DEBT OBLIGATIONS, BUT MIGHT FACE TEMPORARY PROBLEMS IN DOING SO. HE UNDERLINED EGYPT'S WILLINGNESS TO GO TO THE PARIS CLUB FOR A RESCHEDULING OF HER DEBTS AND ENDED WITH AN APPEAL TO EC GOVERNMENTS TO INSTRUCT THEIR REPRESENTATIVES ON THE IMF BOARD NOT TO SEEK TO IMPOSE TOO HARSH TERMS ON EGYPT AND THEREBY UNDERMINE HER INTERNAL STABILITY.

URWICK

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FCO PLEASE PASS SAVING ADDRESSEES

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FM UKDEL IMF/IBRD, WASHINGTON
TO DESKBY 090800Z FCO
TELNO 62
OF 062330Z MARCH 87
AND TO DESKBY 090600Z CAIRO

IMF: EGYPT

SUMMARY

1. INFORMAL MEETING OF FUND DIRECTORS ARRANGED FOR FRIDAY, MARCH 13. CAMDESSUS HAS BEEN ADVISED BY HIS STAFF NOT TO PRESS FOR EXPLICIT CREDITOR GUARANTEES.

DETAIL

2. SHAALAN (HEAD OF THE FUND'S MIDDLE EASTERN DEPARTMENT) TELLS US THAT CAMDESSUS HAS AGREED TO HIS STAFF'S RECOMMENDATION FOR ANOTHER INFORMAL MEETING OF DIRECTORS, WHICH WILL BE ON FRIDAY, MARCH 13.

3. SHAALAN SAYS THE STAFF PUT A NUMBER OF OPTIONS TO CAMDESSUS ON HOW THE FUND COULD BEST SECURE ITS FINANCIAL POSITION. SHAALAN HAS ADVISED AGAINST CAMDESSUS SEEKING AN EXPLICIT GUARANTEE FROM OFFICIAL CREDITORS BECAUSE OF LIKELY CREDITOR HOSTILITY (COMMENT: WE KNOW THAT THE US OFFICE HERE TOLD THE STAFF "NOT EVEN TO ASK FOR A GUARANTEE" AND THAT THE GERMAN OFFICE IS ESPECIALLY UNENTHUSIASTIC. WHAT SHAALAN HAS PROPOSED AS THE BEST OPTION - AND CAMDESSUS IS NOW CONSIDERING - IS THAT ALL FUTURE SBAS REQUIRE EGYPT TO BUILD UP ITS GROSS RESERVES AT A RATE WHICH WILL MAKE IT POSSIBLE FOR THEM TO SERVICE THE DEBT TO THE FUND. (COMMENT: THE PROPOSED FIRST SBA ALMOST CERTAINLY DOES THIS BUT, OF COURSE, THAT IS NOT TO SAY THAT - IF THINGS BECAME DIFFICULT - EGYPT WOULD AGREE TO USE ITS RESERVES TO REPAY THE FUND).

4. WE WILL LIAISE WITH THE G5 NEXT WEEK. IF CAMDESSUS AGREES WITH SHAALAN, WE ARE OFF THE GUARANTEE HOOK.

5. FCO PLEASE ADVANCE TO MOUNTFIELD AND EVANS (HMT), LOEHNIS AND WARE (BOE) AND T RICHARDSON (ERD).

LANKESTER

(ADVANCED AS REQUESTED)

YYYY

ORWBAN 0123
MONETARY
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SIR. D. MIERS

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MR. L.F.T. SMITH - B/ENGLAND

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FROM UKDEL IMF/IBRD WASHINGTON
TO DESKBY 160800Z FCO
TELNO 65
OF 132300Z MARCH 87
AND DESKBY 160800Z UKREP BRUSSELS (FOR JILL HANNA)
AND PRIORITY CAIRO

EGYPT: INFORMAL MEETING OF IMF EXECUTIVE DIRECTORS
SUMMARY

1. MANAGING DIRECTOR PROPOSES EXCEPTIONALLY GENEROUS PARIS CLUB RESCHEDULING AND CREDITOR GOVERNMENT GUARANTEES TO ENSURE THAT THE FUND IS REPAID. FURTHER MEETING TO DISCUSS GUARANTEES NEXT WEEK. FUND MISSION RETURNS TO CAIRO ON MARCH 16 WITH A VIEW TO REACHING FINAL AGREEMENT ON THE FUND PROGRAM.

DETAIL

2. AT THIS MORNING'S (FRIDAY) INFORMAL MEETING OF EXECUTIVE DIRECTORS, THE MANAGING DIRECTOR BEGAN BY OUTLINING THE EGYPTIAN REFORM PROGRAM IN FAMILIAR TERMS, DESCRIBING THEIR GENERAL INTENTIONS WITH REGARD TO THE FISCAL DEFICIT, ENERGY PRICES, EXCHANGE RATES, AND INTEREST RATES. CERTAIN ACTIONS HAD ALREADY BEEN TAKEN, PARTICULARLY IN THE FISCAL AND MONETARY AREAS, BUT COMPARED WITH THE TIMETABLE EGYPT HAD SET AT THE END OF 1986, THERE HAD BEEN SOME SLIPPAGES, PARTICULARLY ON EXCHANGE RATE REFORM AND ENERGY PRICES. THE ENERGY PRICE INCREASES WHICH HAD BEEN PLANNED FOR EARLY IN THE FIRST QUARTER OF 1987 HAD NOW BEEN POSTPONED TO MAY 1, AS ALSO HAD THE START TO THE UNIFICATION OF THE COMMERCIAL BANK AND FREE MARKET EXCHANGE RATES. FURTHERMORE, PARTLY AS A RESULT OF THESE POLICY SLIPPAGES, THE WORLD BANK HAD DECIDED TO REDUCE THEIR ANNUAL LENDING COMMITMENT FROM DLRS 0.6-0.7 BILLION TO DLRS 0.2 BILLION. THE WORLD BANK WERE CONCERNED ABOUT THE LACK OF MEDIUM-TERM BALANCE OF PAYMENTS VIABILITY AND THEREFORE WANTED TO LIMIT ANY INCREASE IN THEIR EXPOSURE. MOREOVER, THE BANK WERE UNHAPPY ABOUT THE SLOW DISBURSEMENT OF LOANS ALREADY IN THE PIPELINE.

3. CAMDESSUS WENT ON TO SAY THAT THE EGYPTIANS APPEARED COMMITTED TO TAKING FURTHER MEASURES BUT WERE UNABLE TO AGREE ANYTHING SPECIFIC AT THE PRESENT TIME. ACCORDINGLY, THERE WOULD STILL BE LARGE CURRENT ACCOUNT DEFICITS AT THE END OF THE DECADE, AND A WORSENING OF THE OVERALL BALANCE OF PAYMENTS IN THE EARLY 1990S BECAUSE OF THE PUSH FORWARD OF DEBT REPAYMENTS FOLLOWING DEBT RESCHEDULING. ALSO, IN THE 18-MONTH PERIOD TO BE COVERED BY A FUND PROGRAM, THERE REMAINED A FINANCING GAP OF DLRS 600-700 MILLION AFTER DEBT RESCHEDULING THOUGH HE THOUGHT "THIS COULD BE CLOSED". (HE DID NOT SAY HOW BUT WE UNDERSTAND THE STAFF HAVE IN MIND THE PLANNED IBRD LENDING, FASTER DISBURSEMENTS OF THE EXISTING AID PIPELINE, AND THE CONVERSION OF ALREADY PLEDGED AID

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INTO QUICK-DISBURSING FORM.) THE MEDIUM-TERM BALANCE OF PAYMENTS PROSPECT RAISED SERIOUS DOUBTS ABOUT EGYPT'S CAPACITY TO REPAY THE PROSPECTIVE SDR 250 MILLION FUND DRAWING.

4. IN THESE CIRCUMSTANCES, THE FUND SEEMED TO HAVE TWO MAIN OPTIONS. FIRST IT COULD DECIDE THAT THE ADJUSTMENT MEASURES WERE NOT YET STRONG ENOUGH TO JUSTIFY A FUND PROGRAM AND INSTEAD OFFER MONITORING WHICH MIGHT PROVIDE A BASIS FOR PARIS CLUB RESCHEDULING. EVEN THOUGH IT WOULD SAFEGUARD THE FUND'S RESOURCES, CAMDESSUS SAID HE WAS OPPOSED TO THIS OPTION. THE FUND HAD A RESPONSIBILITY TO HELP COUNTRIES IN EGYPT'S POSITION AND A DECISION TO PULL BACK NOW WOULD BE A MAJOR SETBACK FOR THE AUTHORITIES. MOREOVER, HE DOUBTED WHETHER THE PARIS CLUB WOULD FEEL COMFORTABLE WITH A MONITORING ARRANGEMENT.

5. THE SECOND OPTION WAS TO PROCEED WITH THE STAND-BY ARRANGEMENT ON THE BASIS OF THE MEASURES TO WHICH THE EGYPTIANS WERE ALREADY COMMITTED, BUT MAKE IT CLEAR TO THE EGYPTIANS THAT THE PROGRAM WAS WEAK AND NEEDED REINFORCING WITH ADDITIONAL MEASURES TO BE AGREED WITH THE FUND AT THE FIRST REVIEW (WHICH WOULD BE IN SEPTEMBER 1987). THE FUND WOULD ESTABLISH A GENERAL UNDERSTANDING WITH THE EGYPTIANS THAT FURTHER MEASURES WOULD BE AGREED AT THE FIRST REVIEW, BUT IN THE ABSENCE OF FIRM COMMITMENTS AT THE START OF THE PROGRAM, THE FUND WOULD NEED TO BE PROTECTED AGAINST THE POSSIBILITY OF NON-REPAYMENT. HE THEREFORE PROPOSED THAT THE PARIS CLUB SHOULD OFFER EXCEPTIONALLY GENEROUS RESCHEDULING, INCLUDING CONCESSIONS ON INTEREST RATES, AND GUARANTEES FROM CREDITOR GOVERNMENTS THAT THE FUND WOULD BE REPAYED. IF THIS OPTION WAS ADOPTED, HE HOPED THAT CREDITOR GOVERNMENTS WOULD ALSO MAKE CLEAR TO THE EGYPTIANS THAT REINFORCING MEASURES WOULD BE REQUIRED AT THE FIRST REVIEW.

6. SHAALAN (DIRECTOR, IMF MIDDLE EASTERN DEPARTMENT) THEN READ OUT A STATEMENT (FAXED TO LONDON) GIVING FURTHER DETAILS. HE EXPLAINED THAT THE ENERGY PRICE INCREASES AND THE EXCHANGE RATE REFORM HAD BEEN DELAYED BECAUSE OF THE APRIL 6 PARLIAMENTARY ELECTIONS. OIL PRODUCT PRICES WOULD RISE BY 66 PER CENT AND ELECTRICITY PRICES BY 29 PER CENT ON MAY 1. EITHER ON OR BEFORE MAY 1, 40 PER CENT OF TRANSACTIONS CURRENTLY GOING THROUGH THE COMMERCIAL BANK EXCHANGE RATE POOL WOULD GO THROUGH THE FREE MARKET POOL, ANOTHER 40 PER CENT WOULD BE FREED BY END 1987 AND THE REMAINDER IN THE SECOND HALF OF 1988, AT WHICH POINT THE FREE MARKET AND COMMERCIAL BANK RATES WOULD BE FULLY UNIFIED. DURING THIS PERIOD THE COMMERCIAL BANK RATE WOULD ALSO BE DEPRECIATED TOWARDS THE FREE MARKET RATE. A MISSION WOULD RETURN TO CAIRO ON MARCH 16 TO REVIEW THE 1987/88 BUDGET PLANS TO MAKE SURE THAT THE BUDGET ACHIEVED A DEFICIT REDUCTION FROM SOME 16 PER CENT IN GDP IN 1986/87 TO 13 PER CENT IN 1987/88. THE MISSION WOULD ALSO ESTABLISH CREDIT TARGETS FOR THE PERIOD TO SEPTEMBER 1987 AND CEILINGS ON FOREIGN DEBT.

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7. AS REGARDS THE FIRST REVIEW, THE FUND WOULD MAKE EVERY EFFORT TO GET CONCRETE COMMITMENTS ON FULL UNIFICATION OF THE EXCHANGE RATE REGIME (I.E. UNIFYING THE CENTRAL BANK RATE AS WELL), IT WOULD PUSH FOR REAL INTEREST RATES IN LINE WITH REAL RATES INTERNATIONALLY, AND IT WOULD SEEK COMMITMENTS ON A FULL PASS THROUGH OF HIGHER INDIRECT TAXES SO AS TO CONSTRAIN CONSUMPTION.
8. THE INTENTION WAS TO CIRCULATE PAPERS TO THE BOARD ON APRIL 7 WITH A VIEW TO BOARD DISCUSSION ON MAY 15. ASSUMING THE BOARD APPROVED THE PROGRAM HE EXPECTED A PARIS CLUB MEETING ON MAY 18, TO BE FOLLOWED SHORTLY THEREAFTER BY A MEETING OF THE CONSULTATIVE GROUP.
9. NIMATALLAH (SAUDI ARABIA) RESPONDED FIRST BY SAYING HE WAS UNHAPPY WITH THE EVIDENT DETERIORATION IN RELATIONS BETWEEN THE WORLD BANK AND EGYPT AND THAT THIS MIGHT HAVE BEEN AVOIDED IF THERE HAD BEEN STRONGER COLLABORATION BETWEEN THE BANK AND THE FUND. HE ALSO CRITICISED THE FUND MANAGEMENT FOR RAISING QUESTIONS AT THIS LATE STAGE ABOUT EGYPT'S MEDIUM-TERM BALANCE OF PAYMENTS VIABILITY.
10. CAMDESSUS DENIED THAT THE STAFF HAD PULLED THE WOOL OVER DIRECTORS' EYES WITH REGARD TO THE BALANCE OF PAYMENTS, THOUGH THE PROSPECT HAD NOW ALSO SOMEWHAT WORSENERD ON ACCOUNT OF THE POLICY SLIPPAGES. VENKATRAMAN (WORLD BANK) EXPLAINED THAT THE BANK'S PROGRAM HAD BEEN REDUCED FOR THE REASONS THE MANAGING DIRECTOR HAD GIVEN, THEY WERE PARTICULARLY UNHAPPY AT THE DELAYS IN RAISING ENERGY PRICES, BUT THEY ALSO HAD TO BE CONCERNED ABOUT EGYPT'S ABILITY TO REPAY THE BANK. HE MADE CLEAR, IN ANSWER TO A SUBSEQUENT QUESTION FROM DALLARA (UNITED STATES) WHO ALSO IMPLIED CRITICISM OF THE BANK FOR PULLING BACK, THAT THE BANK PROGRAM WOULD BE INCREASED IF AND WHEN EGYPT ADOPTED STRONGER ADJUSTMENT MEASURES.
11. RYE (AUSTRALIA) NOTED THAT THE BANK SEEMED TO HAVE GREATER DOUBTS ABOUT THE EGYPTIAN ADJUSTMENT EFFORT THAN THE FUND.
12. GROSCHER (GERMANY) ASKED FOR DETAILS OF THE GUARANTEE PROPOSAL. CAMDESSUS SAID HE WAS NOT IN A POSITION TO GIVE THESE YET, BUT WOULD RECONVENE A MEETING IN A FEW DAYS AT WHICH HE WOULD DO SO.
13. AS INSTRUCTED IN TELNO 55, I SAID THAT WE WOULD BE OPPOSED IN PRINCIPLE TO GIVING THE FUND GUARANTEES AND THAT THE MISSION SHOULD NOT LEAVE FOR CAIRO ON THE PRESUMPTION THAT GUARANTEES WOULD BE AGREED. I ALSO SAID THAT, ALTHOUGH DIRECTORS (INCLUDING MYSELF) HAD TRIED TO BE AS HELPFUL AS POSSIBLE TO EGYPT, WE HAD BEEN FULLY AWARE OF THE DOUBTS RELATING TO EGYPT'S MEDIUM-TERM BALANCE OF PAYMENTS VIABILITY AS HAD BEEN MADE CLEAR IN THE TABLE CIRCULATED AT THE MEETING ON DECEMBER 4. FURTHERMORE, IT WAS NOT FOR FUND DIRECTORS TO BE TOO CRITICAL OF THE BANK FOR WANTING TO RESTRICT ITS LENDING PROGRAM TO EGYPT WHEN IT TOO HAD DOUBTS

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ABOUT THE BALANCE OF PAYMENTS PROSPECTS. FINALLY, I ASKED WHETHER THE FUND HAD SIGNED UP FOR OTHER PROGRAMS ON THE BASIS OF THE INTENTIONS OF THE AUTHORITIES IN QUESTION TO COMMIT THEMSELVES TO ADDITIONAL MEASURES AT THE TIME OF THE FIRST REVIEW.

14. ON THE QUESTION OF GUARANTEES, CAMDESSUS SAID HE WAS NOT PRESUMING ANYTHING: THE MISSION TO CAIRO NEXT WEEK WAS OF A TECHNICAL NATURE AND IT WAS UP TO GOVERNMENTS TO DECIDE HOW THEY WISHED TO RESPOND TO HIS PROPOSAL. ON MY LAST POINT, BOORMAN (FUND STAFF) SAID THAT THERE HAD BEEN OTHER PROGRAMS IN THE PAST WHICH HAD STARTED OUT ON THE BASIS OF PROMISES OF FUTURE UNSPECIFIED MEASURES.

15. ALTHOUGH SEVERAL OTHER EC DIRECTORS HAD EXPRESSED RESERVATIONS ABOUT GUARANTEES AT THE EC DIRECTORS' LUNCH YESTERDAY, NONE SPOKE OUT TODAY.

16. I HAVE SPOKEN TO CHABRIER (FUND STAFF) SEPARATELY ON THE LINES OF PARA. 6 OF YOUR TELNO 55 AND TOLD HIM WE WILL EXPECT TO SEE ITEMISED ESTIMATES OF HOW THE FINANCING GAP MIGHT BE BRIDGED. TABLES WHICH SHAALAN HAS CIRCULATED TODAY (FAXED TO HMT) GIVE ONLY PART OF THE ANSWER.

17. DE GROOTE (BELGIUM) EXPRESSED THE HOPE THAT EGYPTIAN DIPLOMATS WOULD KEEP OUT OF THE NEGOTIATIONS FROM NOW ON. CAMDESSUS SAID HE HOPED THEY WOULD TOO.

18. FCO PLEASE ADVANCE TO LITTLER, LAVELLE, EVANS AND MOUNTFIELD (HMT), WARE (BANK OF ENGLAND), BRAITHWAITE AND T.L. RICHARDSON (FCO), AND WOOTTON (ODA).

LANKESTER

YYYY

ORWBAN 0306

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NEWAD
PS/MR BENTON
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FM CAIRO

TO ROUTINE FCO

TELNO 145

OF 250745Z MARCH 87

INFO ROUTINE ODA, DTI, ECGD, BANK OF ENGLAND

INFO ROUTINE HM TREASURY, UKDEL IMF/IBRD WASHINGTON

INFO SAVING ALEXANDRIA (ACTIONED)

✓ *ef*

THE EGYPTIAN ECONOMY

SUMMARY

1. THE EGYPTIAN POUND HAS DEPRECIATED SHARPLY IN THE LAST MONTH AND CURRENTLY STANDS AT 217 PIASTRES TO THE DOLLAR, A DROP OF 13 PER CENT SINCE THE BEGINNING OF 1987. THIS MAY MAKE IT MORE DIFFICULT FOR THE EGYPTIANS TO CARRY OUT THE PROGRAMME FOR UNIFICATION OF EXCHANGE RATES AGREED WITH THE IMF.

DETAIL

2. AFTER A PERIOD OF STABILITY DURING 1986 IN WHICH THE EXCHANGE RATE BETWEEN THE EGYPTIAN POUND AND THE DOLLAR DEPRECIATED BY ONLY 7 PER CENT, THERE HAS BEEN A FURTHER DEPRECIATION OF 13 PER CENT IN THE FIRST 10 WEEKS OF 1987. THERE SEEMS TO BE TWO MAIN REASONS FOR THIS:

A. MINISTRIES AND PUBLIC SECTOR COMPANIES ARE INCREASINGLY BEING ALLOWED BY THE CENTRAL BANK AND THE MINISTRY OF ECONOMY TO BUY THEIR FOREIGN EXCHANGE ON THE FREE MARKET. TYPICAL EXAMPLES OF THIS ARE THE DOWN PAYMENTS TO BE MADE ON CONTRACTS COVERED BY THE ECGD BACKED 150 MILLION POUNDS STERLING LINE OF CREDIT FOR THE DEFENCE SECTOR.

B. THE BELIEF THAT AN AGREEMENT WITH THE IMF IS IMMINENT HAS ENCOURAGED SPECULATION THAT A DEVALUATION OF THE OFFICIAL RATE WILL SOON FOLLOW AND HAS INCREASED DEMAND FOR FOREIGN EXCHANGE, WHILE AT THE SAME TIME CAUSING POTENTIAL SELLERS TO HOLD BACK IN THE EXPECTATION OF LARGER GAINS IN THE FUTURE.

COMMENT

3. THE DEPRECIATION OF THE EGYPTIAN POUND HAS ACCELERATED ALARMINGLY IN THE LAST TWO WEEKS, WITH THE EXCHANGE RATE DROPPING BY ABOUT 13 PIASTRES FROM 204 PIASTRES TO THE DOLLAR TO 217. THE WIDENING GAP BETWEEN THE OFFICIAL RATE (WHICH HAS REMAINED CONSTANT AT 138 PIASTRES SINCE THE BEGINNING OF FEBRUARY) AND THE FREE MARKET RATE MAY MAKE IT MORE DIFFICULT FOR THE GOVERNMENT TO GO AHEAD WITH THE FIRST STAGE OF THE UNIFICATION OF EXCHANGE RATES (A TRANSFER OF 40 PER CENT OF IMPORTS TO THE FREE RATE TOGETHER WITH RECEIPTS FROM TOURISM AND WORKERS' REMITTANCES) OF MAY, AS REQUIRED IN THEIR AGREEMENT WITH THE IMF.

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TO PRIORITY FCO

TELNO 155

OF 300900Z MARCH 87

AND TO PRIORITY UKDEL IMF/IMBRD WASHINGTON, BANK OF ENGLAND
INFO ROUTINE ODA, DTIC, ECGD, HM TREASURY, WASHINGTON

YOUR TELNO 104: EGYPT/IMF

1. THE POSSIBILITY YOU ENVIAGE OF EXTENDING THE TIMETABLE
FOR RESCHEDULING BEYOND THAT ORIGINALLY CONSIDERED IS LIKELY
TO DAMAGE BUSINESS CONFIDENCE BOTH WITHIN EGYPT AND ABROAD.
THIS APPLIES ESPECIALLY TO COMMERCIAL BANKS, WHO MAY AS A
RESULT MAKE IT MORE DIFFICULT FOR EGYPT TO OBTAIN ACCESS TO
SHORT-TERM FINANCE.

2. IT IS THIS ASPECT OF THE EXTENDED TIMETABLE WHICH WILL
PARTICULARLY WORRY THE EGYPTIANS, RATHER THAN ANY DELAY IN
FORMALISING HER CURRENT POSITION WHICH AS YOU NOTE IN YOUR
PARA 2 IS EFFECTIVELY ONE OF DEFAULT ON MOST OF HER OUTSTANDING
DEBT.

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FROM: J M G TAYLOR

DATE: 16 December 1987

CHANCELLOR

*OK Mubarak.
BST from President's.*

FOREIGN VISITORS

FCO are pitching for you to see two foreign visitors in the early part of the New Year.

2. The first is President Mubarak of Egypt. He is here on 25/26 January. The Foreign Secretary had planned to host a lunch for President Mubarak on 25 January. He is now unable to do this (because a Foreign Affairs council has been called for that day) and he has asked whether you would be prepared to stand in as host. I see no reason why you should do this. It may, however, be worth fitting in a courtesy call sometime during the two days. AEF think this would be very worthwhile.

3. The second visitor is Mr Drushevfi, one of the Joint Presidents of Yugoslavia. He is visiting the UK on 23 and 24 March. AEF think it would also be worthwhile for you to see Mr Drushevfi. On the other hand, you recently saw Mr Rikanovic.

4. What do you think?

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR

A. Phillips



Ch. President Mubarak.

You kindly agreed to see Mr. M when he visits the UK on 25/26 January.

2. The FCO have now said that you will have to call on him, rather than vice versa, because of his precedence as a head of state. (You will probably need to call on him at Claridge's).

3. Do you still want to go ahead, even on this basis?

Only if For's Sec⁴.
considers it important to go
to Mr. M.
30/12

BT 22/1

Details of
calls



✓ President Mubarak.

It now seems that
President Mubarak is
calling on the PM from
11.00 - 12.00 am on Tuesday
26 Jan & FCO suggest
the President call on *
you afterwards at 12.15 pm
Dairy is clear (although
you are lunching at
Thames TV at 1.00 pm).
Content to see President
Mubarak then?

Julie
411.

OK

* Mubarak's presence in Downing Street providing
a let-out from the strictures of protocol *good!*



✓ You have agreed to see
President Mubarak
on Tuesday 26 Jan.
I understand he will
bring with him between
including the Foreign Minister.
3-6 people/- we will not
know exactly until
later next week - do
you want to decide then
who should attend the
meeting with you - or
do you want Est/Sir G L
Peter Mountfield/ Jonathan?

All 4. ^m
Julie
13/1.



FROM: J M G TAYLOR

DATE: 22 December 1987

MISS HIGGINS - AEF

cc PS/Economic Secretary
Sir G Littler
Mr Mountfield
Mr Halligan**FOREIGN VISITORS**

You asked if the Chancellor would be prepared to see:

- (i) President Mubarak of Egypt, when he visits the UK on 25-26 January; and
- (ii) Mr Drushevfi of Yugoslavia, when he visits the UK on 23-24 March.

2. The Chancellor is content to see President Mubarak. He would be grateful, however, if the Economic Secretary could see Mr Drushevfi.

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

J M G TAYLOR