

PO - CH/NL/0646 PART A

PO CH/NC/0646
PART. A

PO CH/NC/0646
PART. A

CHANCELLORS
1988 BRAZIL PAPERS

22-11-88

DD's 25yrs NA303
22-11-96

THIS FOLDER HAS BEEN
REGISTERED ON THE
REGISTRY SYSTEM

BRAZIL 0646-

UNCLASSIFIED

121231
MDLIAN 0125

UNCLASSIFIED
FM BRASILIA
TO PRIORITY FCO
TELNO 2
OF 061235Z JANUARY 88
INFO ROUTINE UKDEL IMF/IBRD
INFO SAVING RIO DE JANEIRO, SAO PAULO

CULL

RESIGNATION OF CENTRAL BANK PRESIDENT

1. FOLLOWING THE APPOINTMENT OF NOBREGA AS FINANCE MINISTER YESTERDAY (BRASILIA TELNO 1), FERNANDO MILLIET CONFIRMED HIS RESIGNATION FROM THE PRESIDENCY OF THE CENTRAL BANK. WHEN BRESSER PEREIRA RESIGNED, MILLIET AGREED TO REMAIN IN HIS POST UNTIL A NEW MINISTER WAS APPOINTED. HE WAS TO HAVE TRAVELLED TO THE UNITED STATES AT THE END OF THIS WEEK AS THE NEW LEADER OF THE BRAZILIAN TEAM, TO CONTINUE THE NEGOTIATIONS WITH THE CREDITOR BANKS. HE WILL NOW NOT DO SO AND IT SEEMS LIKELY THAT THE RESUMPTION OF THESE NEGOTIATIONS WILL BE POSTPONED.

NEWINGTON

FCO PLEASE ADVANCE TO
YYYY

DISTRIBUTION 185

MAIN 185

FINANCIAL
SAMD

NNNN

UNCLASSIFIED

121222
MDLIAN 0123

UNCLASSIFIED

FM BRASILIA
TO PRIORITY FCO

TELNO 1

OF 061245Z JANUARY 88

INFO ROUTINE UKDEL IMF/IBRD

INFO SAVING RIO DE JANEIRO, SAO PAULO

CULL

BRASILIA TELNO 431: RESIGNATION OF FINANCE MINISTER

1. PRESIDENT SARNEY YESTERDAY APPOINTED MAILSON NOBREGA TO SUCCEED BRESSER PEREIRA AS FINANCE MINISTER. THE SUBSTANTIVE APPOINTMENT OF NOBREGA WILL PLEASE FIESP (THE SAO PAULO FEDERATION OF INDUSTRY) AND THE BUSINESS COMMUNITY IN GENERAL. IT HAS ALSO BEEN WELCOMED BY THE TWO MAIN TRADE UNION FEDERATIONS. THE PMDB MADE IT CLEAR FROM THE OUTSET THAT IT WOULD NOT SEEK TO INFLUENCE THE CHOICE OF MINISTER ON THIS OCCASION.

2. THIS IS A TECHNOCRAT APPOINTMENT. NOBREGA IS A CAREER OFFICIAL OF THE BANCO DO BRASIL WHO HAS TWICE SERVED AS SECRETARY GENERAL IN THE FINANCE MINISTRY. HE IS KNOWN IN LONDON WHERE HE WAS EXECUTIVE DIRECTOR OF ENTROBRAS FROM 1985 TO MARCH 1987. HE IS REGARDED AS A HIGHLY COMPETENT, PRAGMATIC OFFICIAL AND IS BELIEVED TO BE NEUTRAL IN POLITICS.

3. NOBREGA HAS APPOINTED MARIO BERARD, A VICE PRESIDENT OF THE CAIXA ECONOMICA FEDERAL (NATIONAL SAVINGS BANK), TO BE THE NEW SECRETARY GENERAL IN THE FINANCE MINISTRY.

NEWINGTON

FCO PLEASE ADVANCE TO
YYYY

PAGE 1
UNCLASSIFIED

UNCLASSIFIED

121222
MDLIAN 0123

DISTRIBUTION

185

MAIN 185

FINANCIAL
SAMD

NNNN

UNCLASSIFIED

124442
MDLIAN 0451

UNCLASSIFIED
FM BRASILIA
TO PRIORITY FCO
TELNO 5
OF 071255Z JANUARY 88
INFO ROUTINE UKDEL IMF/IBRD
INFO SAVING RIO DE JANEIRO. SAO PAULO

CULL

BRASILIA TELNO 2: CENTRAL BANK PRESIDENT

1. NOBREGA'S CHOICE OF A REPLACEMENT FOR MILLIET AS
PRESIDENT OF THE CENTRAL BANK WAS REJECTED YESTERDAY
(APPARENTLY BY MAGALHAES, THE COMMUNICATIONS MINISTER AND
CURRENTLY SARNEY'S CLOSEST COLLABORATOR). NOBREGA HAS THEREFORE
WITHDRAWN HIS ACCEPTANCE OF MILLIET'S RESIGNATION AND REAPPOINTED
MILLIET TO HIS FORMER POST.

NEWINGTON

FCO PLEASE ADVANCE TO
YYYY

DISTRIBUTION

185

MAIN 185

FINANCIAL
SAMD

NNNN

CONFIDENTIAL

Thanks. of the banks, we should choose to work together, we must do with a disaster team.

FROM: J M HALLIGAN
DATE: 8 January 1988

- 1. MR MOUNTFIELD
- 2. CHANCELLOR

cc Economic Secretary
 Sir P Middleton
 Sir G Littler
 Sir A Wilson
 Mr H P Evans
 Mrs Lomax
 Mrs Case
 Mr Walsh

I think this is probably just blackmail; but it could go badly wrong and the US is clearly worried. Sir G Littler will have a chance to discuss it with Mulford at the end of the month.

BRAZILIAN DEBT

R.S.1

The recent agreement with the commercial banks is in trouble. Last year's agreement had three elements:

- i. Brazil to put up \$1.5 billion and the banks \$3 billion to clear Brazil's \$4.5 billion of interest arrears for 1987;
- ii. Brazil to be current on interest payments from 1 January 1988;
- iii. a long term refinancing of Brazil's obligations with a terms sheet to be agreed by end-January.

2. Brazil has not been paying interest from 1 January 1988. Their authorities have told the Advisory Committee that they will not do so until a terms sheet for the longer term refinancing has been signed. They point out (correctly) that item (ii) was not part of last year's legal agreement (which covered only Brazil's arrears) and say that politically they cannot be seen to restart regular debt servicing until they have a long term refinancing agreement in place. Apparently this stance has been confirmed by de Nobrega (the new Finance Minister) and Milliet (who is staying on as Central Bank Governor despite earlier indications that he would resign along with Bresser Pereira).

3. Although the resumption of current interest payments was not part of the legal documentation it was part of the deal and the Brazilians are clearly welching. Their attitude risks undoing both (i) and (iii) of last year's agreement. Last year's arrears were to be cleared in two stages. Arrears relating to 1987 Q4 were to be cleared by 11 January 1988 with the banks putting up \$1 billion and Brazil \$0.5 billion. The final payments under this tranche are due on Monday but we understand that one bank has already threatened to withhold its share of the new money in protest at the Brazilian action. It is possible that this stage will nevertheless be more or less completed by Monday, simply because most banks may not react in time to the Brazilian provocation. (So far only the Advisory Committee knows of the Brazilian position, not the rest of the banking community). However, the second stage of the arrears operation is for payments of \$1 billion by Brazil and \$2 billion by the banks on 16 June 1988. This leg of the operation is certainly now in jeopardy.

4. Also in jeopardy is the long-term refinancing operation. Negotiations are due to resume on Monday about this in New York and Milliet will lead for Brazil. But, the banks are unlikely to be in a very co-operative mood in the face of what they will see as blackmail.

Comment

5. Blackmail is probably a fair description of the Brazilian action. They are trying to get concessions on the longer term refinancing by again withholding interest on current maturities. It is possible that the commercial banks will react philosophically and press on with the negotiations. On the other hand there could be retaliation and the breakdown of negotiations.

6. It is possible, but not probable, that Brazil will back down in the face of US pressure. You will recall that the US authorities were closely involved in last year's discussions and virtually drew up the deal. They are very displeased about Brazil's action and we understand that the Brazilian ambassador

to Washington (Moreria) who is seeing President Sarney may order the resumption of payments but his position is so weak that this is doubtful.

7. So far this information is known only to the Advisory Committee but the rest of the banking community will quickly learn and the story will soon break. There is nothing for us to do at the moment except monitor the situation but if US pressure fails to produce a change in the Brazilian attitude the issue may become one for consultation with other Governments.

J. M. Halligan

J M HALLIGAN



FROM: J M G TAYLOR
DATE: 11 January 1988

MR HALLIGAN

cc PS/Economic Secretary
Sir P Middleton
Sir G Littler
Sir A Wilson
Mr H P Evans
Mrs Lomax
Mr Mountfield
Mrs Case
Mr Walsh

BRAZILIAN DEBT

The Chancellor was grateful for your minute of 8 January.

2. He has commented that if the banks, understandably, choose to act tough, we must do nothing to dissuade them.

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

J M G TAYLOR

UNCLASSIFIED
FM BRASILIA
TP PRIORITY FCO
TELNO 40
OF 021335Z FEBRUARY 88
INFO ROUTINE UKDEL IMF/IBRD
INFO SAVING RIO DE JANEIRO, SAO PAULO

CULL

BRAZIL: EXTERNAL DEBT
SUMMARY

1. BRAZIL PAYS A FURTHER US DOLLARS 350 MILLION IN DEBT SERVICE TO THE BANKS AND ANNOUNCES THAT THE TIME HAS COME TO NORMALISE ITS RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY,

DETAIL

2. ON 1 FEBRUARY THE FINANCE MINISTRY ANNOUNCED THAT BRAZIL WILL NOW PAY THE COMMERCIAL CREDITOR BANKS US DOLLARS 350 MILLION TOWARDS THE INTEREST DUE FOR JANUARY 1988. THE PAYMENT, WHICH CORRESPONDS TO ABOUT 37% OF JANUARY'S INTEREST, IS BEING MADE ON 2 FEBRUARY AND IS UNILATERAL - THERE IS NO COUNTERPART BRIDGING LOAN FROM THE BANKS. BRAZIL'S INTENTION IS TO FACILITATE REACHING A MEDIUM TERM AGREEMENT WITH THE BANKS (COVERING 1987 AND 1988) SOON. THE FINANCE MINISTER AND CENTRAL BANK PRESIDENT BOTH SAID YESTERDAY THAT FURTHER INTEREST PAYMENTS COULD BE MADE AS THE NEGOTIATION OF THE MEDIUM TERM AGREEMENT PROGRESSED.

3. THE FINANCE MINISTRY ISSUED A WRITTEN STATEMENT YESTERDAY WHICH SAID THAT BRAZIL WISHED TO REACH A RAPID UNDERSTANDING WITH ITS EXTERNAL CREDITORS IN ORDER TO REMOVE AN IMPORTANT OBSTACLE TO ECONOMIC STABILITY AND ECONOMIC GROWTH. THE STATEMENT ADDED THAT THE TIME HAD NOW COME TO NORMALISE RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY AND SET OUT FOUR STAGES FOR THIS:

(A) CONCLUSION OF A MEDIUM TERM AGREEMENT WITH THE COMMERCIAL BANKS:

(B) NEGOTIATIONS WITH THE INTERNATIONAL FINANCIAL INSTITUTIONS INCLUDING A POSSIBLE AGREEMENT WITH THE IMF:

(C) CONCLUSION OF AN AGREEMENT WITH THE PARIS CLUB:

(D) THE ADOPTION OF NEW INSTRUMENTS, EG SECURITISATION OF THE DEBT, IN ORDER TO REDUCE THE STOCK OF THE DEBT AND ATTRACT NEW MONEY INCLUDING, POSSIBLY, SUBSTANTIAL JAPANESE FUNDS. THE STATEMENT ENVISAGES THE OPENING OF PRELIMINARY DISCUSSIONS AT THE IMF IN THE MIDDLE OF THIS MONTH.

NEWINGTON

YYYY

DISTRIBUTION 176

MAIN 176

FINANCIAL

SAMD

NNNN

Ch/ Are you prepared to see this min, if we can find a convenient time? (see also further to Cymon behind)

FROM: P MOUNTFIELD
DATE: 4 February 1988

- Approval by Ark. 5/2
1. SIR G LITTLER
 2. CHANCELLOR OF THE EXCHEQUER

cc Mr Lankester
Mr Evans
Mrs Case
Mr Walsh
Ms Life
Mr Halligan

Charles de Chasvion
SPM

VISIT OF THE BRAZILIAN FINANCE MINISTER

The Brazilian Finance Minister, Senor Mailson Ferreira da Nobrega, is in London next week to attend the Herold Tribune/IADB Conference on Latin America. A number of other quite interesting people will be here, including Iglesias, the Uruguay Foreign Minister (and Secretary of the Cartagena Group), Ortiz-Mena, the retiring (or sacked?) President of the IADB itself, Paul Volker, Bill Rhodes, Petricioli, the Mexican Finance Minister, and Dunkel of GATT. But the important catch is Nobrega.

2. If the press report today and Brazilian Telno 40 (enclosed) are to be believed, the Brazilians have capitulated completely to the demands of the international Community, made peace with the IMF, and intend to mend their fences with their creditors. It is almost too good to be true. Sir G Littler may be able to add something, in the light of his weekend contacts, but the Americans seem to believe that the story is genuine.

3. In the circumstances, I think it would be wise for the Chancellor to spare a few minutes to welcome Nobrega back into the fold. The FCO are anxious to make the necessary arrangements. May I tell them to go ahead, and if so, can the diary Secretary suggest some times, please?

R1

P MOUNTFIELD

Brazil confesses to moratorium 'error'

BY IVO DAWNAY IN RIO DE JANEIRO

THE Brazilian Government's declaration last year of a moratorium on \$68bn of commercial bank debt interest was "the worst error that we have yet committed".

That, according to several reports, was President Jose Sarney's verdict last Monday in what appears to have been a Cabinet breast-beating session worthy of a chorus in a Greek tragedy.

Statements by Mr Mailson da Nobrega, the Finance Minister, issued before, during and since the meeting, also suggest that a sea-change has taken place in the country's public posture towards the international financial community.

Announcing the decision to end the moratorium with a new \$350m payment to the creditor banks for interest due in January, Mr Nobrega stated baldly that the disadvantages of the policy had far outweighed its bonuses.

He said:

- Brazil had missed out on the reduction of interest rates to other debtor countries while its banks abroad had to pay increased charges.

- Financial flows from the country had grown and inward investment had declined.

- The ending of export credits from foreign governments had been damaging.

- The slowness of negotiations had produced an inevitable deterioration in relations with creditors without necessarily leading to the best terms and conditions in agreements.

According to figures published by the *Jornal do Brasil* newspaper, these factors have meant that despite the moratorium the country has only added \$500m to its reserves from a trade surplus of \$11.2bn.

Mr Nobrega also justified the decision to return to a full formal agreement with the International Monetary Fund on the grounds that the Fund now "explicitly recognises the need for adjustments with growth".

This apparent change of heart by Mr Sarney and his government is not in fact a U-turn but a radical change in presentation.

Even before the resignation of Mr Luiz Carlos Bresser Pereira as Finance Minister the country had appeared ready to deal with both the banks and the IMF, provided a suitable public relations smokescreen for the domestic audience could be concocted.

The difference is that Mr Sarney's all but formal severing of links with the majority Democratic Movement Party (PMDB) means he now feels free to ignore the need to camouflage the climbdown.

Instead, the President has begun to shift the blame for the moratorium and the declining economy on to Mr Dilson Funaro, Mr Bresser Pereira's predecessor as Finance Minister and a PMDB nominee.

The concepts of Cabinet responsibility or that "the buck stops here" appear to count little to Mr Sarney, whose chief defence in the face of criticism is either that his government was hostage to "disloyal" PMDB policy-makers or that he had not been fully apprised of the situation.

The other key factor lurking behind Brazil's new conciliatory image is the sheer urgency of the situation.

In a bleak presentation to the Cabinet of the economic outlook, Mr Nobrega underlined the country's desperate need for foreign investment if growth was to resume.

He also emphasised that drastic measures to reduce the costs were vital.

Five years ago salaries accounted for 37 per cent of all federal expenditure; last year this was 60 per cent.

When the foreign bankers called Brazil's bluff by refusing to negotiate a medium-term rescheduling without a January payment, the country could only stay out in the cold or concede.

UNCLASSIFIED

FM BRASILIA

TP PRIORITY FCO

TELNO 40

OF 021335Z FEBRUARY 88

INFO ROUTINE UKDEL IMF/IBRD

INFO SAVING RIO DE JANEIRO, SAO PAULO

CULL

BRAZIL: EXTERNAL DEBT

SUMMARY

1. BRAZIL PAYS A FURTHER US DOLLARS 350 MILLION IN DEBT SERVICE TO THE BANKS AND ANNOUNCES THAT THE TIME HAS COME TO NORMALISE ITS RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY,

DETAIL

2. ON 1 FEBRUARY THE FINANCE MINISTRY ANNOUNCED THAT BRAZIL WILL NOW PAY THE COMMERCIAL CREDITOR BANKS US DOLLARS 350 MILLION TOWARDS THE INTEREST DUE FOR JANUARY 1988. THE PAYMENT, WHICH CORRESPONDS TO ABOUT 37% OF JANUARY'S INTEREST, IS BEING MADE ON 2 FEBRUARY AND IS UNILATERAL - THERE IS NO COUNTERPART BRIDGING LOAN FROM THE BANKS. BRAZIL'S INTENTION IS TO FACILITATE REACHING A MEDIUM TERM AGREEMENT WITH THE BANKS (COVERING 1987 AND 1988) SOON. THE FINANCE MINISTER AND CENTRAL BANK PRESIDENT BOTH SAID YESTERDAY THAT FURTHER INTEREST PAYMENTS COULD BE MADE AS THE NEGOTIATION OF THE MEDIUM TERM AGREEMENT PROGRESSED.

3. THE FINANCE MINISTRY ISSUED A WRITTEN STATEMENT YESTERDAY WHICH SAID THAT BRAZIL WISHED TO REACH A RAPID UNDERSTANDING WITH ITS EXTERNAL CREDITORS IN ORDER TO REMOVE AN IMPORTANT OBSTACLE TO ECONOMIC STABILITY AND ECONOMIC GROWTH. THE STATEMENT ADDED THAT THE TIME HAD NOW COME TO NORMALISE RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY AND SET OUT FOUR STAGES FOR THIS:

(A) CONCLUSION OF A MEDIUM TERM AGREEMENT WITH THE COMMERCIAL BANKS:

(B) NEGOTIATIONS WITH THE INTERNATIONAL FINANCIAL INSTITUTIONS INCLUDING A POSSIBLE AGREEMENT WITH THE IMF:

(C) CONCLUSION OF AN AGREEMENT WITH THE PARIS CLUB:

(D) THE ADOPTION OF NEW INSTRUMENTS, EG SECURITISATION OF THE DEBT, IN ORDER TO REDUCE THE STOCK OF THE DEBT AND ATTRACT NEW MONEY INCLUDING, POSSIBLY, SUBSTANTIAL JAPANESE FUNDS. THE STATEMENT ENVISAGES THE OPENING OF PRELIMINARY DISCUSSIONS AT THE IMF IN THE MIDDLE OF THIS MONTH.

NEWINGTON

YYYY

DISTRIBUTION

176

MAIN 176

FINANCIAL

SAMD

NNNN

CONFIDENTIAL

043125
MDLIAN 7929

CONFIDENTIAL
FM BRASILIA
RTO PRIORITY FCO
TELNO 45
OF 051130Z FEBRUARY 88
INFO ROUTINE UKDEL IMF/IBRD
INFO SAVING RIO DE JANEIRO, SAO PAULO

CULL

MY TELNO 40: BRAZILIAN ECONOMIC POLICY

1. DURING MY INITIAL CALL ON HIM ON 3 FEBRUARY, MFA SECRETARY-GENERAL PAULO TARSO SAID HE HOPED THAT HMG AND UK BANKS UNDERSTOOD HOW GREAT WERE THE POLITICAL RISKS ATTACHED TO THE POLICIES NOW BEING PURSUED BY TH SARNEY ADMINISTRATION. CUTTING THE PUBLIC SECTOR DEFICIT WAS GOING TO BE DIFFICULT AND PAINFUL: THE DECISION TO OPEN NEGOTIATIONS WITH THE IMF WOULD HAVE BEEN INCONCEIVABLE A FEW MONTHS AGO: AND THERE WOULD CERTAINLY BE MUCH DOMESTIC CRITICISM OF THE 350 MILLION DOLLAR PAYMENT TO THE BANKS. HAD I HAD ANY FEEDBACK FROM LONDON?

2. I SAID I HAD NO HARD INFORMATION, BUT THOUGHT THAT THE REACTION IN LONDON TO THE POLICIES BEING PROPOUNDED BY MAILSON DA NOBREGA WOULD BE 'SO FAR SO GOOD'. THERE WAS A CREDIBILITY GAP TO BE BRIDGED AND PEOPLE WOULD BE WAITING TO SEE WHETHER THE POLICIES WOULD BE TRANSLATED INTO ACTION. ACKNOWLEDGING THIS, PAULO TARSO SAID THAT NEVERTHELESS, A POSITIVE RESPONSE WOULD BE HELPFUL IN STRENGTHENING THE ADMINISTRATION'S RESOLVE.

COMMENT

3. IT WAS NOT CLEAR, AND I THOUGHT IT BETTER NOT TO ENQUIRE, WHAT PAULO TARSO MEANT BY A POSITIVE RESPONSE. FOUR POSSIBILITIES SPRING TO MIND:

(A) A MORE AMENABLE ATTITUDE ON THE PART OF THE BANKS - HARDLY LIKELY AT PRESENT.

(B) SOME SORT OF PUBLIC WELCOME FOR MAILSON DA NOBREGA'S POLICY FORMULATIONS - WHICH COULD ALL TOO EASILY BE EXPLOITED BY LEFT WING CRITICS HERE. HE IS ALREADY UNDER ATTACK.

(C) A DECISION TO EXTEND ECGD COVER TO 360 DAYS WHICH WOULD OF COURSE

CONFIDENTIAL

043125
MDLIAN 7929

BE MOST WELCOME.

(D) WORDS OF ENCOURAGEMENT CONVEYED PRIVATELY, EG BY THE PUS DURING
HIS FORTHCOMING VISIT. THIS WOULD COST US NOTHING, AND I RECOMMEND IT

NEWINGTON

YYYY

DISTRIBUTION

176

MAIN 176

FINANCIAL

SAMD

NNNN

*Ch/ Contact to write
no proposal?*

FROM: P MOUNTFIELD
DATE: 8 February 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr H P Evans
Mrs Case
Miss Higgins

*Don't know
this @ all.
big M.*

BRAZILIAN FINANCE MINISTER

We now learn that Senor Nobrega is not coming to London this week after all. The new Governor of the Central Bank (Milliet) is; and will be received by the Governor here.

2. I have discussed with FCO, Bank of England and ECGD whether a personal message from you would be appropriate. The general consensus is that it would. The message would be:

- a. Welcome back on board.
- b. Stick to your guns.
- c. If you do, we shall back you.

3. On balance, we are inclined to think this would be helpful. There is a lot at stake, including the debt owed to British banks and to ECGD, and the long-term British trading position in Brazil (historically very healthy) as well as the demonstration effect on the other debtors.

4. I attach a draft for your consideration. To secure maximum impact, it might perhaps be delivered by Sir Patrick Wright in the course of his visit to Brasilia later this week. For that purpose, the FCO will need to telegraph it on Tuesday night. It could of course go later in the week if you do not have time to consider it before then.

PM

P MOUNTFIELD

DRAFT LETTER TO SENOR MAILSON FERREIRA DA NOBREGA

I am sorry that you are not coming to London this week, ^{as} ~~for the Conference organised by the Herald Tribune and the Inter American Development Bank.~~ I was looking forward to meeting you. However, I understand that Governor Milliet will be here, and I know that ~~Robin~~ ^{the Governor} Leigh-Pemberton hopes to see him.

2. Had we met, I would have taken the opportunity to welcome your recent decision to seek an agreement with the IMF and a fresh series of agreements with your creditors. I am very pleased that the Brazilian government has decided on this course. I can assure you that the United Kingdom Government will do its best to support you.

3. Our ability to do so will of course depend on the nature of the programme you eventually agree with the IMF. I recognise that this will take some time, and that some of the changes which the Fund is likely to recommend will cause political difficulties for your Government. I can only encourage you to face up to these difficulties now, just as the government of which I am a member did when it came to office in 1979. The longer they are postponed, the harder they will be. There is no point in going to the Fund with an inappropriate programme which will fail to produce the result you and your trading partners all desire.

4. Provided agreement can be reached on a suitable and strong adjustment programme, the British Government will firmly support it at the Executive Board of the IMF. In addition, we shall take a positive and constructive role in the Paris Club, if renegotiation of your medium and long-term official debt proves necessary. Finally, once such agreement has been reached, and some payments made in the respect of the existing arrears of debt, ECGD will be prepared to consider reopening medium and long-term cover for Brazil as quickly as possible. In that connection, you have probably heard by now that ECGD have decided to extend short-term cover from the present six-month limit up to 365 days - a small gesture which was meant to indicate our willingness to go further in due course.

[Since Sir Patrick Wright, the Permanent Under Secretary of State at the Foreign and Commonwealth Office, happens to be in Brasilia this week, I am asking him to deliver this letter in person, with my warm personal best wishes for your tenure of your new post.]

*1 Tick
2 P2*



FROM: A C S ALLAN
DATE: 9 February 1988

MR P MOUNTFIELD

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr H P Evans
Mrs Case
Miss Higgins

BRAZILIAN FINANCE MINISTER

The Chancellor was grateful for your minute of 8 February, but does not wish to write to Senor Nobrega.

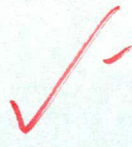
ACSA

A C S ALLAN

UNCLASSIFIED

M

143201
MDLIAN 3965



UNCLASSIFIED
FM BRASILIA
TO PRIORITY FCO
TELNO 77

OF 291450Z FEBRUARY 88
INFO PRIORITY HAMBURG (FOR PS/MR EGGAR)
INFO ROUTINE UKDEL IMF/IBRD, WASHINGTON, RIO DE JANEIRO, SAO PAULO

CULL

BRAZIL - EXTERNAL DEBT

SUMMARY

1. BRAZIL ANNOUNCES AGREEMENT WITH COMMERCIAL CREDITOR BANKS
LEADING TO ENDING OF MORATORIUM.

DETAIL

2. FINANCE MINISTER NOBREGA ANNOUNCED YESTERDAY, 28 FEBRUARY,
THAT BRAZIL AND ITS COMMERCIAL CREDITOR BANKS HAD REACHED AGREEMENT
ON THE MAIN POINTS OF A MEDIUM TERM REFINANCING AGREEMENT FOR ITS
EXTERNAL COMMERCIAL DEBT AND EXPECTED TO SIGN SUCH AN AGREEMENT IN
THE NEXT FEW DAYS. IT IS REPORTED HERE THAT CITYCORP MADE A
SIMILAR ANNOUNCEMENT IN NEW YORK IN ITS CAPACITY AS SPOKESMAN FOR
THE BANKS ADVISORY COMMITTEE.

3. THE MAIN FEATURES OF THE AGREEMENT ARE:-

(A) COVERAGE: 1987, 1988 AND THE FIRST HALF OF 1989

(B) THE BANKS WILL LEND BRAZIL US DOLLARS 5.8 BILLION TO
REFINANCE THE INTEREST DUE DURING THE PERIOD OF THE AGREEMENT

(C) SPREAD: 0.8125 OR 13/16% IE SAME AS MEXICO

(D) THE BANKS WILL PROVIDE US DOLLARS 600 MILLION AS RESTORATION
OF SHORT TERM LINES

(E) BRAZIL WILL MAKE AN IMMEDIATE PAYMENT OF US DOLLARS 700 MILLION
IN RESPECT OF INTEREST FOR HALF OF JANUARY AND ALL OF FEBRUARY
1988.

4. THE CARVE OUT OF THE SPREAD HAS STILL TO BE AGREED. NOBREGA

UNCLASSIFIED

143201
MDLIAN 3965

MENTIONED THAT IT MIGHT APPLY ONLY TO PUBLIC SECTOR DEBT. NEVERTHELESS HE THOUGHT THE SPREAD CONCESSION MIGHT REPRESENT A SAVING OF US DOLLARS 1 BILLION OVER THE TWO AND A HALF YEARS. CURRENT SPREAD VARIES BETWEEN 1.6 AND 2%. OUR UNDERSTANDING IS THAT THE US DOLLARS 5.8 MILLION IS ADDITIONAL TO THE BANKS' LOANS PROVIDED UNDER THE PROVISIONAL AGREEMENT CONCLUDED IN NOVEMBER 1987.

COMMENT

5. THE AGREEMENT, WITH THE IMMEDIATE PAYMENT OF THE US DOLLARS 700 MILLION, IS REGARDED AS THE END OF THE MORATORIUM. NON-PMDB ECONOMISTS SO FAR HAVE TENDED TO WELCOME IT. PMDB ECONOMISTS HAVE MADE GRUDGING NOISES BUT HAVE NOT (NOT) CRITICISED IT. ASKED ABOUT IT BY JOURNALISTS YESTERDAY PMDB PRESIDENT ULYSEES GUIMARAES REFUSED TO COMMENT. THE BRAZILIANS WOULD HAVE PREFERRED TO HAVE GOT MORE IN LOANS FROM THE BANKS. THEY WERE ASKING FOR CLOSE ON US DOLLARS 7 BILLION. BUT NOBREGA SEEMS GENUINELY PLEASED WITH THE AGREEMENT. COMMENTATORS ARE SAYING THAT IT WILL ACT AS A FILLIP FOR THE ECONOMY THIS YEAR BUT THAT IF BRAZIL IS TO CONSOLIDATE ON IT IN THE LONGER TERM IT MUST REDUCE IS PUBLIC DEFICIT

6. THE AGREEMENT IS POSITED ON A SUBSEQUENT SATISFACTORY AGREEMENT WITH THE IMF AND PARIS CLUB. NOBREGA HAS STATED AGAIN THAT THE AGREEMENT WITH THE IMF WILL BE SEPARATE FROM THAT WITH THE BANKS, IE THE BANKS' DISBURSEMENTS WILL NOT BE CONDITIONAL ON FULFILMENT OF THE IMF AGREEMENT.

NEWINGTON

YYYY

DISTRIBUTION

177

MAIN

177

FINANCIAL

SAMD

NNNN

UNCLASSIFIED

pwj

167736
MDLIAN 5945

UNCLASSIFIED

FM BRASILIA

TO PRIORITY FCO

TELNO 89

OF 071215Z MARCH 88

INFO ROUTINE UKDEL IMF/IBRD, WASHINGTON, RIO DE JANEIRO, SAO PAULO

CULL

BRAZIL - EXTERNAL DEBT

SUMMARY

1. BRAZILIANS ANNOUNCE THAT BRAZIL AND THE COMMERCIAL CREDITOR BANKS HAVE REACHED AGREEMENT IN PRINCIPLE ON A MULTI-YEAR RESCHEDULING.

DETAIL

2. FINANCE MINISTER NOBREGA ANNOUNCED LATE ON 4 MARCH THAT BRAZIL HAD REACHED AN AGREEMENT WITH THE BANKS ON THE MAIN POINTS OF A MULTI-YEAR RESCHEDULING AGREEMENT FOR ITS EXTERNAL COMMERCIAL DEBT. ACCORDING TO HIS ANNOUNCEMENT THESE MAIN POINTS ARE:

- RESCHEDULING OF PRINCIPAL MATURITIES DUE BETWEEN 1986 AND 1993 COVERING APPROXIMATELY US DOLLARS 64 BILLION.
- REPAYMENT OVER 20 YEARS, 1988 TO 2008.
- AN 8 YEAR GRACE PERIOD.
- AND A SPREAD OF 13/16THS %. THE RATE OF REPAYMENT WILL BE ON A SLIDING SCALE RUNNING BETWEEN 2% IN THE FIRST YEAR OF PAYMENT AND (SIC) 10% IN THE LAST YEAR. NOBREGA SAID THAT SOME SMALL PAYMENT OR PAYMENTS OF PRINCIPAL WOULD PROBABLY BE MADE DURING THE GRACE PERIOD.

3. THE FINER POINTS OF THE AGREEMENT INCLUDING 'CARVE OUT' HAVE APPARENTLY STILL TO BE DECIDED. THE AGREEMENT IS EXPECTED TO BE CONCLUDED IN THE NEXT TWO WEEKS IN TIME FOR A FULL ANNOUNCEMENT AT THE COMING INTER-AMERICAN DEVELOPMENT BANK ANNUAL MEETING.

COMMENT

UNCLASSIFIED

167736
MDLIAN 5945

4. IT LOOKS AS IF NOBREGA/MILLIET HAVE SECURED A GOOD AGREEMENT FOR BRAZIL, ALTHOUGH IT DOES NOT FOLLOW THAT IT WILL GENERALLY BE REGARDED AS SUCH BY THE BRAZILIAN POLITICAL ESTABLISHMENT. THE REACTIONS OF LEADING BRAZILIANS ARE STILL AWAITED, AS THE NEWS BROKE OVER THE WEEKEND. MEANWHILE THE RAPPORTEUR OF THE SENATE EXTERNAL DEBT COMMITTEE, THE LEFTISH SENATOR FERNANDO HENRIQUE CARDOSO, HAS PRODUCED A 163 PAGE PAPER CRITICISING NOBREGA'S NEGOTIATION OF THE EXTERNAL DEBT, SAYING THAT NOBREGA HAS 'APPARENTLY ABDICATED FROM THE TASK OF FINDING A NEGOTIATED LONG TERM SOLUTION TO THE DEBT PROBLEM, IN ACCORDANCE WITH BRAZIL'S ABILITY TO PAY'.

5. GRATEFUL IN DUE COURSE FOR CONFIRMATION OF THE DETAILS OF THE AGREEMENT FROM BANKING CIRCLES DIRECTLY CONCERNED.

NEWINGTON

YYYY

DISTRIBUTION

177

MAIN 177

FINANCIAL

SAMD

NNNN

UNCLASSIFIED

167776
MDLIAN 5958

UNCLASSIFIED
FM BRASILIA
TO PRIORITY FCO
TELNO 91
OF 081355Z MARCH 88
INFO ROUTINE UKDEL IMF/IBRD, WASHINGTON

CULL

CHANGES AT THE CENTRAL BANK AND BANK OF BRASIL

SUMMARY

1. PRESIDENT OF THE CENTRAL BANK RESIGNS. PRESIDENT OF THE BANK OF BRASIL IS DISMISSED.

DETAIL

2. FERNANDO MILLIET RESIGNED FROM THE PRESIDENCY OF THE CENTRAL BANK FOR PERSONAL REASONS YESTERDAY. HE HAS BEEN REPLACED BY ELMO DE ARAUJO CAMOES, CURRENTLY PRESIDENT OF BANCO SOGERAL. FINANCE MINISTER NOBREGA ALSO ANNOUNCED YESTERDAY THAT HE HAD SECURED THE DISMISSAL OF CAMILO CALAZANS FROM THE PRESIDENCY OF THE BANCO DO BRASIL AND REPLACED HIM WITH HIS ASSOCIATE MARIO BERARD, CURRENTLY SECRETARY GENERAL IN THE FINANCE MINISTRY.

3. MILLIET'S RESIGNATION WAS TO BE EXPECTED. HE WAS APPOINTED BY FORMER FINANCE MINISTER BRESSER AND WAS SOMETHING OF AN OUTSIDER IN NOBREGA'S TEAM. ON BEING APPOINTED FINANCE MINISTER NOBREGA HAD INTENDED TO REPLACE HIM BUT THIS INTENTION FOUNDERED ON THE INSISTENCE OF SAO PAULO INTERESTS THAT THE CENTRAL BANK PRESIDENT SHOULD BE A PAULISTA. IN TENDERING HIS RESIGNATION MILLIET EXPLAINED THAT HE CONSIDERED HE HAD NOW COMPLETED HIS TASK AS FOREIGN DEBT NEGOTIATOR.

4. ELMO CAMOES, WHO REPLACES MILLIET, WORKED AT THE BANCO DO BRASIL FROM 1946 TO 1967 AND SUBSEQUENTLY AT THE CENTRAL BANK. IN THE EARLY 1970S HE WAS MANAGER OF THE NEW YORK OFFICE OF BANESPA, THE STATE BANK OF SAO PAULO. MOST RECENTLY HE HAS BEEN WITH BANCO SOGERAL AND HAS PRESIDED OVER THE BRAZILIAN ASSOCIATION OF COMMERCIAL BANKS AND THE BRAZILIAN BANKING FEDERATION. HE IS 61.

5. CALAZAN'S SALARIES POLICY WITHIN THE BANCO DO BRASIL HAS

UNCLASSIFIED

167776
MDLIAN 5958

CONFLICTED WITH THE FINANCE MINISTRY'S POLICY ON PUBLIC SERVANTS' SALARIES. IN THE LAST FEW DAYS CALAZANS HAS OPENLY FLOUTED NOBREGA'S AUTHORITY. NEVERTHELESS HIS DISMISSAL IS SOMETHING OF A SURPRISE. IT IS A COUP FOR NOBREGA AND CONSIDERABLY STRENGTHENS HIS POSITION.

6. XIMENES, CURRENTLY SECRETARY OF THE NATIONAL TREASURY, BECOMES THE NEW SECRETARY GENERAL AT THE FINANCE MINISTRY.

NEWINGTON

YYYY

DISTRIBUTION

177

MAIN 177

FINANCIAL

SAMD

NNNN

PWP

FROM: AMANDA HIGGINS

DATE: 15 March 1988

MRS THORPE

cc PS/Chancellor
PS/Economic
Secretary
Sir G Littler
Mr Evans
Mr Mountfield

VISIT BY BRAZILIAN FINANCE

This is to confirm our conversation earlier today when I reported that the Sr Mailson de Nobrega has had to cancel his visit to the UK next week for domestic reasons.

Amanda Higgins

A J HIGGINS

CONFIDENTIAL

D/M/38

From: T P Lankester
Date: 22 April 1988

CHANCELLOR

cc

Sir Geoffrey Littler
Mr H Evans
Mr Mountfield
Mr Walsh

Ch.
Content?

✓
22/4

BRAZIL

The banks have for some time been talking to the World Bank about the possibility of the Bank guaranteeing part of the proposed \$5.8 billion financing. Specifically, they are asking the Bank to provide a guarantee on \$500 million in respect of later maturities (years 13 to 17). If the Brazilians defaulted before year 13, the guarantee would not be implemented.

2. The banks asked us some time ago to put pressure on the World Bank to provide such a guarantee. We refused, but did say we would be prepared to look at this on its merits if the Bank were themselves to propose it. (As you will recall, we did agree a similar Bank guarantee for Mexico.)

3. Bill Rhodes has today spoken to Sir Geoffrey Littler in Tokyo about this, arguing once again that if the guarantee is not provided, the bank package will collapse. On further reflection, Sir Geoffrey and I believe that, if the Bank decide that the guarantee should be offered, we should be prepared to go along with this. But this would be on condition that the Bank guarantee is not committed unless and until an IMF programme is in place.

4. If you agree, we would propose to tell the Americans that this our position.

T.

T P LANKESTER

CONFIDENTIAL



FROM: J M G TAYLOR

DATE: 25 April 1988

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

MR LANKESTER

cc Sir G Littler
Mr H Evans
Mr Mountfield
Mr Walsh

BRAZIL

The Chancellor has seen your minute of 22 April. He is content with your proposal that, if the Bank decides that the guarantee should be offered, we should be prepared to go along with this. He is also content that you should tell the Americans that this is our position.

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

J M G TAYLOR

CONFIDENTIAL

*John New Baker
my + Baker
don't like
much.*

CHANCELLOR

*Ch
I hadn't seen
this before Baker
rang*

From: Sir G. Littler
Date: 25 April 1988

c.c. Mr Lankester
Mr Huw Evans
Mr Mountfield
Mr Walsh

BRAZIL

I spoke this afternoon to David Mulford, to let him know of my conversation with Bill Rhodes (which Tim Lankester reported to you in his minute of 22 April).

2. Mulford said that Baker is inclined to go on resisting the pressure for an IBRD guarantee, mainly because he suspects the same problem may arise soon with Argentina as well, and because any sense that guarantees are becoming more widely used could do damage to the prospects of getting the IBRD General Capital Increase through Congress.

3. I emphasised to Mulford that I had been careful to explain to Rhodes that there could be no question of the UK positively supporting a guarantee: the most I would suggest you might consider was that we should agree not to stand in the way if the IBRD wanted to go ahead and others were prepared to acquiesce.

4. Mulford was grateful for having this clarified. As he said, we are all used to being told that everybody is in support except us, and it helps to know positions more exactly!

(Geoffrey Littler)



FROM: A C S ALLAN
DATE: 26 April 1988

SIR G LITTLER

cc Mr Lankester
Mr H P Evans
Mr Mountfield
Mr Walsh

BRAZIL

Secretary Baker rang the Chancellor yesterday evening. This turned out to be about Brazil. The Chancellor had not at that time seen your minute of 25 April (nor was it evident that Mulford had relayed to Baker the points you had made to him).

2. Baker was very concerned about the trend towards "public sector solutions". He said the banks' advisory committee had been lobbying central banks hard (and had approached Loehnis at the Bank of England). Baker was very concerned about going into the discussions offering a World Bank guarantee; at the very most, this was something that could be considered right at the end as the final component in a package.

3. The Chancellor took note of Baker's points and said he would look into them.

A handwritten signature in black ink, appearing to read 'ACSA', with a long horizontal stroke underneath.

A C S ALLAN

CONFIDENTIAL



From: Sir G.Littler
Date: 27 April 1988

MR ALEX ALLAN

c.c. Mr Lankester
Mr Huw Evans
Mr Mountfield
Mr Walsh

BRAZIL

Thank you for your minute of 26 April. I infer that there is no obligation on the Chancellor to contact Baker again - I see no need.

2. Since I minuted on 25 April I have spoken again with David Mulford, reemphasising that the UK is not in any way pressing for a guarantee, but merely indicating to the US that we would not dig in against one in the form and on the conditions described. He accepted this. (I got the impression that he is personally more sympathetic to the proposition than Baker and is positively expecting some move right at the end to clinch an overall deal, as Baker himself hinted to the Chancellor).

3. I have also spoken to Frank Cassell to report these various exchanges.



(Geoffrey Littler)

RESTRICTED

145016
MDHIAN 7596

A handwritten signature in blue ink is located in the upper right quadrant of the page. Below the signature, there are two red checkmarks: one is a large, stylized checkmark, and the other is a smaller, more standard checkmark.

RESTRICTED
FM BRASILIA
TO IMMEDIATE FCO
TELNO 153
OF 282000Z APRIL 88
INFO IMMEDIATE DTI (FOR OT4)
INFO SAVING RIO DE JANEIRO, SAO PAULO

CULL

NEW BRAZILIAN CONSTITUTION: THE ECONOMIC CHAPTER

SUMMARY

1. THE CONSTITUENT ASSEMBLY ADOPTS A RESTRICTIVE AND NATIONALISTIC DEFINITION OF WHAT CONSTITUTES A BRAZILIAN NATIONAL COMPANY, ELIGIBLE FOR PREFERENTIAL TREATMENT UNDER THE CONSTITUTION. DISCOURAGING BUT NOT TRAGIC FOR FOREIGN COMPANIES.

DETAIL

2. THE CONSTITUENT ASSEMBLY HAS THIS WEEK TURNED ITS ATTENTION TO THE CONTROVERSIAL ECONOMIC CHAPTER OF THE NEW CONSTITUTION. AT THE BEGINNING OF THE WEEK THE FORCES TO THE RIGHT OF CENTRE (THE CENTRAO) AND THOSE TO THE LEFT BEGAN DISCUSSIONS AIMED AT NEGOTIATING A COMPROMISE BETWEEN A MARKET ORIENTATED CENTRAO DRAFT AND THE INTERVENTIONIST SYSTEMATISATION COMMISSION DRAFT. WHEN THESE DISCUSSIONS RAN INTO DIFFICULTIES, THE CENTRAO DECIDED TO ABANDON THEM IN FAVOUR OF A GO-IT-ALONE ATTEMPT TO SECURE AN ABSOLUTE MAJORITY IN PLENARY IN FAVOUR OF ITS DRAFT. THE ATTEMPT WAS DEFEATED. THE CENTRAO FELL 70 VOTES SHORT OF AN ABSOLUTE MAJORITY, AND ITS OPPONENTS FAILED BY ONLY ONE VOTE TO SECURE AN ABSOLUTE MAJORITY AGAINST THE CENTRAO TEXT. A SUBSTANTIAL NUMBER OF CENTRAO CONGRESSMEN FAILED TO SUPPORT THE CENTRAO DRAFT. THE CENTRAO WAS THEREFORE OBLIGED TO RESUME NEGOTIATIONS FOR A COMPROMISE. THIS SECOND ROUND OF DISCUSSIONS NOW SEEMS TO HAVE PRODUCED A RELUCTANT AGREEMENT, AND VOTING ON INDIVIDUAL PROVISIONS BEGAN YESTERDAY, 27 APRIL.

3. VOTING IN PLENARY YESTERDAY LED TO THE ADOPTION OF THE FIRST FIVE ARTICLES OF THE ECONOMIC CHAPTER, INCLUDING ARTICLE 200 CONTAINING IMPORTANT DEFINITIONS. AS ADOPTED, THE ARTICLE MAKES A DISTINCTION BETWEEN A BRAZILIAN COMPANY AND A BRAZILIAN COMPANY OF NATIONAL CAPITAL. IT DEFINES THE FIRST AS A COMPANY CONSTITUTED

RESTRICTED

145016
MDHIAN 7596

ACCORDING TO BRAZILIAN LAW WITH ITS REGISTERED OFFICE AND ITS MANAGEMENT/ADMINISTRATION LOCATED IN BRAZIL. IT DEFINES THE SECOND AS A COMPANY THE EFFECTIVE CONTROL OF WHICH IS, DIRECTLY OR INDIRECTLY, PERMANENTLY IN THE HANDS EITHER OF PERSONS DOMICILED OR RESIDENT IN BRAZIL OR OF BRAZILIAN PUBLIC INSTITUTIONS. EFFECTIVE CONTROL IS DEFINED AS MAJORITY VOTING CAPITAL AND THE EXERCISE, DE BACTO OR DE JURE, OF ADMINISTRATIVE DECISION MAKING WITHIN THE COMPANY. THE SAME ARTICLE PROVIDES THAT A BRAZILIAN COMPANY OF NATIONAL CAPITAL MAY ENJOY, UNDER THE TERMS OF ORDINARY LEGISLATION, SPECIAL PROTECTION AND BENEFITS ON A TEMPORARY BASIS IN ORDER TO DEVELOP ACTIVITIES WHICH ARE CONSIDERED STRATEGIC IN RELATION TO NATIONAL DEFENCE OR ESSENTIAL FOR THE COUNTRY'S DEVELOPMENT. THE ARTICLE ALSO PROVIDES THAT THE ORDINARY LEGISLATION ENVISAGED MAY REQUIRE A BRAZILIAN COMPANY OF NATIONAL CAPITAL, WORKING IN A FIELD OF TECHNOLOGY WHICH THE LAW DEEMS TO BE ESSENTIAL FOR THE COUNTRY'S DEVELOPMENT, TO RETAIN CONTROL OF DECISION MAKING OVER THE DEVELOPMENT AND ABSORPTION OF THE RELEVANT TECHNOLOGY. THIS MEANS THAT A BRAZILIAN COMPANY INVOLVED IN A JOINT VENTURE WITH A FOREIGN COMPANY MAY BE GIVEN THE RIGHT TO REFUSE TO DEVELOP OR ACCEPT TECHNOLOGY PROVIDED BY ITS FOREIGN PARTNER.

4. THE POINT IS NOT YET CLEAR, BUT THE ASSUMPTION IS THAT A BRAZILIAN COMPANY OF NATIONAL CAPITAL WOULD NOT (NOT) BE ALLOWED TO REMIT PROFITS ABROAD.

COMMENT

5. THE OUTCOME OF THE VOTING SO FAR, THOUGH NOT AS ENCOURAGING AS FOREIGN COMPANIES AND FOREIGN INVESTORS WOULD HAVE WISHED, WILL NOT NECESSARILY AFFECT THE EXISTING OPERATIONS OF MULTINATIONALS TOO BADLY. THE TEXT WHICH HAS BEEN APPROVED IS NOT AS LIBERAL AS THE CENTRAO TEXT NOR AS ILLIBERAL AS SOME OF THE PROPOSALS MADE BY THE LEFT. IN PRACTICE, IT INSTITUTIONALISES A SITUATION WHICH IN SOME RESPECTS HAS EXISTED DE FACTO FOR THE LAST FEW YEARS. IT PAVES THE WAY FOR EXTENSION OF MARKET RESERVES, BUT ULTIMATELY, MUCH WILL DEPEND ON THE IMPLEMENTING LEGISLATION WHICH IS ENACTED.

6. THE DIVISIONS WHICH HAVE APPEARED WITHIN THE CENTRAO ARE DUE TO INTENSIVE LOBBYING BY BRAZILIAN COMPANIES WITH A VESTED INTEREST IN THE CONTINUATION OF MARKET RESERVES, CARTELS AND OTHER RESTRICTIVE PRACTICES WHICH LIMIT FOREIGN COMPETITION. AS MANY AS 80 MEMBERS OF THE CENTRAO ARE BELIEVED TO BE IN THE POCKETS OF SUCH COMPANIES,

RESTRICTED

145016
MDHIAN 7596

NOTABLY THE BIG ENGINEERING AND BUILDING CONTRACTORS. IN EFFECT THE CENTRAO WAS SABOTAGED BY A SHORT TERM ALLIANCE BETWEEN THE LEFT, NATIONALISTS AND THE REPRESENTATIVES OF PART OF THE PRIVATE SECTOR.

7. ON PRESENT FORM IT SEEMS LIKELY, BUT FAR FROM CERTAIN THAT COMPROMISE TEXTS WILL PROHIBIT FUTURE (BUT MAINTAIN EXISTING) RISK CONTRACTS FOR HYDROCARBON EXPLORATION BY FOREIGN COMPANIES EXCEPT WITH SPECIFIC CONGRESSIONAL APPROVAL: PLACE SOME LIMITATION (PROBABLY NOT TOO EXTENSIVE) ON MINING BY FOREIGN COMPANIES: AND LEAVE FOREIGN PARTICIPATION IN DISTRIBUTION OF PETROLEUM DERIVATIVES MUCH AS IT IS.

NEWINGTON

FCO PLEASE ADVANCE TO

BANK OF ENGLAND - CRAWFORD
HM TREASURY - CASE
ECGD - BREACH
DTI - OWEN, DRYE
YYYY

DISTRIBUTION

183

MAIN 182

FINANCIAL
SAMD

ERD

ADDITIONAL 1

OT4, DTI VICT ST

NNNN

RESTRICTED

130154
MDLIAN 4697

RESTRICTED
FM BRASILIA
TO PRIORITY FCO
TELNO 188
OF 031935Z JUNE 88
INFO ROUTINE RIO DE JANEIRO, SAO PAULO

BRAZIL'S CONSTITUTION

SUMMARY

1. ON 2 JUNE THE CONSTITUENT ASSEMBLY AGREED A FIVE YEAR MANDATE FOR PRESIDENT SARNEY BY A MAJORITY BIG ENOUGH SIGNIFICANTLY TO STRENGTHEN THE PRESIDENT'S POLITICAL POSITION OVER THE NEXT 18 MONTHS.

DETAIL

2. BY A LARGE MAJORITY - 328 TO 222 AND 3 ABSTENTIONS - THE CONSTITUENT ASSEMBLY INCLUDED IN TRANSITIONAL PROVISIONS DATE OF 15 MARCH 1990 FOR TERMINATION OF PRESIDENT SARNEY'S MANDATE AND ASSUMPTION OF POWER OF NEW PRESIDENT. PRESIDENTIAL ELECTIONS TO BE HELD ON 15 NOVEMBER 1989. IT IS HARDLY CONCEIVABLE THAT THESE DECISIONS WILL BE OVERTURNED DURING FINAL READING.

3. OTHER TRANSITIONAL PROVISIONS AGREED INCLUDE:

- (A) PLEBESCITE TO BE HELD ON 7 SEPTEMBER 1993 TO ENABLE ELECTORATE TO DETERMINE FORM (REPUBLIC OR CONSTITUTIONAL MONARCHY) AND SYSTEM (PARLIAMENTARY OR PRESIDENTIAL) OF GOVERNMENT TO APPLY TO BRAZIL.
- (B) CONSTITUTIONAL REVISION TO TAKE PLACE FIVE YEARS AFTER ENTRY INTO FORCE OF THE NEW CONSTITUTION BY AN ABSOLUTE MAJORITY VOTE OF THE MEMBERS OF BOTH HOUSES OF CONGRESS IN A UNICAMERAL SESSION.
- (C) MANDATES OF GOVERNORS AND VICE-GOVERNORS ELECTED ON 15 NOVEMBER 1986 TO TERMINATE ON 15 MARCH 1991.

COMMENT

4. PROLONGED UNCERTAINTY OVER THE LENGTH OF PRESIDENT SARNEY'S

MANDATE AND THE DETERMINED EFFORT, LARGELY LED BY LEFT-WING ELEMENTS IN THE ASSEMBLY, TO HAVE PRESIDENTIAL ELECTIONS HELD THIS YEAR, HAVE MADE IT EXCEPTIONALLY DIFFICULT FOR THE GOVERNMENT TO PURSUE COHERENT ECONOMIC POLICIES. IT REMAINS TO BE SEEN WHETHER THE PRESIDENT WILL NOW EXERCISE MORE DECISIVE LEADERSHIP, BUT CERTAINLY ONE OF THE EXCUSES FOR HIS NOT DOING SO HAS NOW BEEN REMOVED. THE POLICY FRAMEWORK IS THERE: REDUCTION OF PUBLIC SECTOR DEFICIT, CONCLUSION OF NEGOTIATIONS WITH BANKS, IMF AND PARIS CLUB, AND IMPLEMENTATION OF NEW INDUSTRIAL POLICY (MY TELNO 181). BUT PURSUIT OF THESE POLICIES WILL NOT ONLY ENTAIL DIFFICULT AND PAINFUL DECISIONS. IT MAY ALSO CONFLICT WITH PLEDGES AND COMMITMENTS SARNEY HAS ALMOST CERTAINLY HAD TO MAKE IN ORDER TO SECURE HIS FIVE YEARS. AND HE CERTAINLY DOES NOT HAVE ANYTHING LIKE AN ASSURED MAJORITY IN CONGRESS.

5. THE ASSEMBLY WILL PROBABLY SPEND THE NEXT TWO WEEKS CONCLUDING THE TRANSITIONAL PROVISIONS. THE FINAL READING OF THE DRAFT CONSTITUTION (INCLUDING THESE PROVISIONS) WILL PROBABLY TAKE PLACE IN JULY. THERE WILL BE INTENSIVE LOBBYING, AND PROBABLY HEAVY GOVERNMENT PRESSURE, TO CUT OUT SOME OF THE MORE ABSURD ARTICLES AND, I HOPE, SOME OF THE NATIONALISTIC PROVISIONS OF PARTICULAR CONCERN TO BRITISH COMPANIES. THE CHANCES ARE I THINK IMPROVED BY YESTERDAY'S VOTE.

NEWINGTON

YYYY

DISTRIBUTION

191

MAIN . 186

FINANCIAL
ERD (-)

SAMD

ADDITIONAL 5

CRAWFORD, BANK OF ENGLAND
CASE, HM TRSY
BREACH, ECGD

DRYE, DTI
OWEN, DTI

RESTRICTED

130154
MDLIAN 4697

RESTRICTED
FM BRASILIA
TO PRIORITY FCO
TELNO 188
OF 031935Z JUNE 88
INFO ROUTINE RIO DE JANEIRO, SAO PAULO

BRAZIL'S CONSTITUTION

SUMMARY

1. ON 2 JUNE THE CONSTITUENT ASSEMBLY AGREED A FIVE YEAR MANDATE FOR PRESIDENT SARNEY BY A MAJORITY BIG ENOUGH SIGNIFICANTLY TO STRENGTHEN THE PRESIDENT'S POLITICAL POSITION OVER THE NEXT 18 MONTHS.

DETAIL

2. BY A LARGE MAJORITY - 328 TO 222 AND 3 ABSTENTIONS - THE CONSTITUENT ASSEMBLY INCLUDED IN TRANSITIONAL PROVISIONS DATE OF 15 MARCH 1990 FOR TERMINATION OF PRESIDENT SARNEY'S MANDATE AND ASSUMPTION OF POWER OF NEW PRESIDENT. PRESIDENTIAL ELECTIONS TO BE HELD ON 15 NOVEMBER 1989. IT IS HARDLY CONCEIVABLE THAT THESE DECISIONS WILL BE OVERTURNED DURING FINAL READING.

3. OTHER TRANSITIONAL PROVISIONS AGREED INCLUDE:

- (A) PLEBESCITE TO BE HELD ON 7 SEPTEMBER 1993 TO ENABLE ELECTORATE TO DETERMINE FORM (REPUBLIC OR CONSTITUTIONAL MONARCHY) AND SYSTEM (PARLIAMENTARY OR PRESIDENTIAL) OF GOVERNMENT TO APPLY TO BRAZIL.
- (B) CONSTITUTIONAL REVISION TO TAKE PLACE FIVE YEARS AFTER ENTRY INTO FORCE OF THE NEW CONSTITUTION BY AN ABSOLUTE MAJORITY VOTE OF THE MEMBERS OF BOTH HOUSES OF CONGRESS IN A UNICAMERAL SESSION.
- (C) MANDATES OF GOVERNORS AND VICE-GOVERNORS ELECTED ON 15 NOVEMBER 1986 TO TERMINATE ON 15 MARCH 1991.

COMMENT

4. PROLONGED UNCERTAINTY OVER THE LENGTH OF PRESIDENT SARNEY'S

MANDATE AND THE DETERMINED EFFORT, LARGELY LED BY LEFT-WING ELEMENTS IN THE ASSEMBLY, TO HAVE PRESIDENTIAL ELECTIONS HELD THIS YEAR, HAVE MADE IT EXCEPTIONALLY DIFFICULT FOR THE GOVERNMENT TO PURSUE COHERENT ECONOMIC POLICIES. IT REMAINS TO BE SEEN WHETHER THE PRESIDENT WILL NOW EXERCISE MORE DECISIVE LEADERSHIP, BUT CERTAINLY ONE OF THE EXCUSES FOR HIS NOT DOING SO HAS NOW BEEN REMOVED. THE POLICY FRAMEWORK IS THERE: REDUCTION OF PUBLIC SECTOR DEFICIT, CONCLUSION OF NEGOTIATIONS WITH BANKS, IMF AND PARIS CLUB, AND IMPLEMENTATION OF NEW INDUSTRIAL POLICY (MY TELNO 181). BUT PURSUIT OF THESE POLICIES WILL NOT ONLY ENTAIL DIFFICULT AND PAINFUL DECISIONS. IT MAY ALSO CONFLICT WITH PLEDGES AND COMMITMENTS SARNEY HAS ALMOST CERTAINLY HAD TO MAKE IN ORDER TO SECURE HIS FIVE YEARS. AND HE CERTAINLY DOES NOT HAVE ANYTHING LIKE AN ASSURED MAJORITY IN CONGRESS.

5. THE ASSEMBLY WILL PROBABLY SPEND THE NEXT TWO WEEKS CONCLUDING THE TRANSITIONAL PROVISIONS. THE FINAL READING OF THE DRAFT CONSTITUTION (INCLUDING THESE PROVISIONS) WILL PROBABLY TAKE PLACE IN JULY. THERE WILL BE INTENSIVE LOBBYING, AND PROBABLY HEAVY GOVERNMENT PRESSURE, TO CUT OUT SOME OF THE MORE ABSURD ARTICLES AND, I HOPE, SOME OF THE NATIONALISTIC PROVISIONS OF PARTICULAR CONCERN TO BRITISH COMPANIES. THE CHANCES ARE I THINK IMPROVED BY YESTERDAY'S VOTE.

NEWINGTON

YYYY

DISTRIBUTION

191

MAIN 186

FINANCIAL
ERD (-)

SAMD

ADDITIONAL 5

CRAWFORD, BANK OF ENGLAND
CASE, HM TRSY
BREACH, ECGD

DRYE, DTI
OWEN, DTI

NNNN

PERSONAL AND CONFIDENTIAL

CHANCELLOR

FROM: A G TYRIE

DATE: 23 JUNE 1988

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Cropper
Mr Call

FREE TRADE, OR THE LACK OF IT

Since the budget I have started to take an interest in trade issues. I am astonished how little the Thatcherite lager has penetrated the DTI, and particularly Alan Clark's fiefdom.

We seem to be running a consumer-led deregulation and privatisation policy domestically but a producer-led trade policy externally. (Perhaps I exaggerate a little!). The recent correspondence on VRAs and anti-dumping duties has been particularly depressing. Mercantilism is certainly not dead, the current account deficit may give it a fillip. And Europrotectionism is coming in the wake of the removal of trade barriers within the EEC. So what can be done?

First, there are various practical things (major and minor) we can do:

- we could suggest that the EDU get their teeth into trade issues. They need to keep an eye on their own department's protectionist leanings;
- we could stir up Sally Oppenheim and co;
- we could get another report on the MFA done by Silberston, which Alan Clark is resisting, and ensure it a good run in the press;
- any chance of getting Lord Young to shake up Alan Clark, who was recently described to me (by a senior DTI official) as 'one of nature's protectionists'.

Secondly, it might also be worth doing something, if only at the level of exhortation, along the lines of your 'ten principles' on agriculture, with an eye on the Uruguay round. There is to be a mid-term Ministerial review of the Round at Montreal in December which could serve as a peg.

I've had a preliminary word with Tim Lankester about this. Before we go any further are you content for some work to go ahead? Could we have a word at Prayers?

pp
RJ
A G TYRIE

C/ You have several meetings on 18 July - especially you are speaking at the Payroll Giving Seminar, early evening & you have Lord Plender's dining group at 8.00pm.

However we could find 1/2 hr or so if you wish.
Accept / Pass to EST. ?

FROM: P MOUNTFIELD

DATE: 27 JUNE 1988

PS/CHANCELLOR

Julie 28/6

1/2 hr

gmc

cc: PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Evans
Mr Bottrill
Mrs Thomson

C/ Subject to confirmation from Brazil we have personally agreed 10.00am on Monday 18 July before Prayers.
Content? *OK*
If so do you want Sir G to attend *yes* *July 18/6*

VISIT OF BRAZILIAN FINANCE MINISTER

Senor Mailson da Nobrega will be in London on 18 July, as part of a flying trip round European capitals to explain his recent agreements with the IMF and with the commercial banks. He hopes to see the Governor, and would like to see the Chancellor as well.

2. Miss ^{Wallace}Wallis tells me that the Chancellor will be in London that day, and although he has several meetings, might possibly be able to find time.

3. I believe it is important that we should try to take this opportunity. Brazil has recently joined the company of the "good boys", and it is important to keep them there. I attach an extract from a dispatch just received from the Ambassador, which tends to confirm this.

4. If the Chancellor cannot make this, the next opportunity will be on 30 September, when Nobrega will be here for an FT-style seminar on Brazil, and for a Brazilian debt auction in London. We had in any case intended to ask the Chancellor if he would see Mailson da Nobrega. But his programme will be very crowded, and the July appointment would be better.

RM

P MOUNTFIELD

EXTRACT FROM DISPATCH FROM THE BRITISH AMBASSADOR, BRAZILIA

"The second major factor alluded to above [the recent relative improvement in Brazil's situation], flows largely from the appointment of Mailson da Nobrega as Finance Minister and the establishment of a coherent economic team at the heart of government. Mailson is

clearly committed to a policy of austere housekeeping at home and to Brazil's early reintegration into the international financial community. The Planning Minister, Abreu, and the Central Bank President, Camões, are longstanding friends and collaborators of Mailson and share his views. He and his team command a good deal of respect both at home and abroad. He enjoys wide support among industrialists and businessmen (except where particular policies conflict with individual interests). He is respected in Congress, though his policies are not to everyone's taste; and, from what they have said to me, he has the backing of the six Armed Forces Ministers. So far the economic team, with strong rhetorical support from the President, have handled the return to orthodoxy with some skill. The negotiations with the banks on the public sector debt and the opening of negotiations with the IMF have, as yet, provoked remarkably little domestic criticism; and the announcement of the government's new industrial policy, which rests on a clear statement that Brazil can no longer afford to rely as heavily as hitherto on import substitution, was well timed to convey the impression that a progressive liberalisation and opening up of the economy was in Brazil's own interest (which it clearly is) and not being pursued solely at the behest of the IMF: because here, as elsewhere, any appearance that policies are being imposed by hard-faced IMF officials and top-hatted millionaire bankers could and would be exploited by populist politicians of all shades of opinion."



C/ Brazilian Finance Minister
Courtesy call.

On Monday 18 July Marleson
de Nobrega will be
accompanied by the
Brazilian Ambassador
& his (Nobrega's) side-kick
Sergio Amaral.

I have asked Sir G Little
to attend the meeting & I
understand Mr Mountfield
is keen to attend as well.

Content? *PK*

Julie
13/7.



FROM: MRS JULIE THORPE

DATE: 30 June 1988

MR P MOUNTFIELD

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Evans
Mr Bottrill
Mrs Thomson

VISIT OF BRAZILIAN FINANCE MINISTER

The Chancellor has seen your minute of 27 June and is content to see the Brazilian Finance Minister, Senor Mailson da Nobrega, when he is in London on Monday 18 July. I have confirmed with the Foreign Office that the Chancellor will see the Finance Minister at No.11, at 10.00am and they have agreed to let me know who will accompany him. The Chancellor has said he would like Sir G Littler to attend the meeting as well.

2. I would be grateful if you could let us have suitable briefing by close of play on Thursday 14 July.

A handwritten signature in cursive script that reads 'Julie Thorpe'.

MRS JULIE THORPE
Diary Secretary

RESTRICTED

036615
MDLIAN 1378

RESTRICTED
FM BRASILIA
TO ROUTINE FCO
TELNO 213
OF 081245Z JULY 88
INFO ROUTINE UKDEL IMF/IBRD, RIO DE JANEIRO, SAO PAULO

CULL

VISIT OF BRAZILIAN FINANCE MINISTER

SUMMARY

1. BRAZILIAN FINANCE MINISTER'S COMING LONDON VISIT FOLLOWS CONCLUSION OF AN AGREEMENT WITH THE COMMERCIAL BANKS WHICH HAS BEEN QUITE WELL RECEIVED IN BRAZIL. INTERNALLY, IMPLEMENTATION OF DEFICIT CONTAINMENT IS PROVING HARD WORK AND HAS STILL TO PRODUCE RESULTS. BUT THE COMMITMENT CONTINUES STEADY.

DETAIL

2. THE FOLLOWING MAY BE HELPFUL IN PREPARATION FOR THE VISIT OF FINANCE MINISTER MAILSON DA NOBREGA ON 18 JULY.

3. EXTERNAL. THE DEBT AGREEMENT WHICH BRAZIL HAS REACHED WITH THE COMMERCIAL BANKS HAS RECEIVED A FAIRLY FAVOURABLE RECEPTION. THE WIDESPREAD VIEW IS THAT IT IS A REASONABLY GOOD AGREEMENT: IF NOT THE BEST EVER CONCLUDED BY BRAZIL, AS NOBREGA AND PRESIDENT SARNEY HAVE CLAIMED, THEN THE BEST THAT PROBABLY COULD HAVE BEEN OBTAINED IN THE CIRCUMSTANCES. THOSE WHO COULD BE EXPECTED TO OPPOSE IT HAVE BEEN UNITED IN THEIR CRITICISM. FOR THE MOMENT AT LEAST, THE AGREEMENT IS NOT UNDER ATTACK AND NOBREGA IS BEING GIVEN THE BENEFIT OF THE DOUBT. THE DEGREE OF LINKAGE WITH AN IMF AGREEMENT MAY NOT BE FULLY REALISED HERE. WORLD BANK LINKAGE HAS RECEIVED MORE PROMINENCE.

4. THERE HAVE BEEN SUGGESTIONS THAT BRAZIL IS WANTING A BRIDGING LOAN TO HELP IT PAY THE INTEREST DUE FOR JUNE AND JULY. IT IS NOT YET CLEAR HERE WHETHER IT IS SEEKING SUCH A LOAN OR WHETHER IT REALLY NEEDS IT.

5. INTERNAL. INFLATION FOR JUNE WAS 19.53 PER CENT. THE MONTHLY RATE HAS ZIG-ZAGGED IN THE LAST THREE MONTHS BUT THE UNDERLYING TREND HAS CONTINUED UPWARDS. THE ECONOMY REMAINS

RESTRICTED

036615
MDLIAN 1378

DEPRESSED. THERE ARE STILL NO REAL SIGNS OF A RECOVERY TREND. IMPLEMENTATION OF NOBREGA'S DEFICIT CONTAINMENT POLICY CONTINUES TO BE AN UPHILL STRUGGLE. THE HIGHEST LABOUR TRIBUNAL HAS RULED THAT THE TWO MONTH'S SUSPENSION OF THE URP WAGES INDEXATION IS UNCONSTITUTIONAL. THE GOVERNMENT'S RESPONSE SEEMS TO BE TO PLAY THIS LONG. THE CONSTITUTIONAL ASSEMBLY HAS GIVEN SMALL BUSINESSES AND FARMERS A DEBT AMNESTY WHICH COULD AMOUNT TO A CRUZADOS 300 BILLION PLUS DRAIN ON GOVERNMENT FINANCES. THE GOVERNMENT WILL TRY HARD TO GET THIS PROVISION WITHDRAWN AT THE SECOND READING OF THE DRAFT CONSTITUTION. IF IT FAILS IT WILL PROBABLY INTRODUCE MEASURES TO OFFSET THE COST. PROGRESS WITH REVISION OF THE FEDERAL BUDGET IS SLOW. AGREEMENT OF THE SPENDING MINISTERS WILL BE DIFFICULT TO SECURE. MEANWHILE NOBREGA REMAINS DETERMINED AND PRESIDENT SARNEY'S SUPPORT FOR HIM HAS NOT FALTERED.

6. **NOBREGA'S PERSONAL POSITION.** THOUGH NOT EXACTLY POPULAR (HIS POLICIES HURT TOO MANY INTERESTS FOR THAT), NOBREGA IS ADMIRER AND RESPECTED. HIS POLICIES ARE SEEN AS CLEAR AND CONSISTENT AND HIS STANDPOINT AS OBJECTIVE AND DISINTERESTED. HE HAS DEMONSTRATED THAT PROVIDED HE HAS THE UNWAVERING SUPPORT OF THE PRESIDENT IT CAN BE AN ADVANTAGE FOR A BRAZILIAN FINANCE MINISTER IN THE PRESENT SITUATION TO HAVE NO POLITICAL BASE OR PARTY AFFILIATIONS.

THOMAS

YYYY

DISTRIBUTION 182

MAIN 177

FINANCIAL SAMD

ADDITIONAL 5

CRAWFORD BNK OF ENG
CASE TSY
BREACH ECGD

OWEN DTI VIC ST
DRYE DTI VIC ST

NNNN

RESTRICTED

045644
MDLIAN 2057

RESTRICTED
FM BRASILIA
TO PRIORITY FCO
TELNO 217
OF 111935Z JULY 88
INFO PRIORITY TOKYO, UKDEL IMF/IBRD, WASHINGTON
INFO SAVING RIO DE JANEIRO, SAO PAULO

CULL

BRAZIL: FINANCE MINISTER'S VISIT TO JAPAN

1. FINANCE MINISTER MAILSON DA NOBREGA RETURNED TO BRASILIA ON 9 JULY AFTER AN EXTENDED VISIT TO JAPAN.
2. ACCORDING TO REPORTS OF A PRESS CONFERENCE GIVEN BY THE MINISTER SHORTLY BEFORE LEAVING TOKYO, THE JAPANESE GOVERNMENT HAS AGREED TO HELP BRAZIL IN THE FOLLOWING FOUR AREAS:
 - (A) BY PARTICIPATING IN THE US DOLLARS 500 MILLION 'BRIDGING LOAN' TO HELP PAY INTEREST
 - (B) BY HELPING TO ORGANISE A PARIS CLUB MEETING, TO TAKE PLACE BEFORE THE END OF JULY, TO DISCUSS RESCHEDULING AND NEW MONEY
 - (C) BY RE-STARTING EXPORT CREDITS
 - (D) BY HELPING PROJECTS AIMED AT IMPROVING BRAZIL'S INFRASTRUCTURE IN AGRICULTURE, IRRIGATION, TRANSPORT AND STEEL PRODUCTION.
3. MAILSON CONTINUED BY SAYING THAT ALTHOUGH JAPANESE BANKS HAD NOT SAID THAT THEY WOULD SOON BE ACCEPTING THE DEBT NEGOTIATION PACKAGE, HE WAS 'CONVINCED' THAT THEY WOULD BE DOING SO SHORTLY.
4. ON THE REQUEST BY BRAZIL FOR US DOLLARS 5.5 BILLION FROM THE NAKASONE FUND (NICHOLS'S LETTER OF 16 JUNE TO EVERARD, SAMD, FCO), MAILSON SAID THAT THE JAPANESE WOULD MAKE NO COMMITMENT AS YET. A TEAM WOULD BE SENT TO BRAZIL LATER THIS YEAR TO EVALUATE THE BRAZILIAN LIST OF PROPOSED PROJECTS.
5. ON HIS RETURN TO BRASILIA, MAILSON WAS REPORTED AS SAYING THAT BRAZIL WILL START REPAYING PRINCIPAL IN 1991. 5 PER CENT OF

RESTRICTED

045644
MDLIAN 2057

THE ''DEBT DUE IN 1991'' WILL BE PAID THAT YEAR, 10 PER CENT WILL BE PAID OF DEBT DUE IN 1992, AND 15 PER CENT IN 1993, AS A DEMONSTRATION OF ''GOODWILL'' AND AN INTENTION TO RESTART REGULAR PAYMENTS.

COMMENT

6. AS USUAL, THE MINISTER'S REMARKS AT THE PRESS CONFERENCE SEEM TO HAVE BEEN DIRECTED AT HIS DOMESTIC AUDIENCE IN BRAZIL AND IMPLY THAT THE JAPANESE WERE MORE FORTHCOMING THAN WAS PERHAPS THE CASE. MAILSON'S COMMENTS ON REPAYMENT OF PRINCIPAL ARE NO DOUBT INTENDED AS A CURTAIN RAISER FOR HIS TRIP TO EUROPE LATER THIS WEEK.

EWING

YYYY

DISTRIBUTION 186

MAIN 181

FINANCIAL
SAMD

ADDITIONAL 5

MR CRAWFORD/B/ENG
MR CASE/HM TREASURY
MR BREACH/ECGD

MR OWEN/DTI
MR DRYE/D

NNNN

7/cx

MR LANKESTER
MR R I G ALLEN
MR H P EVANS
MR MOUNTFIELD

FROM: VIVIEN LIFE
DATE: 11 JULY 1988

cc: PS/Chancellor
PS/ Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Odling Smee
Mr Peretz
Mr Tyrie

INTERNATIONAL ISSUES: CHANCELLOR'S MONTHLY MEETINGS

1. The next meeting with the Chancellor on international issues has been fixed for 11.30 on Monday, 18 July. At the last meeting the Chancellor asked for Mr Tyrie's paper on trade to be discussed. I should be grateful if he would arrange for his paper to be distributed to those attending the meeting.

2. The other main item for discussion will be possible themes for the annual meeting. Those suggested at the last meeting were:

- The risk of world inflation
- Effects of the October stock market crash one year on
- Trade in general

I will put together a draft agenda with short notes on these points in the light of any discussions at ECOFIN. I should be grateful for any further suggestions for possible themes.

3. The agenda will also cover the usual general run over recent developments and again I should be grateful for suggestions.

4. May I please have replies by close on Thursday, 14 July.

Vivien Life

VIVIEN LIFE

UNCLASSIFIED

Folders



Manday

FROM: MRS JULIE THORPE

DATE: 14 July 1988

MR P MOUNTFIELD

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Evans
Mr Bottrill
Mrs Thomson

VISIT OF BRAZILIAN FINANCE MINISTER

My minute to you of 30 June confirmed that the Chancellor is content to see the Brazilian Finance Minister at 10.00am on Monday 18 July, at No.11.

2. The Minister will be accompanied by Mr Sergio Amaral and the Brazilian Ambassador. The Chancellor has confirmed that he would like Sir Geoffrey Littler and you to attend the meeting as well.

Julie Thorpe.

MRS JULIE THORPE
Diary Secretary

FROM: A BOTTRILL

DATE: 14 JULY 1988

CHANCELLOR

cc: Chief Secretary
 Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Anson
 Mr Lankester
 Mr Beastall
 Mr C D Butler
 Mr H P Evans
 Mrs Lomax
 Mr Peretz
 Mr Turnbull
 Mr Watts
 Mrs Thomson
 Mr Savage
 Mr Cassell (Washington)
 Miss Wheldon (T/Sol)

Ch.
 Agree with advice
 (para 9) that we should
 reluctantly go along with
 this proposal?

*OK, see paper
 with on below.*

BRAZIL: BRIDGING LOAN

The Bank of England has been asked by the BIS to participate in a bridging facility for Brazil. The BIS facility would be for \$250 million alongside a further \$250 million from the United States - making a total of \$500 million. The UK share would be \$40 million and the Bank of England would be seeking an indemnity from the Treasury if it were to participate. The BIS has asked for a reply from the Bank by close of business in Basle tomorrow (Friday).

2. The BIS and US facilities are to be handled *pari passu*. The Brazilians are hoping that the loan would enter into force on 18 July although drawings would not be permitted until the IMF Executive Board approves the Fund's proposed Standby Arrangement with Brazil in principle. The Brazil discussion is on 26 July.

3. It is proposed that the bridging loan should be drawn in two tranches. The first tranche of \$465 million would be available at end-July. It would be repaid from the first disbursement of SDR 365 million (equivalent to about \$475 million) under the Fund SBA. The BIS expects this to be made by 31 August. This may be optimistic since we would not expect the IMF Board to

agree that the programme should become effective and Fund disbursements be made until a critical mass of commercial banks has signed their own financing agreement. This is apparently not likely to be achieved until early-September although there are inducements for banks to sign earlier.

4. The second tranche of the bridging loan is a comparatively modest \$35 million. Brazil would be able to draw this on condition either that it was meeting its performance criteria under the Fund programme or the Managing Director was ready to recommend that it should be eligible for the second tranche of SDR 31 million (\$40 million) under the SBA. The second stage of the bridge would then be repaid when the Fund disbursement was made. All drawings under the bridge, together with any accrued interest would have to be repaid by 30 December.

5. The proposal for the bridge was first made by the US representatives, Corrigan and Johnson, at last weekend's Basle meeting of central bank governors. Other governors are reported by the Bank of England to have said that they would consider it sympathetically but they criticised the US attempt to rush the bridge facility and insisted that drawings should wait at least for Fund Board approval in principle of the programme.

6. The US argue that an official bridging facility is needed to help Brazil make interest payments of \$1 billion this month to commercial banks. The cash flow arguments, however, are not strong since Brazil is currently earning a trade surplus of more than \$1 billion a month and apparently had reserves of about \$4 billion at end-June. Mr Lankester, however, spoke today to the US Executive Director to the IMF who insisted that the Brazilians needed encouragement to maintain interest payments to the banks. This was important to secure banks' acceptance of the new financing agreement negotiated by the banks' Steering Committee. The small second tranche of the bridging facility was apparently added mainly to secure a round number of '\$500 million'.

7. We shall be briefing you in detail on the IMF programme for Brazil in preparation for your meeting on Monday with the Finance Minister, Mr Mailson da Nobrega. The present economic situation clearly requires radical measures. Inflation is running at an annual rate of more than 600 per cent. A depressed domestic economy, however, has allowed a strong improvement in the trade balance. The Fund identifies fiscal action as the main pre-requisite for reducing inflation. The programme envisages a reduction in the inflation-adjusted PSBR from 5½ per cent of GDP in 1987 to 4 per cent this year and 2 per cent in 1989.

8. The Fund programme leaves at first sight a number of unanswered questions. The trade surplus so far this year has probably been stronger than the Fund has allowed so the 1988 financing requirements may not be as great as the IMF suggests. On the other hand the programme contains no precise measures for 1989 either on budgetary or monetary policies. Since the Brazilian budget would normally be presented at the end of August, it is regrettable to be faced with an incomplete IMF programme at this stage. Next year of course will see the run-up to Presidential elections so it will be particularly important that Brazil maintains firm policies in the face of electoral pressures which could derail any IMF programme. We expect to brief the UK Executive Director to criticise this lack of precision in the design of the programme.

9. In the meantime, we have discussed the bridge facility with Mr Lankester, and we recommend with reluctance that you approve participation by the Bank of England. A Treasury indemnity will need to be given to the Bank under the 1983 International Monetary Arrangements Act. We shall also need to inform No 10, and both Houses of Parliament. Sir Peter Middleton as Accounting Officer for the Consolidated Fund will wish to consider the implications for the Treasury's contingent liabilities.

AB/Ank

A BOTTRILL



Ch.

Brazil

160 sh
 Lower than
 40
 France 30
 UK 30
 100
 30
 30
 30
 30
 M.

Table behind gives proposed shares.

Clear, the
 good @ 15/100
 must work
 Can't want to
 by 100% (at 100% of total & accept 100% of UK & Fr.)
 share with 100% of UK & Fr.

(29)

THE FIRST SCHEDULE
(Text of the BIS Facility)

THE SECOND SCHEDULE

	Proportions	Maximum amounts of principal (in millions of US dls)
Banque Nationale de Belgique	6/250	6
Bank of Canada	25/250	25
Deutsche Bundesbank	40/250	40
Bank of England	40/250	40
Banque de France	40/250	40
Banca d'Italia	15/250	15
Bank of Japan	60/250	60
De Nederlandsche Bank N.V.	6/250	6
Schweizerische Nationalbank	12/250	12
Sveriges Riksbank	6/250	6
Total	<u>250/250</u>	<u>250</u>



FROM: J M G TAYLOR

DATE: 15 July 1988

MR BOTTRILL

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Anson
Mr Lankester
Mr Beastall
Mr C D Butler
Mr H P Evans
Mrs Lomax
Mr Peretz
Mr Turnbull
Mr Watts
Mrs Thomson
Mr Savage
Mr Cassell
Miss Wheldon

BRAZIL: BRIDGING LOAN

The Chancellor has seen your minute of 14 July.

2. He is reluctantly prepared to approve participation by the Bank of England.

3. He has commented that, clearly, this has been agreed at the BIS and there is no time to re-open the decision. But in future we must insist that, if Italy and Canada want to play in the big league (G7 and all that), they must accept equal shares of such bridging facilities with the UK and France. Thus, in this case, the Banks of England, France, Italy, and Canada would each contribute \$30 million - rather than the present split of \$40 million for England and France, \$25 million for Canada, and \$15 million for Italy.

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

J M G TAYLOR

CONFIDENTIAL

FROM: A BOTTRILL

DATE: 15 JULY 1988

CHANCELLOR

cc: Chief Secretary
Sir G Littler
Mr Lankester
Mr H P Evans
Mr Mountfield
Mr Kilpatrick
Mrs Thomson

MEETING WITH BRAZILIAN FINANCE MINISTER

You are to meet with Mr Mailson da Nobrega on Monday. He is in London as part of a tour of European capitals to explain his recent agreement with the IMF and to encourage commercial banks to support the deal struck with the banks' Advisory Committee. Mailson has already visited Toronto and Tokyo.

2. You will be supported by Sir Geoffrey Littler and Mr Mountfield.

ABottrill

A BOTTRILL

MEETING WITH BRAZILIAN FINANCE MINISTER

Line to take

- (i) Welcome Brazil's decision to end last year's break with the international financial community and agree an IMF programme.
- (ii) Note that difficult decisions still remain to be taken. Strength of trade surplus this year welcome but this reflects at least partly the depressed state of the domestic economy. It will be important to sustain strong external performance as demand recovers.
- (iii) Inflation rate of 600 per cent a year is clearly a major source of concern - distorting economic decisions and undermining the operation of fiscal and monetary policies.
- (iv) Share view of IMF that firm budgetary policy is essential to control of inflation. Welcome Mailson's intention to curb deficit but regret lack of precision in plans for 1989. Can Mailson indicate actions he is contemplating?
- (v) Fiscal policy needs to be supported by firm monetary control. Note that volatile inflation has resulted in wide fluctuation in real interest rates. Positive real interest rates necessary to secure monetary control. Regret lack of specific provision for these in IMF programme.
- (vi) Recognise that Brazilian government will face political pressures next year in run-up to presidential election. This reinforces case for early policy action. Vital that IMF programme is not derailed again.
- (vii) UK recognises need for adequate in financing arrangements alongside IMF programme. Glad to be able to tell Mailson that we shall support the BIS bridging facility - provided others also participate.

- (viii) We shall also work towards successful conclusion of negotiations with the Paris Club - although these may be difficult. We are concerned that Brazil is asking the Paris Club to reschedule both principal and interest on exceptionally generous terms to June 1990. This goes beyond normal Paris Club arrangements and is a particular worry in the absence of clear policy indications even for 1989. Any new cover to be considered normally in the light of progress with both multilateral and bilateral agreements.
- (ix) Hope that Mailson will make good progress with commercial banks. Attitude of UK banks a matter for their own judgment.

Background

Brazil's agreement with the IMF and the parallel deal with the banks' steering committee mark an initial step towards the normalisation of relations with creditors following last year's moratorium. Mailson da Nobrega has been largely responsible for the new approach and has so far at least had the backing of President Sarney.

2. The economic situation in Brazil has some favourable features but also still very considerable problems. The trade surplus in the five months to May was \$6.8 billion - equivalent to almost \$16 billion at an annual rate. This is being achieved as a result of strong export growth helped by rising volumes and firmer commodity prices while imports remain sluggish as a result of depressed domestic demand. The Brazilians expect some decline in the trade surplus later in the year but the current account out-turn for 1988 may be rather better than the \$1½ billion deficit forecast by the IMF.

3. The situation of the domestic economy is more difficult. GDP which rose by 8 per cent in 1986, slowed to 3 per cent last year and is expected to be only 2 per cent this year which implies a fall in per capita terms. Despite this slowdown in the domestic economy, inflation is running at close to 20 per cent a month

or 600 per cent a year. This reflects the hefty budget deficit and the inflationary financing of it in a highly indexed system.

4. Both the IMF and Mailson have identified firm fiscal action as the key to the reduction of inflation. The IMF programme provides for the inflation-adjusted budget deficit to be reduced to 4 per cent of GDP this year compared to 7 per cent without action. The measures to achieve this include reductions in public expenditure, a two-month freeze on public sector wages, tighter controls on borrowing by states, municipalities and public enterprises and elimination of the wheat subsidy to consumers. The nominal deficit will still be 37 per cent of GDP.

5. The Brazilian intention is that the inflation-adjusted PSBR will be reduced to 2 per cent of GDP in 1989 but no details of measures have been given. The Fund Staff have stressed that major expenditure and revenue measures will be needed. The Fund has also emphasised that control over credit may need a rise in real interest rates. It would be worth re-inforcing these messages. They will be essential if domestic demand is to be kept under control and an excessive deterioration in the current balance avoided in 1989.

6. The IMF programme which is intended to run to February 1990 and the next Presidential election, forms the cornerstone of Brazil's external financing. The World Bank and the IADB will make substantial disbursements but these will largely be offset by repayments. The commercial bank package provides for the rescheduling of maturities due between 1987-93, together with new money of \$5.2 billion to be disbursed over the period to September 1989 alongside the IMF programme.

7. The Brazilians have requested exceptional treatment in the Paris Club with rescheduling of 1987 arrears and all future principal and interest to mid-1990 including previously rescheduled debt. This goes beyond the terms judged necessary by the Fund and the inclusion of interest is not welcome for a country such as Brazil. They are also seeking to extend repayments over 12 years rather than the normal 10 years. It may well be worth warning the Brazilians that these terms could be difficult to achieve.

8. The Brazilians have also requested a \$250 million bridging facility from BIS central banks together with a further \$250 million from the United States. The UK has agreed to guarantee \$40 million of this as long as others also participate. [We shall try to let you know on Monday morning if the BIS replies are favourable.]

9. The Brazilians will be seeking assurances that export credit agencies will provide new credits immediately after the Paris Club multilateral is signed. We would normally not go back on DX cover until after the bilateral agreement. We shall wish to consider carefully the stage at which we return to cover. There will be competitive pressures to re-open quickly but in view of the uncertainties about 1989 we shall be arguing for only a cautious resumption. ECGD already has some £1.2 billion at risk in Brazil.

10. Finally, Mr Mailson may wish to raise the question of whether Brazil can hold a debt auction in London. Under the Financial Services Act holding an auction could count as carrying on an investment business: this would only be legal if carried out under the auspices of an institution registered under the Act - for example, a bank. The FCO and Bank of England have been approached but it is not clear whether the Brazilians have been told of the above preliminary legal opinion and if so how they would act. It may be too late for them to hold one after the Gazeta Mercantil Seminar on 18 September, as was originally intended: the process of educating potential investors and registering the bids would clearly take some time.

CONFIDENTIAL

FROM: A BOTTRILL

DATE: 15 JULY 1988

CHANCELLOR

cc: Chief Secretary
Sir G Littler
Mr Lankester
Mr H P Evans
Mr Mountfield
Mr Kilpatrick
Mrs Thomson

MEETING WITH BRAZILIAN FINANCE MINISTER

You are to meet with Mr Mailson da Nobrega on Monday. He is in London as part of a tour of European capitals to explain his recent agreement with the IMF and to encourage commercial banks to support the deal struck with the banks' Advisory Committee. Mailson has already visited Toronto and Tokyo.

2. You will be supported by Sir Geoffrey Littler and Mr Mountfield.

ABottrill

A BOTTRILL

MEETING WITH BRAZILIAN FINANCE MINISTER**Line to take**

- (i) Welcome Brazil's decision to end last year's break with the international financial community and agree an IMF programme.
- (ii) Note that difficult decisions still remain to be taken. Strength of trade surplus this year welcome but this reflects at least partly the depressed state of the domestic economy. It will be important to sustain strong external performance as demand recovers.
- (iii) Inflation rate of 600 per cent a year is clearly a major source of concern - distorting economic decisions and undermining the operation of fiscal and monetary policies.
- (iv) Share view of IMF that firm budgetary policy is essential to control of inflation. Welcome Mailson's intention to curb deficit but regret lack of precision in plans for 1989. Can Mailson indicate actions he is contemplating?
- (v) Fiscal policy needs to be supported by firm monetary control. Note that volatile inflation has resulted in wide fluctuation in real interest rates. Positive real interest rates necessary to secure monetary control. Regret lack of specific provision for these in IMF programme.
- (vi) Recognise that Brazilian government will face political pressures next year in run-up to presidential election. This reinforces case for early policy action. Vital that IMF programme is not derailed again.
- (vii) UK recognises need for adequate financing arrangements alongside IMF programme. Glad to be able to tell Mailson that we shall support the BIS bridging facility - provided others also participate.

(viii) We shall also work towards successful conclusion of negotiations with the Paris Club - although these may be difficult. We are concerned that Brazil is asking the Paris Club to reschedule both principal and interest on exceptionally generous terms to June 1990. This goes beyond normal Paris Club arrangements and is a particular worry in the absence of clear policy indications even for 1989. Any new cover to be considered normally in the light of progress with both multilateral and bilateral agreements.

(ix) Hope that Mailson will make good progress with commercial banks. Attitude of UK banks a matter for their own judgment.

Background

Brazil's agreement with the IMF and the parallel deal with the banks' steering committee mark an initial step towards the normalisation of relations with creditors following last year's moratorium. Mailson da Nobrega has been largely responsible for the new approach and has so far at least had the backing of President Sarney.

2. The economic situation in Brazil has some favourable features but also still very considerable problems. The trade surplus in the five months to May was \$6.8 billion - equivalent to almost \$16 billion at an annual rate. This is being achieved as a result of strong export growth helped by rising volumes and firmer commodity prices while imports remain sluggish as a result of depressed domestic demand. The Brazilians expect some decline in the trade surplus later in the year but the current account out-turn for 1988 may be rather better than the \$1½ billion deficit forecast by the IMF.

3. The situation of the domestic economy is more difficult. GDP which rose by 8 per cent in 1986, slowed to 3 per cent last year and is expected to be only 2 per cent this year which implies a fall in per capita terms. Despite this slowdown in the domestic economy, inflation is running at close to 20 per cent a month

or 600 per cent a year. This reflects the hefty budget deficit and the inflationary financing of it in a highly indexed system.

4. Both the IMF and Mailson have identified firm fiscal action as the key to the reduction of inflation. The IMF programme provides for the inflation-adjusted budget deficit to be reduced to 4 per cent of GDP this year compared to 7 per cent without action. The measures to achieve this include reductions in public expenditure, a two-month freeze on public sector wages, tighter controls on borrowing by states, municipalities and public enterprises and elimination of the wheat subsidy to consumers. The nominal deficit will still be 37 per cent of GDP.

5. The Brazilian intention is that the inflation-adjusted PSBR will be reduced to 2 per cent of GDP in 1989 but no details of measures have been given. The Fund Staff have stressed that major expenditure and revenue measures will be needed. The Fund has also emphasised that control over credit may need a rise in real interest rates. It would be worth re-inforcing these messages. They will be essential if domestic demand is to be kept under control and an excessive deterioration in the current balance avoided in 1989.

6. The IMF programme which is intended to run to February 1990 and the next Presidential election, forms the cornerstone of Brazil's external financing. The World Bank and the IADB will make substantial disbursements but these will largely be offset by repayments. The commercial bank package provides for the rescheduling of maturities due between 1987-93, together with new money of \$5.2 billion to be disbursed over the period to September 1989 alongside the IMF programme.

7. The Brazilians have requested exceptional treatment in the Paris Club with rescheduling of 1987 arrears and all future principal and interest to mid-1990 including previously rescheduled debt. This goes beyond the terms judged necessary by the Fund and the inclusion of interest is not welcome for a country such as Brazil. They are also seeking to extend repayments over 12 years rather than the normal 10 years. It may well be worth warning the Brazilians that these terms could be difficult to achieve.

8. The Brazilians have also requested a \$250 million bridging facility from BIS central banks together with a further \$250 million from the United States. The UK has agreed to guarantee \$40 million of this as long as others also participate. [We shall try to let you know on Monday morning if the BIS replies are favourable.]

9. The Brazilians will be seeking assurances that export credit agencies will provide new credits immediately after the Paris Club multilateral is signed. We would normally not go back on DX cover until after the bilateral agreement. We shall wish to consider carefully the stage at which we return to cover. There will be competitive pressures to re-open quickly but in view of the uncertainties about 1989 we shall be arguing for only a cautious resumption. ECGD already has some £1.2 billion at risk in Brazil.

10. Finally, Mr Mailson may wish to raise the question of whether Brazil can hold a debt auction in London. Under the Financial Services Act holding an auction could count as carrying on an investment business: this would only be legal if carried out under the auspices of an institution registered under the Act - for example, a bank. The FCO and Bank of England have been approached but it is not clear whether the Brazilians have been told of the above preliminary legal opinion and if so how they would act. It may be too late for them to hold one after the Gazeta Mercantil Seminar on 18 September, as was originally intended: the process of educating potential investors and registering the bids would clearly take some time.



FROM: J M G TAYLOR

DATE: 15 July 1988

MR BOTTRILL

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Anson
Mr Lankester
Mr Beastall
Mr C D Butler
Mr H P Evans
Mrs Lomax
Mr Peretz
Mr Turnbull
Mr Watts
Mrs Thomson
Mr Savage
Mr Cassell
Miss Wheldon

BRAZIL: BRIDGING LOAN

The Chancellor has seen your minute of 14 July.

2. He is reluctantly prepared to approve participation by the Bank of England.

3. He has commented that, clearly, this has been agreed at the BIS and there is no time to re-open the decision. But in future we must insist that, if Italy and Canada want to play in the big league (G7 and all that), they must accept equal shares of such bridging facilities with the UK and France. Thus, in this case, the Banks of England, France, Italy, and Canada would each contribute \$30 million - rather than the present split of \$40 million for England and France, \$25 million for Canada, and \$15 million for Italy.

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

J M G TAYLOR



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

Handwritten signature/initials

18 July 1988

R Peirce Esq
PS/Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON
SW1A 2AL

cc: Chief Secretary
Sir G Littler
Mr Lankester
Mr H P Evans
Mr Mountfield
Mr Kilpatrick *MR Bottrill*
Mrs Thomson

Dear Bob

COURTESY CALL BY BRAZILIAN FINANCE MINISTER

The Brazilian Finance Minister, Mr Mailson da Nobrega, paid a courtesy call on the Chancellor this morning. He was accompanied by Mr Sergio Amaral; HE the Brazilian Ambassador; and a Press Secretary. Sir Geoffrey Littler and Mr Mountfield were also present.

The Chancellor said he was glad of this opportunity to talk with Mailson. It was good to see that the Brazilian economy was now moving in the right direction.

Mailson said that co-operation, not confrontation, was the way out of Brazil's economic difficulties. He was determined to "normalise" Brazil's relations with the international economic community and to bring the internal economy under control. His target this year was to reduce the PSBR from 8 per cent to 4 per cent of GDP; and his aim was to reduce it further, to 2 per cent of GDP, next year. Mailson was convinced that the best way to tackle Brazil's inflation was to reduce the size of the public sector deficit. He needed also to reduce the role of the state in the economy, to free up the supply side, and to liberalise trade. Progress was being made in all these areas.

Mailson said that "normalisation" required agreement with the banks; agreement with the IMF; and rescheduling at the Paris Club. Normalising relations with the international financial community, and positive domestic adjustment, were mutually supporting programmes. Mailson said a good rescheduling programme was particularly necessary. He commented that imports of investment



goods into Brazil were required, and that expanded export credit cover was therefore needed. Mailson concluded by saying that he would be seeing the UK commercial banks later today.

The Chancellor said that the UK commercial banks would take their own decisions. As far as Paris Club rescheduling was concerned, it made all the difference that Brazil was on the brink of an agreement with the IMF. The UK shared in the goodwill towards Brazil at the Club, but the precise proposal would need to be discussed further. Brazil's internal adjustment programme, as described by Mailson, must be the right approach. The problem would be implementing it. The Chancellor said that we had found that positive real interest rates were essential to keeping inflation under control. Mailson agreed. Although there were some protected sectors of the Brazilian economy which enjoyed negative real interest rates (notably farming), most of the economy was exposed to positive real rates. Recent reforms to the financial system had ensured that the Government could use the tool of interest rates much more effectively.

I am copying this letter to Charles Powell (No.10), and John Footman (Bank).

Mrs. G. Taylor
J. M. G. Taylor

J M G TAYLOR
Private Secretary

FROM: A BOTTRILL

DATE: 18 JULY 1988

PS/CHANCELLOR

Chy
Content for me
to write as proposed?

OK -
18/7

cc: PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Mountfield
Mr Watts
Mr Gieve
Mr Savage
Ms J Simpson
Mrs Thomson

BRAZIL: BRIDGING LOAN

I attach a draft Private Secretary letter you to send to No 10.

ABottrill

A BOTTRILL

Be type for [unclear] [unclear]
 Cto Charles Powell, Esq.
 PS/Prin [unclear]
 No 10

DRAFT LETTER FROM PS/CHANCELLOR TO NO 10

cc: PS/Foreign Secretary
 PS/Leader of the House
 PS/Leader of the Lords
 PS/Chief Whip Commons
 PS/Chief White Lords
 Chief Press Officer No 10
 PS/Governor of Bank
 of England

BRAZIL: BRIDGING LOAN

The Prime Minister will wish to be aware that the Brazilian Government has requested the Bank for International Settlements to arrange a \$250 million bridging loan. This will be alongside a parallel loan of \$250 million from the United States - making a total of \$500 million.

2. The Bank of England has been asked to guarantee \$40 million of the BIS facility, and the Chancellor has agreed that the Bank may take part as long as other central banks also participate fully. The Treasury will give the Bank of England an indemnity on lines similar to that given recently for Yugoslavia.

3. The bridging loan is to help Brazil's cash flow as interest payments are made to commercial banks in the interval before Brazil receives disbursements from the International Monetary Fund. The IMF Board is expected to approve a new Standby Arrangement with Brazil on 26 July, and this will enable drawings on the bridging facility. The BIS will be repaid once IMF disbursements begin - probably in mid-September. The bridging facility is to be repaid in full by the end of December.

4. Under the terms of the International Monetary Arrangements Act, 1983 we are required to inform both Houses of Parliament. The BIS loan is expected to be finalised tomorrow, and the Chancellor proposes to lay a Paper under Act on Wednesday or as soon after that as the BIS loan is announced. I should be glad to hear that the Prime Minister sees no objection. Our view is that the operation will be uncontroversial and is unlikely

to provoke much comment in Parliament.

5. The FCO will send briefing to Brasilia and other posts. Press officers at the Treasury, FCO and Bank will have question and answer briefing. As a matter of courtesy we shall notify the Public Accounts Committee and the Treasury and Civil Service Select Committee.



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

18 July 1988

R Peirce Esq
PS/Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON
SW1A 2AL

Dear Bob

COURTESY CALL BY BRAZILIAN FINANCE MINISTER

The Brazilian Finance Minister, Mr Mailson da Nobrega, paid a courtesy call on the Chancellor this morning. He was accompanied by Mr Sergio Amaral; HE the Brazilian Ambassador; and a Press Secretary. Sir Geoffrey Littler and Mr Mountfield were also present.

The Chancellor said he was glad of this opportunity to talk with Mailson. It was good to see that the Brazilian economy was now moving in the right direction.

Mailson said that co-operation, not confrontation, was the way out of Brazil's economic difficulties. He was determined to "normalise" Brazil's relations with the international economic community and to bring the internal economy under control. His target this year was to reduce the PSBR from 8 per cent to 4 per cent of GDP; and his aim was to reduce it further, to 2 per cent of GDP, next year. Mailson was convinced that the best way to tackle Brazil's inflation was to reduce the size of the public sector deficit. He needed also to reduce the role of the state in the economy, to free up the supply side, and to liberalise trade. Progress was being made in all these areas.

Mailson said that "normalisation" required agreement with the banks; agreement with the IMF; and rescheduling at the Paris Club. Normalising relations with the international financial community, and positive domestic adjustment, were mutually supporting programmes. Mailson said a good rescheduling programme was particularly necessary. He commented that imports of investment



goods into Brazil were required, and that expanded export credit cover was therefore needed. Mailson concluded by saying that he would be seeing the UK commercial banks later today.

The Chancellor said that the UK commercial banks would take their own decisions. As far as Paris Club rescheduling was concerned, it made all the difference that Brazil was on the brink of an agreement with the IMF. The UK shared in the goodwill towards Brazil at the Club, but the precise proposal would need to be discussed further. Brazil's internal adjustment programme, as described by Mailson, must be the right approach. The problem would be implementing it. The Chancellor said that we had found that positive real interest rates were essential to keeping inflation under control. Mailson agreed. Although there were some protected sectors of the Brazilian economy which enjoyed negative real interest rates (notably farming), most of the economy was exposed to positive real rates. Recent reforms to the financial system had ensured that the Government could use the tool of interest rates much more effectively.

I am copying this letter to Charles Powell (No.10), and John Footman (Bank).

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

J M G TAYLOR
Private Secretary

CONFIDENTIAL

From: S D H SARGENT

Date: 18 July 1988

MR BOTTRILL

cc Chancellor
Chief Secretary
Economic Secretary
Sir G Littler
Mr Anson
Mr Lankester
Mr Beastall
Mr C D Butler
Mr H Evans
Mrs Lomax
Mr Peretz
Mr Turnbull
Mr L Watts
Mrs Thomson
Mr Savage

Mr Cassell - Washington
Miss Wheldon - Tsy Sol

BRAZIL: BRIDGING LOAN

Sir Peter Middleton has seen your minute of 14 July.

2. Like the Chancellor, he does not see any alternative to what is proposed. However, he has commented that the procedure in these cases seems rather odd. He does not like agreeing to indemnities as a fait accompli.

S D H SARGENT
Private Secretary

INTERNATIONAL ISSUES: CHANCELLOR'S MONTHLY MEETING

3rd Meeting: 11.30, Monday, 18 July 1988 in H M Treasury

Present: Chancellor
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr R I G Allen
Mr H P Evans
Mr Mountfield
Mr Gieve
Mr Bottrill
Ms Life
Mr Tyrie

1. The meeting followed the agenda circulated under Ms Life's minute of 15 July.

Recent and forthcoming meetings

ECOFIN

2. The Economic Secretary reported that Lord Cockfield was trying to push Tax Approximation through as fast as possible. According to some reports, the Greeks appeared prepared to try to find a compromise to enable agreement to be reached during their presidency. It was therefore essential to ensure that all the issues were properly considered. The Chancellor stressed the importance of putting forward the UK paper in good time for the informal ECOFIN in September. We should also find out the line that others would be taking at September ECOFIN.

3. The Chancellor said that the Governor had reported to him that the high level (Delors) study group on European monetary union, set up at Hanover, had decided to have two secretaries: Padoa - Schioppe and one from the BIS. In practice the BIS secretary would do most of the organisational work. The meeting had considered European monetary union and parallel currencies but had not made much progress. It had decided to put to ministers propositions as to how a series of different aims could be achieved, rather than specific recommendations for change. This

was welcome, but we should keep a close watch to ensure that this continued to be the approach. Sir G Littler undertook to obtain minutes of the meetings. The Chancellor was not in favour of a system of parallel currencies.

G7 Deputies

4. Sir G Littler reported that, for the indicators exercise, the IMF had produced two sets of charts on commodity prices, one including oil and one not, showing changes and levels on the same sheet and timescale. These were well received and it was agreed that they should be presented to the next ministerial meeting. There would be no formal announcement. Mr Gieve said that Secretary Baker had said at Toronto that agreement had been reached on commodity price indicators, and the US press had been asking what this meant in practice. The Chancellor said that the most that should be said in September was that the necessary action had been taken.

5. Sir G Littler said that there had been a wide range of ideas put forward on the study of international coordination and monetary arrangements. Mulford had concentrated on the coordination process, while Trichet wanted to range more widely, arguing for the need to develop a perception of the ultimate goal in order to tackle the intermediate steps. It had been agreed that the study should be divided into three elements:

- Improvements in the coordination process
- Improvements in exchange rate management
- Possible roles and uses of reserve assets in the context of coordination.

There would be a meeting of deputies with central bank representatives on 15 September.

OECD WP3

6. Sir G Littler said that the OECD secretariat were now much more optimistic about the immediate economic prospects than they had been over the previous year. They were also optimistic on the financing of a continuing US deficit which they thought could go

on for up to 10 years. Sir T Burns thought that this was evidence of the tendency of economic commentators to follow fashion. A year ago they had been arguing that the dollar had to fall and that the levels in the Louvre agreement were unsustainable. The Chancellor pointed out that the DM/\$ rate was now at about the central point of the Louvre range.

G10 Deputies

7. Sir G Littler said that the deputies had met to discuss the study of the role of the IMF and World Bank in the debt strategy, as requested by ministers at the Spring Meetings. Dini had put forward a comprehensive agenda for the study which the UK and others had tried to focus more closely. It would not be coming up with anything substantive for the Annual meetings.

EC Monetary Committee

8. Sir G Littler reported that work was continuing along the lines mapped out at Informal ECOFIN in May.

IMF/IBRD Annual Meetings

9. The Chancellor said that a main theme should be Trade. Discussion of the effects of the October stock market crash would now be rather outdated, but the success of coordinated efforts to control those effects could be mentioned in the context of discussing the risk of world inflation. The US deficit would be a sensitive issue in the run up to the election, so references would need to be restricted to expressing confidence that an incoming administration would place the problem high on their list of priorities.

10. A further key theme would be the debt problem. The focus would be on the middle income debtors now that agreement had been reached on help for the poorest. He asked for a paper suggesting some points which he could make. He would then decide how much to say on this issue in his speeches. Mr Evans suggested that a link could be made to the need for better fiscal policies in debtor

countries, drawing on material in the recent World Development Report. The Economic Secretary said that the need to focus on the middle income debtors had been raised at ECOFIN.

11. On the World economy, Sir T Burns said that the picture was very different from that at the last annual and Spring meetings. For instance, the German and Japanese fiscal deficits were now beginning to cause concern and the German inflation rate had just gone over 1%. The Chancellor said that there would certainly be a need to look back over the shorter and longer term in discussing the World Economy, but the precise emphasis would need to be decided nearer the time in the light of developments.

12. It was agreed that there should be separate meeting to prepare for the Annual Meetings in more detail.

Debt

Chancellor's sub-Saharan debt initiative

13. Mr Mountfield said that the US appeared to be trying to back away from rescheduling over 25 years, as agreed at Toronto. It might be necessary for the Chancellor to raise this with Secretary Baker. The Chancellor agreed to the proposal that the UK should offer a 3½% reduction in the rate of interest and 14 years rescheduling as its contribution, since this was the exact equivalent of the French offer. Mr Mountfield said that he thought that the FRG would adopt the UK system, although they would not announce this until the Annual meetings. The Italians would also follow the UK, provided that they were free to offer more bilaterally.

14. Mr Gieve pointed out that there would be scope for further news stories when agreement was reached on the details of the Toronto agreement and when the first countries were granted relief. The Chancellor said that it would be essential for an anglophone country to be among that first group.

Individual Countries

Brazil

15. Mr Bottrill said that the BIS bridging loan for Brazil had been signed by all but two banks, but their difficulties were only bureaucratic and they would be signing shortly. The Chancellor said that in future cases, the Italians should be pressed to increase their share. He had been surprised to see that their share was as low as \$15m when the UK share was \$40m. If the Italians wished to take a more prominent role in the World economy, they should take a bigger share in this sort of operation. He had met Mailson da Norbrega earlier that morning, but there was nothing new to report. Nevertheless the economic reforms proposed were encouraging, provided that Brazil had the political capacity to carry them out.

16. Mr Mountfield warned that Brazil could face difficult negotiations in the Paris Club, since the French and Germans were not happy with their demands on previously rescheduled debt and on the rescheduling period. Generally, Brazil was asking the public sector to do too large a share of an overall package which was more than was strictly needed.

Nigeria

17. Mr Mountfield said that it was probably now time for the Prime Minister to send a message to the President of Nigeria. He would put forward a submission shortly.

General developments

18. The Chancellor said that the Brazilian deal could not be seen as bailing out the banks. There was still general agreement on the debt strategy, although Japan, as evidenced by their putting forward a scheme at Toronto, were a possible weak link. Mr Mountfield warned that the outcome of the Mexican election could lead Mexico to change its approach to debt.

ECGD

19. Mr Mountfield explained that the Treasury was particularly unhappy with the current position on export credit for arms sales. It was agreed to return to this at the next meeting.

World Economy

The Chancellor said that was general uncertainty in the market over whether the US wanted the value of the dollar to be stable or an increase in order to keep inflation down in the run up to the election. He thought Secretary Baker should express a view privately in order to give a clear steer to the Federal Reserve Board, where there were internal disagreements.

Next meeting: 3.00pm, 13 September

20. The main item for the next meeting would be preparation for the Annual meetings and the Commonwealth Finance Ministers meeting. Mr Tyrie's paper on trade would also be discussed.

Vivien Life

VIVIEN LIFE
20 JULY 1988

cc: Those present
Mr Lankester
Mr Scholar
Mr Byatt
Mr Culpin
Mrs Lomax
Mr Odling-Smee
Mr Peretz
Mr P G Davis
Mr Matthews
Mr Mercer
Mr Mortimer
Mr Walsh
Miss Simpson
Mr Hudson



J
Yes BM is content
Sarah
Tom
B/LB
M

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

19 July 1988

Charles Powell, Esq
PS/Prime Minister
No.10 Downing Street
London SW1

Tommy P
Pse spk. to the Party
Clerk, + find out the
answer to 'X', below.

PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Mountfield
Mr Watts
Mr Gieve
Mr Savage
Ms J Simpson
Mrs Thomson
MR Bottrill

Dear Charles

HF
2

BRAZIL: BRIDGING LOAN

The Prime Minister will wish to be aware that the Brazilian Government has requested the Bank for International Settlements to arrange a \$250 million bridging loan. This will be alongside a parallel loan of \$250 million from the United States - making a total of \$500 million.

The Bank of England has been asked to guarantee \$40 million of the BIS facility, and the Chancellor has agreed that the Bank may take part as long as other central banks also participate fully. The Treasury will give the Bank of England an indemnity on lines similar to that given recently for Yugoslavia.

The bridging loan is to help Brazil's cash flow as interest payments are made to commercial banks in the interval before Brazil receives disbursements from the International Monetary Fund. The IMF Board is expected to approve a new Standby Arrangement with Brazil on 26 July, and this will enable drawings on the bridging facility. The BIS will be repaid once IMF disbursements begin - probably in mid-September. The bridging facility is to be repaid in full by the end of December.

Under the terms of the International Monetary Arrangements Act, 1983 we are required to inform both Houses of Parliament. The BIS loan is expected to be finalised tomorrow, and the Chancellor proposes to lay a Paper under Act on Wednesday or as soon after that as the BIS loan is announced. I should be glad to hear that the Prime Minister sees no objection. Our view is that the operation will be uncontroversial and is unlikely to provoke much comment in Parliament.

X/



The FCO will send briefing to Brasilia and other posts. Press officers at the Treasury, FCO and Bank will have question and answer briefing. As a matter of courtesy we shall notify the Public Accounts Committee and the Treasury and Civil Service Select Committee.

I am copying this letter to the Private Secretaries to the Foreign Secretary, the Leader of the House of Commons, the Leader of the House of Lords, the Chief Whip, the Chief Whip (Lords), the Governor of the Bank of England, and to the Press Secretary at No.10.

Yours sincerely
Jonathan Taylor

J M G TAYLOR
Private Secretary

✓2017

CH/EXCHEQUER	
REC.	20 JUL 1988
ACTION	Mr Bottrill
COPIES TO	PSICST, PSIEST
	SIR P. Middleton
	SIR G. Little
	Mr Maughfield
	MR NALTS MR Giora
	MR D. Savage Ms J Simpson
From the Private Secretary	



10 DOWNING STREET
LONDON SW1A 2AA
MRS Thomson

20 July 1988

Dear Jonathan.

BRAZIL: BRIDGING LOAN

Thank you for your letter of 19 July about the proposed bridging loan to Brazil and the indemnity to be provided by the Treasury to the Bank of England for their participation in it. The Prime Minister is content with this.

I am copying this letter to the Private Secretaries to the Foreign Secretary, the Leader of the House of Commons, the Leader of the House of Lords, the Chief Whip, the Chief Whip (Lords), and to the Governor of the Bank of England.

Yours sincerely,

CHARLES POWELL

Jonathan Taylor, Esq.,
H.M. Treasury.

FROM: A BOTTRILL

DATE: 20 JULY 1988

Handwritten initials

SIR GEOFFREY LITTLER

- cc: Chancellor
- Chief Secretary
- Economic Secretary
- Sir P Middleton
- Mr Lankester
- Mr Peretz
- Mrs Lomax
- Mr Turnbull
- Mr C D Butler
- Mr Beastall
- Mr R I G Allen
- Mr Watts
- Mr Walsh
- Mr Mountfield
- Mrs Thomson
- Mr Savage Parly Section
- Mr Cassell - Washington
- Mr Enoch - Washington
- Miss Wheldon - T.Sol

Ch
PM is content
(Mr Parrot's letter, behind)
✓

20/7

BRAZIL: BIS BRIDGING LOAN

The Bank of England has now had confirmation from the BIS that all central banks and the United States are prepared to go ahead with the bridging loan for Brazil and the Brazilians have accepted the terms. The Bank of England is therefore committed to the loan and it would be appropriate now to issue the Treasury indemnity. Sir Peter Middleton as Accounting Officer of the Consolidated Fund, has already agreed this. I attach a draft letter for you to send to Mr Loehnis.

ABottrill

A BOTTRILL

A D Loehnis Esq
Bank of England
Threadneedle Street
London EC2R 8AH

1. Following discussions between the Bank and the Treasury, I am writing to record the terms of the indemnity which the Treasury has agreed to give the Bank of England in relation to the Bank's \$40 million participation in the credit facility to be granted by the Bank for International Settlements to the Central Bank of Brazil.

2. On our side, the Treasury undertakes to reimburse the Bank any sums which the Bank may be called on to pay the BIS under the Substitution Agreement which the Bank intends to enter into with them. In addition the Treasury undertakes to reimburse the Bank any unrequited interest cost borne by the Bank in relation to foreign currency deposits taken to fund claims assigned under the Substitution Agreement. In return the Bank would reimburse the Treasury any monies recovered under the Substitution Agreement including any receipts of interest relating to such recoveries.

3. It is also agreed that it would be appropriate, as a reflection of the Treasury's contingent liability, for the Bank to pay to the Treasury three-quarters of any commission received by the Bank under the Substitution Agreement.

4. I should be grateful if you would confirm the Bank's agreement to these arrangements.

Sir Geoffrey Littler

FROM: A BOTTRILL

DATE: 20 JULY 1988

1. ECONOMIC SECRETARY
2. MR SAVAGE (Parliamentary Section)

cc: Chancellor
Chief Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Peretz
Mrs Lomax
Mr Turnbull
Mr C D Butler
Mr Beastall
Mr R I G Allen
Mr Watts
Mr Walsh
Mr Mountfield
Mrs Thomson
Mr Cassell - Washington
Mr Enoch - Washington
Miss Wheldon - T.Sol

BRAZIL: BRIDGING LOAN

The Bank of England has now agreed to participate in the BIS bridging loan for Yugoslavia, and the Treasury is giving the Bank an indemnity as approved by the Chancellor and by Sir Peter Middleton. The BIS has received confirmation from the Yugoslavs that they accept the terms of the loan. It would therefore be appropriate for you to present a Paper under Act to both Houses of Parliament as required by the International Monetary Arrangements Act 1983. I attach a draft.

A BOTTRILL

INTERNATIONAL MONETARY ARRANGEMENT ACT 1983

STATEMENT of Indemnity given by the Treasury to the Bank of England on 20 July 1988 in pursuance of Section 2(1) of the International Monetary Arrangements Act 1983 covering the Bank of England's commitment to the Bank for International Settlements in respect of a loan to Brazil.

Treasury Chambers)
20 July 1988) **PETER LILLEY**

Presented pursuant to Section 2 (3) of the
International Monetary Arrangements Act 1983

NOT TO BE PRINTED

INTERNATIONAL MONETARY ARRANGEMENTS ACT 1983

Statement of Indemnity given by the Treasury in pursuance of Section 2 (1) of the International Monetary Arrangements Act 1983.

US dollars

Undertaking to indemnify given on 20 July 1988 for commitment by the Bank of England to the Bank for International Settlements in respect of a loan to the Central Bank of Brazil to an amount not exceeding 40,000,000

Extent of Indemnity - Principal plus any unpaid accrued interest and costs.

INTERNATIONAL MONETARY ARRANGEMENT ACT 1983

STATEMENT of Indemnity given by the Treasury to the Bank of England on 20 July 1988 in pursuance of Section 2(1) of the International Monetary Arrangements Act 1983 covering the Bank of England's commitment to the Bank for International Settlements in respect of a loan to Brazil.

Treasury Chambers)
20 July 1988) **PETER LILLEY**

Presented pursuant to Section 2 (3) of the
International Monetary Arrangements Act 1983

NOT TO BE PRINTED

FROM: A BOTTRILL
DATE: 21 JULY 1988

MR GIEVE

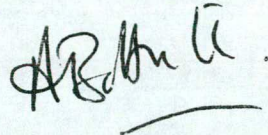
cc: PS/Chancellor
Sir P Middleton
Sir G Littler
Mr Mountfield

BRAZIL: BRIDGING LOAN

You have seen the correspondence on this. The Chancellor has approved a Treasury indemnity to the Bank of England for its participation in a \$250 million BIS bridging loan for Brazil. The UK share is \$40 million. The BIS loan is being accompanied by a \$250 million bridging loan to Brazil from the United States - making a total of \$500 million.

2. Disbursements under the bridging facilities depend upon the IMF Executive Board agreeing in principle a Standby Arrangement with Brazil. The bridging facility is to support Brazil's cash flow position until disbursements from the Fund itself are available. These will depend upon completion of the overall financing arrangements for the SBA including agreement by the Paris Club on rescheduling Brazil's debts and support by a critical mass of commercial banks for the package agreed between Brazil and the banks' steering committee.

3. If you receive Press inquiries, you will want to point out that this arrangement is similar to previous operations under the International Monetary Arrangements Act, 1983. Detailed questions should be referred to the Bank of England.


A BOTTRILL

*Thanks,
In general, ok.
Bank to (c) in an agreement to (b) of Paris Club
to some*

FROM: P MOUNTFIELD
DATE: 22 JULY 1988

CHANCELLOR

cc: Economic Secretary
Sir P Middleton
Sir G Littler
Mr Evans
Mr Bottrill
Mr Walsh
Mrs Thomson
Mr T Jones

*Ch. Points for decision
Summarised in para 10. (I don't see why we should let ourselves be pulled into (b) and (especially) (c) of that list).*

BRAZIL: PARIS CLUB

25 22/7

This note seeks your approval of the line to take at the Paris Club meeting on Brazil next week.

2. When you saw Mailson da Nobrega on Monday, you said that the UK welcomed Brazil's return to the paths of financial rectitude; promised that the UK would support the Brazilian IMF programme if we were satisfied with its conditions; and similarly, said that the UK would in principle support Brazil at the Paris Club if we were convinced that it had a good case for its demand. You carefully avoided giving any specific commitments.

3. We received the IMF papers last week and discussed them with the Bank. The programme is weaker than we hoped. In particular it contains no specific fiscal targets for 1989. (The Budget for that year is due in September.) But the general thrust is sensible. We therefore intend to brief Mr Cassell to vote for the loan; but to point to the deficiencies on the fiscal side and say we shall pay particular importance to these at the time of the first review. (See below for ways of using the Paris Club agreement to reinforce this.)

4. We have also now received the Paris Club demand, and discussed it with the IMF, the US, France and FRG. We have also discussed it with the other British Government departments concerned.

5. The demand is in four parts:

- (a) rescheduling of 100 per cent of all principal due since 1 January 1987 until end-June 1990;
- (b) likewise, rescheduling of 100 per cent of interest falling due from August 1988 to end-June 1990;
- (c) and of principal and interest falling due under earlier rescheduling agreements;
- (d) over 12 years including 6 years' grace.

6. The total sums involved for ECGD are about \$860 million, of which over \$600 million is in categories (a) and (c). There is not much point in objecting to the rescheduling of arrears which built up during the period of Brazilian moratorium. Brazil could not pay off the whole of the accumulated sum. But it is unusual for a middle-income country like Brazil to seek to reschedule as much as 100 per cent of all new maturities of principal. It is even worse to reschedule interest. (To do so increases the exposure of government creditors when banks are reducing theirs.) We are not satisfied that this is necessary: the IMF programme assumes only the rescheduling of 100 per cent of principal. Nor is it desirable to include sums falling due under previous rescheduling agreements: this is the sort of treatment normally reserved for the poorest African countries. It is undesirable to reschedule over a period longer than that of the stand-by agreement; and finally, we normally limit the repayment period for middle-income countries to ten years.

7. The Brazilian case, as put to me by Amaral (whom you met with Nobrega) last week, is that there is an element of doubt about the IMF figures: it is necessary to aim off, particularly because it is not possible to calculate accurately the effect of liberalising imports, which is one of the conditions of the IMF package. We put this point to the IMF, who believe Brazil has asked for too much. This is also the view of the FRG. The

USA, however, say that if the figures (which they had not then studied) bear out the need, they would support the case. This is probably code for US determination to push the agreement through and avoid any hiatus in the Brazilian programme or in the agreement with the banks. The 12-year repayment period is necessary (he said) to smooth out the repayment profile.

8. Likewise, Amaral argued that, with elections in September 1989, and a new administration taking over in February, Brazil needed an agreement which ran until the middle of 1990 to give the new administration time to settle its policies about a successor IMF programme. This might make sense if we were satisfied about the IMF programme itself (though we normally try to make reschedulings run concurrently with IMF programmes). But the IMF programme itself is notably unspecific beyond the end of 1988. The budget for 1989 has not yet been published, and the Brazilian commitment to reduce the public sector deficit in that year remains undemonstrated. We therefore agree with the American suggestion that the Paris Club agreement should be staged, so that the second phase comes into operation only if Brazil meets performance criteria (yet to be set by the IMF) covering the first part of 1989. In that way we would be able to judge whether the budget met the IMF objectives, and (by threatening to withhold approval of rescheduling) give Brazil an incentive to do so.

9. Nobrega also asked you about new export credit. He recognises this is not a matter for the Paris Club to decide but intends to raise it there. US Exim, which originally orchestrated the concerted ban on new cover, has just announced its resumption of cover, with great publicity. We would normally hold-off until completion of our bilateral agreements (some time this autumn). But we are preparing a proposal for ministers for ECGD to provide 'DX cover' (ie for goods contributing directly to economic recovery and to export potential) for possible use before then. FCO and DTI are very anxious we should not lose market share to our competitors. A separate submission follows in a week or two. Meanwhile, if pressed in Paris, I propose to say that we hope to resume cover soon on a modest scale but are still considering our position.

10. Accordingly, the line I have agreed with departments, and submit for approval, is:

- (a) try to stick to rescheduling of 100 per cent of arrears; and of new maturity of principal, as assumed by the IMF;
- (b) if necessary, and only in order to follow a merging consensus in the Paris Club, to fall back and agree to rescheduling of 100 per cent of new maturities of interest;
- (c) finally, to agree that payments in respect of previously rescheduled debt should also be rescheduled;
- (d) to hold this to 10 years (including 5 years' grace) rather than 12;
- (e) to contain the rescheduling period to the end of 1989 if possible; if extended to the first-half of 1990, then only on condition that the agreement is staged in the way described above;
- (f) avoid giving any promises on new credit at this stage.

11. May we proceed on these lines at the meeting on Thursday and Friday of next week please?

R₁

P MOUNTFIELD



FROM: J M G TAYLOR
DATE: 25 July 1988

Handwritten initials, possibly 'JMG', in blue ink.

MR MOUNTFIELD

cc Economic Secretary
Sir P Middleton
Sir G Littler
Mr H P Evans
Mr Bottrill
Mr Walsh
Mrs Thomson
Mr T Jones

BRAZIL: PARIS CLUB

The Chancellor was grateful for your minute of 22 July.

2. In general, he is content. But he has commented that we should not agree to (c) in any circumstances, and only agree to (b) if it is absolutely essential in order to secure Paris Club agreement.

Handwritten signature in blue ink, appearing to be 'JMG'.

J M G TAYLOR

*Programme this is
on course for next
month, only on 1/2 of sum
2. X is clearly indicated.*

FROM: A BOTTRILL

DATE: 28 JULY 1988

SIR GEOFFREY LITTLER

cc: PS/Chancellor
Sir P Middleton
Mr Lankester (o.r)
Mr Mountfield
Mr H P Evans
Mrs Thomson
Mr Cassell (UK/DEL/IMF)

BRAZIL: BRIDGING LOAN

We spoke about the procedure for the arrangement of bridging loans. The present situation is unsatisfactory, as demonstrated by the Chancellor's remarks about the allocation of individual central banks' shares in the latest Brazil facility, and Sir Peter Middleton's very understandable concern about being presented with indemnities as a fait accompli. The Yugoslav operation some weeks ago also raised very difficult issues about the mechanisms for both triggering and repaying the loan.

2. Part of the problem stems from the international framework for these operations and part from our own domestic arrangements with the Bank of England. In view of the fact that there are likely to be further requests for bridging loans, it may be worth considering how we tighten procedures.

3. At the international level, the need for bridging finance may stem from a variety of pressures on debtor countries' cash flow. In the case of Yugoslavia, it reflected the need for international liquidity as the exchange market was liberalised as a prior condition for a Fund programme. In Brazil's case, the US argued on the basis of some partial figures that the loan was needed to enable interest payments to be made to commercial banks. In neither case were objective short-term cash flow figures provided. The IMF Staff appeared to accept the case for the Yugoslav facility but were sceptical of the need for the Brazil loan. A particular cause for concern in the Brazilian case is the call on official creditors to provide bridging finance to

clear arrears to banks was followed immediately by a Brazilian demand for exceptionally generous Paris Club terms.

4. A second difficulty of the international arrangements has been the mechanism for triggering disbursements under bridging facilities. The BIS has shown signs of wanting them made available on Camdessus' recommendation ahead of consideration of Fund programmes in the Executive Board. We and others have insisted that bridge loans should only be disbursed once the Board has agreed a programme at least in principle. Repayments are then from subsequent IMF disbursements.

5. This procedure of agreeing IMF programmes in principle - before the overall financing is identified - opens us to the risk that Fund disbursements will not be made and the bridge not repaid. Overall financing depends typically on the agreement of a critical mass of commercial banks to a rescheduling agreement. This has sometimes proved difficult to obtain. The commercial banks have also taken to stipulating the contribution they expect from Paris Club creditors which puts an additional pressure on governments.

6. This whole process risks tilting the balance against Paris Club creditors. In the past we looked to the Fund to strike a fair bargain between debtors and creditors with the degree of adjustment dictated at least partly by the availability of credit. We also looked to the Fund to ensure equitable burden-sharing among creditors. Present procedures risk tilting the balance against government creditors who are being asked not only to bridge interim financing gaps but also to provide increasingly generous Paris Club reschedulings. We have used approval in principle for Fund programme to avoid disbursing IMF resources before financing is identified - but we must recognise that this puts a burden on other creditors.

7. Domestically, I had already expressed our concern about the Brazilian operation to the Bank of England and I have relayed informally the specific comments made by the Chancellor and Sir Peter Middleton. It may be helpful to consider some guidance

to the Bank for future occasions. The first point is that we expect bridging finance to be the exception rather than the rule with countries making a timely approach to the IMF to avoid cash flow problems.

X 8. If bridging finance is nevertheless required, we should expect some forewarning before the Governor goes to Basle. This would entail the Bank checking carefully with both the BIS and other central banks about possible requests for bridging finance. There is a case for suggesting that if a bridging loan is to be negotiated, the Governor should be accompanied by a Treasury official. This would be anathema to the Bank of England but would reflect the fact that the Treasury has the sole financial liability.

9. Requests for bridge loans should be supported by a cash flow analysis - preferably by the IMF Staff. We also need to have a good idea of the adequacy of IMF programmes before agreeing to bridging loans since these effectively tie our hands in the Executive Board if we wish to be repaid. We should continue to insist that disbursements are linked to IMF Board approval of programmes so that creditor governments rather than the Managing Director retain control. We expect the shares of respective central banks in bridging operations to be allocated fairly to reflect their weight in the international economy and hence their stake in its stability. The exposure of individual countries' banks alone is not necessarily a good guide to this as the small shares for Italy and Canada in the Brazilian operation showed.

10. We may need to intensify our efforts to improve the conditionality of IMF programmes and in particular the financing arrangements. Likewise we need to examine the issue of burden-sharing with commercial banks. In the meantime, I attach a draft letter for you to send to Mr Loehnis on the handling of future bridging loans.



A BOTTRILL

DRAFT LETTER TO MR LOEHNIS**BRAZIL: BRIDGING LOAN**

The latest loan for Brazil has raised some questions about our procedures for handling these facilities - particularly where the Bank of England seeks an indemnity from the Treasury.

I believe that these loans should be seen as the exception rather than the rule. This means that we must all press debtor countries to approach the IMF in a timely fashion before their cash flow problems become acute and a bridge is needed. We must also consider carefully whether official bridging support is the appropriate form of finance in the particular instance. A concern in Brazil's case is that the official bridge is being used to pay interest arrears to other creditors, ie commercial banks while Brazil is requesting exceptionally generous treatment from the Paris Club.

In general I should be grateful if the Bank of England would use its contacts with the BIS and other central banks to forewarn the Treasury ahead of Basle meetings if a bridging request is likely. In this case it may be helpful to have a Treasury official accompany the Governor. We should expect central bank governors to insist that requests for bridge loans are supported by a cash flow analysis - preferably by the IMF Staff who should be best placed to provide an objective assessment.

I understand that governors have stipulated in the Brazilian case that disbursements under the bridging facility will only be available once the IMF Executive Board has approved a programme in principle. I am sure that this is right and we should expect to see this in any future operations.

The Chancellor has also expressed concern that the contribution of individual central banks should be allocated fairly. The present basis of allocation is not entirely clear. I understand that it is based largely on commercial banking exposure figures.

It would be preferable to give greater weight perhaps to countries' importance in the world economy. In the case of Brazil, this would have implied a greater contribution from Italy.

G L



Your Ref

e-cps/chancellor

with compliments
SIR GEOFFREY LITTLER

Treasury Chambers
Parliament Street
London SW1P 3AG
Tel: Direct Line 01-270
Switchboard 01-270-3000



H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000

Direct Dialling 01-270

Sir Geoffrey Littler KCB
Second Permanent Secretary

29 July 1988

Dear Anthony,

BRAZIL: BRIDGING LOAN

This latest in the series of 'bridging loans' prompts me to raise some questions about what seems to me to be becoming too regular a practice.

2. I think we share the view that these loans should be seen as the exception, rather than the rule. Situations can arise in which a debtor has a genuine short-term cash flow problem against the background of a satisfactory future IMF, etc financing arrangement. But they are rare and the Brazil case is one in which we have had doubts whether the need was genuine.

3. I have a general unease about the way in which, once a bridging loan has been offered, the lenders have an incentive to ensure that other parties reach agreements, and this may distort their judgment and tempt them into taking sides in negotiations between other parties. Two particular worries are:

- a tendency (on the part of debtor countries and perhaps the IMF) to invoke a bridging loan as way to encourage commercial banks to settle agreements; we should not fall for this tactic;
- the risk (a real risk because we have seen it happen) that where a bridging loan is agreed before the final agreement of an IMF operation the subsequent IMF Board discussion of the loan is prejudiced because countries participating in the bridge are looking to agreement on the IMF loan in order to get their money back: this is extremely damaging to the integrity of IMF operations.

It is also troublesome that, in the Brazil case, the bridging loan is being used to pay interest arrears to commercial banks, while Brazil is requesting exceptionally generous treatment from the Paris Club.

/4.....

Anthony Loehnis Esq CMG
Bank of England.

4. I suspect, based on occasional conversations with some of my opposite numbers in other creditor countries, that my worries are quite widely shared, but the objectors do not feel strongly enough to stand out alone, or take the lead, in opposing a case made urgently by, e.g. the U.S. Fed or even Camdessus. We might have a better chance if there were longer notice and opportunity for some private exchanges of views in advance of decisions.

5. It is relevant that several Finance Ministries, including the U.K. Treasury, have a direct locus because they provide an indemnity in some form to cover the risk of their participating central bank. I have three practical suggestions to offer, which I hope you would endorse and help us pursue, especially in the Basle framework but also elsewhere as appropriate.

6. First, to avoid our being bounced, can you please use your contacts with the BIS and other central banks to get forewarning of any future bridging requests. We shall do the same on our nets. We shall then be able to do both some analysis and some lobbying in advance; and in this connection I hope you could get agreement that any future requests are accompanied by a thorough cash flow analysis, preferably by the IMF who should be well placed to provide an objective assessment. We would want to see this in the Treasury before any U.K. participation in an agreement was considered. Even in case of dire urgency we should still not bypass this step and could readily at need offer a representative to join ad hoc in the Basle discussions.

7. Secondly, I understand that the Governors have stipulated in the Brazil case that disbursements under the bridging facility shall only be available after the IMF Board has approved a programme in principle. I am sure this is right and we should insist on the condition being repeated in future operations.

8. Finally, the Chancellor has expressed concern that the contributions of individual central banks should be allocated fairly. The basis of allocations currently adopted is not clear but I understand that it is based largely on national exposure of commercial bank lending. Our view is that this is by no means the whole story, or necessarily appropriate as an important element. It is important that the operation must not be viewed as central banks rescuing their own nationals. On the contrary, the rationale for bridging loans is much more the systemic line of argument. On that basis, contributions should reflect the overall weight of creditor countries in the world economy, and Italy and Canada, for example, should play a larger part.

Jones,

Geoffrey

(Geoffrey Littler)

UNCLASSIFIED

124157
MDLIAN 6557

UNCLASSIFIED

FM BRASILIA

TO PRIORITY FCO

TELNO 234

OF 011340Z AUGUST 88

INFO PRIORITY UKDEL IMF/IBRD

INFO ROUTINE RIO DE JANEIRO, SAO PAULO

CULL

BRAZIL: PARIS CLUB AGREEMENT

1. THE BRAZILIAN PRESS CARRIED REPORTS ON 30 JULY OF THE CONCLUSION IN PRINCIPLE OF AN AGREEMENT BETWEEN BRAZIL AND THE PARIS CLUB FOR THE RESCHEDULING OF US DOLLARS 4.992 BILLION OF BRAZIL'S TOTAL OF US DOLLARS 17 BILLION OF OFFICIAL DEBT. THESE REPORTS WERE BASED ON A STATEMENT BY FINANCE MINISTER NOBREGA THE PREVIOUS NIGHT. OF THE SUM RESCHEDULED, US DOLLARS 3.856 BILLION IS GIVEN AS PRINCIPAL AND US DOLLARS 1.136 BILLION AS INTEREST. ACCORDING TO THE REPORTS, THE AGREEMENT PROVIDES FOR THE DEBT MATURING BETWEEN 1 JANUARY 1987 AND 31 JULY 1988 TO BE RESCHEDULED ON THE BASIS OF REPAYMENT OVER 10 YEARS WITH A 5 YEAR GRACE PERIOD STARTING FROM 1 AUGUST 1988, AND THE DEBT MATURING BETWEEN 1 AUGUST 1988 AND 31 MARCH 1990 TO BE RESCHEDULED WITH A 10 YEAR REPAYMENT AND 5 YEAR GRACE PERIOD STARTING FROM 1 APRIL 1990. THE REPORTS STATE THAT OF THE US DOLLARS 1.136 BILLION OF RESCHEDULED INTEREST, 30% WILL BE PAID IN TWO EQUAL TRANCHES OF US DOLLARS 170 MILLION - THE FIRST TRANCHE BEING PAID ON 1 APRIL 1990 AND THE SECOND ON 1 APRIL 1991. THE REMAINING 70% WILL BE PAID OVER 10 YEARS WITH A 5 YEAR GRACE PERIOD STARTING FROM 1 APRIL 1990. THE REPORTS CALCULATE THAT THE RESCHEDULING OF INTEREST WILL SAVE BRAZIL US DOLLARS 283 MILLION IN 1988 AND US DOLLARS 682 MILLION IN 1989.

2. IN HIS STATEMENT, NOBREGA SAID THAT THE CONCLUSION OF AN AGREEMENT WITH THE PARIS CLUB OPENED THE WAY FOR BRAZIL TO RESUME NORMAL RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY. HE FORESAW THAT BRAZIL WOULD HAVE TO OVERCOME SOME DIFFICULTIES IN NEGOTIATING THE BILATERAL AGREEMENTS WITH INDIVIDUAL MEMBERS OF THE PARIS CLUB. HE ADDED THAT BRAZIL'S NEXT OBJECTIVE IN THE EXTERNAL ECONOMIC FIELD WAS TO NEGOTIATE WITH JAPAN FOR A SLICE OF THE NAKASONE FUND.

3. NO REACTIONS SO FAR TO THE NEWS OF THE AGREEMENT, WHICH BROKE

UNCLASSIFIED

124157
MDLIAN 6557

OVER THE WEEKEND.

THOMAS

YYYY

DISTRIBUTION 185

MAIN 181

FINANCIAL

SAMD

ADDITIONAL 4

CRAWFORD, BANK OF ENGLAND
CASE, TREASURY

BREACH, ECGD
OWEN, DTI

NNNN

FROM: P MOUNTFIELD
DATE: 1 AUGUST 1988

CHANCELLOR

cc: Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester o/r
Mr Evans
Mr Bottrill o/r
Mr Walsh
Mrs Thomson
Mr T Jones
Mr Cassell - UKDEL

BRAZIL: PARIS CLUB

After another late-night cliffhanger, we reached an agreement with Brazil at 2 am on Saturday. It was within the instructions you approved (Mr Taylor's minute of 25 July) although we had to go a lot further in rescheduling current interest payments than any of the creditors hoped. I attach the reporting telegram.

2. The UK was a relatively small creditor (about 7 per cent), while FRG had about 43 per cent of total. Nevertheless, as instructed, I took a strong line over rescheduling interest, when FRG and Japan held out for a long time against rescheduling more than 50 per cent. Trichet then told the three of us he thought Brazil was about to break-off negotiations, and after consulting Bonn, FRG moved to 70 per cent. I had already spoken to Sir G Littler and we concluded I had your authority to go up to 100 per cent if absolutely necessary to maintain a consensus and avoid a breakdown; but in the end this proved unnecessary. The ingenious device which eventually got a settlement was actually invented by the new ECGD member of the team; I held it back until the last moment and it worked well.

3. The two worrying features of this negotiation are mentioned in the telegram: the way the figures changed at the last minute, leading to a wider financing gap than we expected; and the consequent need for government creditors to act as lenders of last resort, providing proportionately more relief than the banks. I shall pursue the first point with Mr Cassell.

4. The US took a pretty tough line this time, unlike the disastrous negotiation in February 1987 when they pressurised us into agreeing an exceptionally soft deal without an IMF standby. (Baker later described this as 'the worst mistake I ever made'). However, the US delegate did tell me that Washington believes the position with the middle-income debtors is deteriorating rapidly, with the Argentine reform programme collapsing and the much-reduced Salinas majority in Mexico. He does not expect the present administration to change policy in its remaining months, but believes a rethink is likely next year. If Dukakis wins, he thinks it very probable the Democrats will favour some form of debt relief for middle income countries.

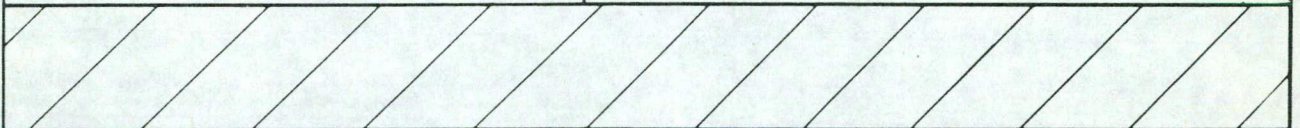
RM

P MOUNTFIELD

OUT TELEGRAM

		Classification CONFIDENTIAL	Caveat	Precedence IMMEDIATE
--	--	---------------------------------------	--------	--------------------------------

ZCZC TC CAVEAT FM TO TELNO OF AND TO	1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29	ZCZC CONFIDENTIAL FM FCO TO IMMEDIATE BRASILIA TELNO OF 011145Z AUGUST 88 INFO ROUTINE PARIS, UKDEL IMF/IBRD PARIS CLUB: BRAZIL Agreement reached on fairly generous rescheduling of debt up to March 1990. Main features: (a) 100 per cent of arrears of principal which built up during moratorium from February 1987 to July 1988 rescheduled. (Brazil remained current with interest payments during this period). (b) Also rescheduled: new maturities of principal (100 per cent) and interest (70 per cent) from August 1988 to March 1990 - ie, one month after end of current standby and fifteen days after new government takes office. (c) Previously - rescheduled debt (PRD) is excluded. (d) Rescheduled debt will be repaid over ten years including five years' grace. (e) Balance of interest will be repaid <i>in April 1990 and April 1991.</i> over three years.	
---	---	--	--



YYYY MAIN ADDITIONAL NNNN	Catchword: AGREEMENT		
File number	Dept TREASURY	Drafted by (Block capitals) P MOUNTFIELD	Telephone no 270 4479
Authorised for Initials Date/time despatch by:			
For COD use only	Comcen reference	Telegram number	Processed by

<<<<

Agreement includes normal clause providing for its cancellation should SBA with IMF be terminated. A separate side - letter from the Chairman draws attention to this and states that creditors will therefore pay special attention to the results of the first review of SBA in February 1989. Letter also draws attention to likely effects of collapse of IMF programme upon availability of new export credit.

Texts of Agreed Minute and side-letter follow by bag to Brasilia with detailed record of meeting.

Comment

On our figures, agreement is worth about dollar 7.5 billion over whole period. (UK share dollar 583 million) together with short-term relief on about another dollar 65 million (UK about dollar 32 million). The bulk of total relief falls in 1989. Press reports today speak of ~~pound~~^{dollar} 5 billion, but this appears to be principal only, and is still a bit low. This falls well short of original Brazilian demand totalling ~~pound~~^{dollar} 10.5 billion, which included rescheduling of PRD and of 100 per cent (not 70 per cent) of new maturities of interest, through to June 1990. But it is more generous than original IMF assumption of 100 per cent of principal only on arrears and new maturities. This is because Brazil produced new figures, which IMF was unable to demolish completely, showing a wider financing gap in 1988 and 1989 than IMF had assumed. As UK pointed out, this left the Paris Club in an unhappy position of lender of last resort. But creditors agreed that some further concession was necessary to avoid total breakdown. Creditors' initial offer was 50 per cent of interest, but this was forced up to 70 per cent. Majority of creditors including France were prepared to go further, but FRG (by far the largest) and Japan, with UK support, held out for 70 per cent, and Brazil insisted on more. UK eventually broke

1 <<<<
2

3 deadlock at 2 am Saturday by proposing short rephrasing of
4 remaining interest payments. This allows Brazil to maintain
5 planned reserve build in 1989 and 1990, while recovering
6 shortfall rapidly thereafter.

7 US was prepared to be more generous on cash, but also sought
8 (with UK support) to stage agreement so that second part should
9 come into operation only on successful conclusion of first
10 review of SBA. This move was intended to strengthen hand
11 of IMF in demanding further adjustment then if necessary.
12 But AMARAL (Brazilian negotiator) made it clear that this
13 degree of formal linkage with IMF was politically unacceptable.
14 UK therefore proposed device of side-letter, not forming part
15 of Agreed Minute.

16 Brazilian attitude was firm but conciliatory at first; they
17 got rattled as time drew on and failure seemed possible. Their
18 two bottom lines appeared to be (a) no further reduction in
19 published level of reserves and (b) a deal which could be
20 presented as no worse than FUNARO got in 1987 without any
21 IMF linkage. Final deal was only struck after late-night
22 consultation with NOBREGA in Brasilia. AMARAL described result
23 as fair and reasonable. Brief neutral press statement issued
24 afterwards, which Brazil will no doubt elaborate. Creditors
25 will not comment further.
26

27 HOWE
28
29

30 <<<<

31 YYY Y

32 NNN N

33
34

For distribution by Air Mail, see Post



FROM: J M G TAYLOR
DATE: 4 August 1988

[Handwritten signatures and initials]

MR BOTTRILL

cc Sir P Middleton
Sir G Littler
Mr Lankester
Mr Mountfield
Ms Life
Mr H P Evans
Mrs Thomson
Mr Cassell (UK/DEL/IMF)

BRAZIL: BRIDGING LOAN

The Chancellor has seen your minute of 28 July.

2. He would like this issue to go on the agenda for his next meeting on international issues.

3. He has noted your comment that if bridging finance is required, we should expect some forewarning before the Governor goes to Basle. He has commented that this is clearly essential.

[Handwritten signature]

J M G TAYLOR

CONFIDENTIAL

135151
MDHOAN 1802

CONFIDENTIAL
FM FCO
TO IMMEDIATE BRASILIA
TELNO 188
OF 041130Z AUGUST 88
AND TO IMMEDIATE RIO DE JANEIRO
AND TO SAVING SAO PAULO



BRAZIL : ECGD COVER

1. THE EGC MEETING ON 4 AUGUST DECIDED TO RECOMMEND A DX FACILITY FOR BRAZIL OF PDS STG 250 MN TO INCLUDE COVER FOR AMX AND WESTLANDS BUSINESS. (AS YOU KNOW, USUAL DX CRITERIA DO NOT (NOT) INCLUDE ARMS SALES. COVER OF WESTLANDS UNDER DX - AS OPPOSED, FOR EXAMPLE, TO THE NEW ARMS SALES FACILITY - MAY BE REVIEWED IN THE NEXT FEW MONTHS). COVER WILL BE REVIEWED FROM TIME TO TIME IN THE LIGHT OF PROGRESS IN IMPLEMENTING THE IMF PROGRAMME.

2. BECAUSE OF MINISTERIAL ABSENCES IT WILL NOT (NOT) BE POSSIBLE TO ANNOUNCE THIS UNTIL THE LAST WEEK IN AUGUST (IN TIME FOR THE FARNBOROUGH AIR SHOW). WE ARE BRIEFING MR EGGAR TO TELL SODRE THAT WE ARE REVIEWING URGENTLY OUR POSITION ON COVER IN THE LIGHT OF RECENT AGREEMENTS WITH THE IMF AND PARIS CLUB. YOU MAY WISH TO USE THE SAME LINE.

CHALKER

YYYY

DISTRIBUTION

156

MAIN

154

.MONETARY
SAMD

MR FEARN
MR GILLMORE

ADDITIONAL

1

MR WICKS NO 10 DOWNING ST

SAVING 1
SAO PAULO

PAGE 1
CONFIDENTIAL

NNNN



MPW

FROM: MISS M P WALLACE

DATE: 18 August 1988

MR MOUNTFIELD

BRAZIL: PARIS CLUB

The Chancellor was most grateful for your minute of 1 August.

MPW

MOIRA WALLACE

CONFIDENTIAL

FROM: G T W JONES
DATE: 18 August 1988

PAYMASTER GENERAL

cc Chancellor
Chief Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Mountfield o/r
Mr Robson
Mr Bottrill o/r
Mrs Thomson o/r
Mr Call

BRAZIL: RESUMPTION OF EXPORT CREDIT COVER

The Export Guarantees Committee (EGC) (an interdepartmental committee under Treasury chairmanship) has recommended the resumption of ECGD export credit cover for Brazil. The Committee agreed to the reintroduction of ECGD cover for Brazil in the form of a £250 million DX limit to become effective on signature of a Paris Club multilateral agreement and on ratification by the IMF of Brazil's adjustment programme in a Stand-by Agreement (SBA). EGC also recommended that on resumption of cover, ECGD should, if necessary, be allowed to extend export credit cover for the prospective sale of Westland Lynx helicopters to the Brazilian Navy.

2. The resumption of export credit cover to coincide with the IMF declaration that the SBA is effective and the offer of cover for the prospective Westland deal, go beyond the EGC rules for the resumption of ECGD cover for rescheduling countries. However, in the circumstances we recommend that you endorse the EGC recommendations.

BACKGROUND

3. Agreement was reached last month between Brazil and the Paris Club of government creditors on the rescheduling of some \$5.6 billion of official debts. This followed an IMF structural

adjustment programme which was approved in principle by the IMF's Executive Board. The IMF programme will become effective when critical mass (95pc) of new money commitments from Brazil's commercial bank creditors has been reached. The UK delegation to the IMF report that the fund staff hope to issue a paper later this week announcing that critical mass has been reached and proposing that the programme becomes effective early next week.

DX CRITERIA

4. The DX criteria which govern the resumption of cover for rescheduling countries are set out in the attached EGC paper (EGC(88)11 of 14 April 1988 (flag A)). Criterion (a) confirms that no irrevocable commitment to provide new cover should be given until after the first bilateral restructuring agreement has been signed, although decisions may be taken at an earlier date and announced in principle following the conclusion of the multilateral agreement.

5. ECGD confirm that the US export credit agency (Eximbank) announced immediately after the multilateral rescheduling agreement that it is prepared to consider applications for cover, which might be confirmed when an IMF SBA is in place. Both the German and French export credit agencies have also indicated their intention to resume cover when the SBA becomes effective. The ECGD negotiations on a bilateral rescheduling agreement are unlikely to be completed until February/March 1989. ECGD will come under pressure from exporters to give indications of cover (whereby ECGD inform the company that a successful bid will be eligible for cover if there is sufficient cover left within the limit when contracts are finalised) immediately there is a public announcement that the SBA is in place.

6. FCO have argued strongly in favour of an early resumption of cover in order to enhance our bilateral relations with Brazil. DTI are anxious that UK exporters are not disadvantaged in comparison with their major competitors.

7. On balance we support the EGC recommendation that ECGD should be allowed to give indications of cover when the IMF confirm that the SBA is in place. It would be difficult to resist pressure from UK exporters for official support when the US, France and Germany in particular, are offering cover to our major competitors in a market with substantial potential. It is unlikely that negotiations on any major contracts will be finalised before the end of the year and ECGD will not be required to confirm official credit support for any substantial business before the negotiations on the bilateral rescheduling agreement are near completion. The Treasury has insisted that the market should be further reviewed in February 1989 by which time the bilateral agreement should be ready for signature. We will also monitor carefully with ECGD in the interim period that Brazil is following the IMF programme.

COVER FOR WESTLAND

8. Under the DX criteria cover is not given for business that does not contribute directly to a debtor country's foreign exchange earning capacity, economic rehabilitation or immediate benefit (criterion d). Defence sales, except where they relate to export earning projects, are excluded.

9. Ministry of Defence and Department of Trade Ministers sought Treasury agreement in the middle of last year to allow ECGD to offer cover outside the normal rules, for the prospective sale by Westland of helicopters to the Brazilian Navy. The exceptional treatment was sought to enable Westland to compete against French competition with official export credit agency support. There was however no clear evidence of French export credit agency support for the bid by Aerospatiale. The then Chief Secretary concluded that there were no grounds for conceding exceptional treatment at that time and said that if DX cover was available he was not convinced that the normal rules, which exclude defence contracts, should be set aside (letter of 18 May 1987-flag B).

10. The Minister for Trade said in his letter of 13 July 1987 (flag c), that he had told Westland that we would reconsider ECGD support if cover was resumed for Brazil, or there was clear evidence that the French Government were giving official support to a competing bid by Aerospatiale. The Chief Secretary did not support the interim strategy proposed by the Minister of Trade which included giving an undertaking to Westland and the Brazilian Government that ECGD cover would be available when DX cover was introduced (flag D). But he confirmed the earlier agreement to consider further the extension of cover for the sale of Naval helicopters if there was evidence of French competition. At a subsequent meeting with the Brazilians, Mr Clarke confirmed that if Brazil's circumstances altered ECGD would provide export credit and match French terms. The French have maintained at official level since that time that they would not give new export credit cover for Brazil until there was progress on an IMF agreement.

11. ECGD is not under immediate pressure to offer cover for the Westland deal and there are indications that the Brazilians will defer a decision on the purchase of Naval helicopters, possibly until next year. But ECGD want to be in a position to respond quickly to any request for cover by Westland if the Brazilians resurrect this contract shortly. The French will not hesitate to offer official support to any competitive bid by Aerospatiale.

12. The earlier Ministerial support for this deal, including the implied assurance of export credit support given by the Minister for Trade, and the pressure that we are likely to face to allow Westland to compete on similar terms with Aerospatiale when this contract is resurrected, encourage us to support the EGC recommendation to allow this contract to be covered exceptionally under the DX facility. The circumstances of this case should enable ECGD to ring-fence any offer of cover which might be necessary and to avoid any repercussions.

CONCLUSION

13. I should be grateful for your endorsement of the EGC recommendations on the terms of the resumption of cover for Brazil, including:

- (i) the introduction of a DX facility of £250 million when the IMF confirm that the SPA is effective; and
- (ii) if necessary, the extension of cover to Westland for the sale of helicopters to the Brazilian Navy.

Jones

G T W JONES

CONFIDENTIAL



FROM: Ms K ELLIMAN
DATE: 22 August 1988

M

MR G T W JONES

cc PS/Chancellor
PS/Chief Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Lankester
Mr Mountfield
Mr Robson
Mr Bottrill
Mrs Thomson
Mr Call

BRAZIL: RESUMPTION OF EXPORT CREDIT COVER

The Paymaster General has agreed your submission of 18 August. On 13(ii) he has noted it will be important to ensure that this particular sale is ring-fenced and does not set a precedent for others.

Kim Elliman

KIM ELLIMAN
Private Secretary

Top Brazil.

BRAZILIAN EMBASSY

EFIN-L00-H11

Nº 065

The Brazilian Embassy present their compliments to the Foreign and Commonwealth Office and have the honour to enclose herewith a letter, to which a translation is appended, from the Finance Minister of Brazil, Mr. Mailson Ferreira da Nóbrega, to the Chancellor of the Exchequer, The Rt. Hon. Mr. Nigel Lawson, MP.

2. The Embassy would be grateful if this letter and the appended translation were to be forwarded to Mr. Lawson.

The Brazilian Embassy avail themselves of the opportunity to renew to the Foreign and Commonwealth Office the assurance of their highest consideration.

London, 31st August 1988



UNOFFICIAL TRANSLATION

The Right Honourable
Nigel Lawson MP
Chancellor of the Exchequer

Sir,

I have the honour to refer to our last meeting in London, on July 18, when we had occasion to exchange views on cooperation between our two countries and to discuss new avenues for strengthening our bilateral economic ties.

2. May I express my thanks for your kind hospitality then. I would like at this time to reaffirm the commitment of the Brazilian Government to see fully normalized, as shortly as possible, Brazil's relations with the international financial community and its desire to broaden its links with the United Kingdom.

I avail myself of this opportunity to renew to Your Excellency the assurance of my highest consideration.



Mailson Ferreira da Nóbrega

Ministro da Fazenda

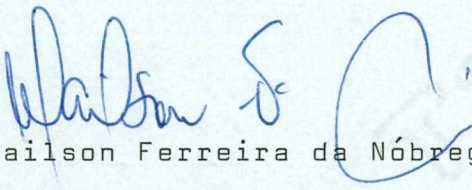
A Sua Excelência Senhor
Nigel Lawson
"Chancellor of the Exchequer"

Senhor Chanceler

Tenho a honra de referir-me à nossa recente entrevista em Londres, no dia 18 do corrente mês, quando tivemos a excelente oportunidade de trocar informações sobre a cooperação brasileiro-britânica e traçar planos para o incremento dos laços econômicos entre os nossos países.

2. Ao agradecer a amabilidade da acolhida de Vossa Excelência, desejo reafirmar o empenho do Governo brasileiro em concluir, o mais rápido possível, o processo de normalização das relações do Brasil com a comunidade financeira internacional e reiterar o interesse do Governo em ampliar a cooperação bilateral com a Grã-Bretanha.

Aproveito a oportunidade para renovar a Vossa Excelência os protestos de minha alta estima e distinta consideração.


Mailson Ferreira da Nóbrega



the department for Enterprise

The Hon. Alan Clark MP
Minister for Trade

Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
London SW1

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CHIEF SECRETARY	
REC.	26 OCT 1988
ACTION	Mr Mountfield
COPIES TO	EX, EST, Mr Ayton Sir G. Little, Mr Lancaster P. Davis Mr Booth, Mr G. Jones Mr Call.

Direct line 01-215 5144
Our ref WO3AST
Your ref
Date 24 October 1988

ECGD COVER FOR BRAZIL

As you know, we recently resumed medium term ECGD cover for Brazil following the successful conclusion of an IMF standby agreement and of a rescheduling agreement with the Paris Club. The cover is under a £250m DX limit.

Philips Radio Communications Systems Ltd has now asked for cover for prospective contracts worth some £30m for the supply of integrated radio communications systems for use by the Brazilian Federal and Sao Paulo State police to improve their emergency and customs surveillance services. There is some doubt whether this sort of business qualifies for DX cover, and this has been the subject of some discussion between our officials.

I understand that Philips might lose the business to foreign competitors without ECGD cover. It is not defence business, but equipment which would help the Brazilian police to combat a very high crime rate, which would be to the benefit of the country. Moreover, the company has indicated that, if they got this business, it might be followed by further orders and that it would also provide an opportunity for Philips to licence technology to a Brazilian company. Such transfer of technology could eventually contribute to Brazil's foreign exchange earnings, bearing in mind that Brazil has an advanced industry and already exports a considerable amount of manufactured goods.



the department for Enterprise

2

Rt Hon John Major MP

October 1988

There is also a more general consideration. We were one of the first countries to restore cover and we should not lose the goodwill which this has created in Brazil. The country is our most important market in Latin America and one in which we ought to have a greater market share. If we now refuse to give cover for a sale to the Brazilian Government, for unconvincing reasons, we could create the impression that we are not serious in wanting to increase our trade with Brazil.

On consideration of all these factors, I hope you will agree that we should offer Philips cover.

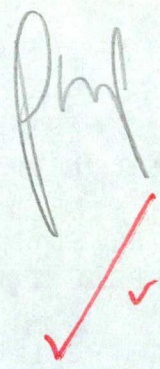
I am copying this letter to David Trefgarne and Tim Eggar.

A handwritten signature in black ink, appearing to read 'Alan Clark', is written above the typed name. The signature is fluid and cursive, with a long horizontal stroke at the end.

ALAN CLARK

RESTRICTED

051362
MDLIAN 8005



RESTRICTED
FM BRASILIA
TO PRIORITY FCO
TELNO 299
OF 241215Z OCTOBER 88
INFO ROUTINE UKDEL IMF/IBRD, RIO DE JANEIRO
INFO SAVING SAO PAULO

CULL

BRAZIL: ECONOMIC AND POLITICAL SITUATION

SUMMARY

1. BRAZIL: IS HYPERINFLATION IMMINENT? A FEELING OF CRISIS IN THE AIR.

DETAIL

2. PRELIMINARY OFFICIAL CALCULATIONS OF INFLATION IN OCTOBER (15 SEPTEMBER - 15 OCTOBER) AND INFORMED ESTIMATES FOR NOVEMBER HAVE BEEN REVISED UPWARDS SEVERAL TIMES IN THE LAST FEW DAYS: OVER 28 PER CENT FOR OCTOBER AND POSSIBLY 35 PER CENT FOR NOVEMBER. LATTER FIGURE HAS BEEN RIDICULED BY FINANCE MINISTER MAILSON DA NOBREGA, BUT FEW DOUBT THAT THERE IS NOW A SERIOUS RISK OF INFLATION SPIRALLING OUT OF CONTROL. CONFIDENCE HAS SUFFERED FROM:-

- (A) THE ILL JUDGED ATTEMPT BY THE CENTRAL BANK ON 13 OCTOBER (MY TELNO 290) TO EFFECT A PRECIPITATE INCREASE IN OVERNIGHT INTEREST RATES.
- (B) THE APPARENT ABILITY OF SOME POWERFUL MINISTERS TO IGNORE GOVERNMENT POLICY OVER PUBLIC SECTOR EXPENDITURE, AND CONCERN THAT IT WILL BE INCREASINGLY HARD TO CONTROL IN AN ELECTION YEAR.
- (C) THE POSSIBILITY THAT THE GOVERNMENT MAY BE FORCED, PROBABLY AFTER THE MUNICIPAL ELECTIONS ON 15 NOVEMBER, BUT CONCEIVABLY BEFORE, TO IMPOSE SOME KIND OF SHORT TERM PRICES AND INCOMES FREEZE.
- (D) SHARP INCREASES IN THE PARALLEL EXCHANGE RATE AND THE PRICE OF GOLD, THOUGH THESE ARE MORE A CONSEQUENCE THAN A CAUSE

OF DECLINING CONFIDENCE.

(E) A WAVE OF STRIKES IN THE PUBLIC SERVICE - THOUGH THESE ARE MUCH MORE APPARENT IN BRASILIA THAN IN SAO PAULO.

(F) WORRIES OVER THE IMPACT OF THE NEW CONSTITUTION.

3. A CRISIS ATMOSPHERE INEVITABLY GENERATES MUCH LOOSE TALK OF MILITARY INTERVENTION. I REMAIN OF THE VIEW THAT THE MILITARY WOULD INTERVENE ONLY IF THE GOVERNMENT PROVED UNABLE OR UNWILLING TO PRESERVE PUBLIC ORDER, AND PUBLIC ORDER IS NOT YET UNDER THREAT. IF INFLATION THREATENS TO GET TOTALLY OUT OF CONTROL, THE MOST LIKELY OUTCOME WILL BE A FUDGE - A RATHER LOOSELY DRAFTED SOCIAL CONTRACT ASSOCIATED PERHAPS WITH SOME MEASURE OF PROGRESSIVE DE-INDEXATION. THERE ARE SIGNS THAT MAILSON DA NOBREGA CONSIDERS THIS THE LEAST BAD OF THE LIMITED NUMBER OF OPTIONS OPEN. IT WOULD NOT BRING INFLATION DOWN 'AT A STROKE'. BUT IF A WAY CAN BE FOUND TO REDUCE THE DEGREE OF INDEXATION (A BIG IF) THERE IS AT LEAST SOME PROSPECT OF STABILISING AND THEN REDUCING THE MONTHLY INFLATION RATE.

NEWINGTON

YYYY

DISTRIBUTION

162

MAIN 157

CULL

SAMD

ADDITIONAL 5

MR CRAWFORD/BANK OF ENGLAND
MR BOTTRIL/TRSY
MR BREACH/ECGD

MR OWEN/DTI
MR DRYE/DTI

NNNN



CHIEF SECRET	
REC.	- 8 NOV 1988
ACTION	Mr Mountfield
COPIES TO	CG, EST, Mr Amos
	Sir G. Little, Mr Lancaster, Mr P Davis
	Mr B. Hill, Mr G. Jones

Foreign and Commonwealth Office

London SW1A 2AH

4 November 1988

From the Parliamentary Under Secretary of State

in call

I have seen a copy of Alan Clark's letter to you of 24 October about ECGD cover for Brazil. I support the points he makes, and not just because of the impact on our relations of a decision which disappointed the Brazilians.

We are very keen to encourage international cooperation in the fight against drugs. Brazil is an important link in the drugs chain. The equipment they wish to buy could significantly enhance their capabilities in this area, which is important not least because the drugs mafias pose a real threat to the security and integrity of some South American countries.

There is also the more technical issue of debt. The Chancellor's initiative on Sub Saharan debt has markedly improved our profile on debt generally. We gained a good deal of credit politically in Brazil for being the first government to resume medium term cover. If we now refuse cover for the first major government contract which comes up, I suspect that decision will be seen, however unjustly, as an empty gesture, given the deeply ingrained suspicion of our motives. I therefore hope you will agree that, taking the broader picture into account, our national interests are best served by showing flexibility in this case.

I am copying this letter to Alan Clark and David Trefgarne.

Gillian Triggs

pp Tim Eggar

Approved by Mr Eggar and signed in his absence

The Rt Hon John Major MP
 Chief Secretary
 HM Treasury
 Parliament Street
 LONDON SW1P 3AG

RESTRICTED

117625
MDLIAN 1916

RESTRICTED

FM BRASILIA

TO PRIORITY FCO

TELNO 318

OF 071200Z NOVEMBER 88

INFO ROUTINE UKDEL IMF/IBRD

INFO SAVING RIO DE JANEIRO, SAO PAULO, MEXICO CITY, CARACAS

INFO SAVING BOGOTA, LIMA, MONTEVIDEO, BISBA

CULL

BRAZIL: EXTERNAL FINANCE

SUMMARY

1. BRAZIL SOLICITS SUPPORT OF OECD COUNTRIES FOR ITS SECURING DISBURSEMENT OF FIRST TRANCHE OF IBRD POWER SECTOR LOAN BEFORE END OF 1988. ALSO INVITES CONSIDERATION OF SUGGESTION, IN THE CONTEXT OF INTER-AMERICAN DEBT, THAT CREDITOR COUNTRIES SUCH AS BRAZIL BE ALLOWED BY THE PARIS CLUB TO GIVE CONCESSIONAL TERMS TO THEIR LATIN AMERICAN DEBTORS.

DETAIL

2. AT A BRIEFING FOR REPRESENTATIVES OF OECD EMBASSIES TODAY, OSTENSIBLY ON THE ECONOMIC SUBJECTS DISCUSSED AT THE PUNTA DEL ESTE MEETING OF THE GROUP OF EIGHT, MINISTRO SERGIO AMARAL, HEAD OF THE FINANCE MINISTRY'S INTERNATIONAL RELATIONS DEPARTMENT, APPEALED TO OECD GOVERNMENT'S TO INSTRUCT THEIR EXECUTIVE DIRECTORS IN THE WORLD BANK TO VOTE IN FAVOUR OF THE DISBURSEMENT BEFORE THE END OF 1988 OF THE FIRST PART OF THE BANK'S POWER SECTOR LOAN. AMARAL SAID THAT DURING 1988 BRAZIL HAD PAID THE BANK US DOLLARS 1 BILLION IN PRINCIPAL AND 700 MILLION IN INTEREST AND RECEIVED US DOLLARS 730 MILLION IN LOAN DISBURSEMENTS. UNLESS IT OBTAINED THE FIRST TRANCHE OF THE POWER SECTOR LOAN IN 1988 IT WOULD END UP WITH A US DOLLARS 1 BILLION NEGATIVE FLOW FOR THE YEAR (AGAINST AN ORIGINALLY PROJECTED POSITIVE US DOLLARS 1.4 BILLION). THIS WOULD PUT THE BRAZILIAN GOVERNMENT IN AN IMPOSSIBLE POLITICAL SITUATION BECAUSE REALISATION OF THE WORLD BANK LOAN WAS LINKED TO A PROVISION IN THE AGREEMENT WITH THE COMMERCIAL BANKS INVOLVING A US DOLLARS 600 MILLION CREDIT, AND LINKED ALSO TO LOANS TOTTALLING US DOLLARS 450 MILLION WHICH BRAZIL HOPED TO GET FROM OTHER OFFICIAL AGENCIES UNDER CO-FINANCING ARRANGEMENTS. AMARAL ADDED THAT A BRAZILIAN TEAM WAS IN WASHINGTON AT THE MOMENT DISCUSSING ITS LOAN WITH THE WORLD

RESTRICTED

117625
MDLIAN 1916

BANK AND THAT THE PROPOSAL FOR THE LOAN WOULD HAVE TO GO BEFORE THE BOARD BY 8 DECEMBER IF A DISBURSEMENT THIS YEAR WAS POSSIBLE.

3. AS REGARDS THE PUNTA DEL ESTA MEETING, AMARAL SAID IT HAD DISCUSSED TWO MAIN ECONOMIC SUBJECTS: THE PROBLEM OF INTER-AMERICAN DEBT, AND IDEAS FOR DEBT REDUCTION. THESE TWO ISSUES WOULD BE WHAT THE FINANCE MINISTERS OF THE EIGHT WOULD BE DISCUSSING AT THEIR MEETING IN RIO, THE DATE OF WHICH STILL HAD TO BE FIXED.

4. ON INTER AMERICAN DEBT, THE PROBLEM WAS THAT BRAZIL, FOR EXAMPLE, WAS OWED US DOLLARS 3 BILLION BY OTHER LATIN AMERICAN COUNTRIES AND MANY OF THE LOANS WERE NON-PERFORMING. WITH ITS OWN BALANCE OF PAYMENTS PROBLEMS, BRAZIL COULD NOT AFFORD TO REFINANCE. OTHER MEMBERS OF THE EIGHT WERE IN A SIMILAR SITUATION. THERE WAS A PRESSING NEED TO RESTORE THE CAPACITY TO FINANCE THE INTER AMERICAN DEBT. THE FINANCE MINISTERS WOULD THEREFORE BE CONSIDERING MEANS TO OVERCOME THE PROBLEM BY MEANS OF MUTUAL ARRANGEMENTS SUCH AS COMPENSATORY AGREEMENTS, DEBT/EXPORTS SWAPS, AND SPECIAL CONCESSIONARY TERMS. AMARAL SUGGESTED THAT, AS THE LATTER CONTRAVENED PARIS CLUB PRACTICE, IT WAS FOR CONSIDERATION WHETHER THE CLUB OUGHT NOT TO RELAX ITS ATTITUDE SOMEWHAT AND ALLOW BRAZIL TO HAVE PREFERRED CREDITOR STATUS. (HE HAS ALREADY MADE THE SAME SUGGESTION - TO THE BANK OF ENGLAND, SEE CRAWFORD'S LETTER OF 5 OCTOBER AND PENTECOST'S LETTER OF 11 OCTOBER BOTH TO MOUNTFIELD).

5. ON DEBT REDUCTION, AMARAL EXPLAINED THAT THE EIGHT AS DEBTORS HAD SO FAR NOT MADE AN EVALUATION OF THE POSSIBILITIES, NOR PUT FORWARD IDEAS. THEY WOULD NOW DO SO IN CONNECTION WITH THE FINANCE MINISTERS MEETING, IN A SPIRIT NOT OF CONFRONTATION BUT OF COLLABORATION. AMARAL COMMENTED THAT THE PUNTA DEL ESTE MEETING REPRESENTED A CLEAR CHANGE OF ATTITUDE IN THIS RESPECT.

COMMENT

6. WE ARE NOT IN A POSITION HERE TO MAKE A RECOMMENDATION ON BRAZIL'S WORLD BANK LOAN REQUEST (PARA 2). FACTORS TO BE TAKEN INTO CONSIDERATION ARE:

(A) ANY APPARENT EARLY FAILURE OF THE EXTERNAL DEBT AGREEMENTS WHICH HE HAS NEGOTIATED IS LIKELY SERIOUSLY TO COMPROMISE FINANCE MINISTER NOBREGA'S POSITION AND TO PUT AT RISK THE RESPONSIBLE ECONOMIC POLICIES WHICH HE IS TRYING TO IMPLEMENT,

(B) EARLIER THIS WEEK THE LAST OF BRAZIL'S 300 ODD CREDITOR BANKS

RESTRICTED

117625
MDLIAN 1916

SIGNED THE DEBT AGREEMENT WITH THE COMMERCIAL BANKS, MARKING THE FORMAL CONCLUSION OF THAT AGREEMENT. BRAZIL MADE A CONSEQUENT INTEREST PAYMENT WHICH NOW MAKES IT CURRENT ON INTEREST.

7. WE WILL BE INFORMING MR EGGAR OF THE ABOVE BEFORE HIS CALL ON THE FINANCE MINISTER AT 1700Z ON 8 NOVEMBER.

NEWINGTON

FCO PLEASE ADVANCE TO
BANK OF ENGLAND - CRAWFORD
HM TREASURY - CASE
ECGD - BREACH
DTI - OWEN, DRYE

YYYY

DISTRIBUTION 158

MAIN 158

FINANCIAL (CULL)
SAMD

BSLNAN 4901

NNNN

ARAB
15/11



FROM: G T W JONES
DATE: 17 November 1988

1. MR BOTTRILL
2. CHIEF SECRETARY

cc Chancellor - 2nd -
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Mountfield
Mr Robson
Mr Jones
Mr Call

BRAZIL : DEFENCE SALES

The Minister for Trade, in his letter of 24 October, seeks your agreement to allow ECGD to offer export credit cover of some £30m to Philips Radio Communications System Ltd for the supply of radios for use by the Brazilian Federal and Sao Paulo State Police. The FCO (Mr Eggar's letter of 4 November) have now confirmed their support of the application. There was no consensus in EGC about whether this equipment qualified to be covered by the DX facility. On balance, I am inclined to accept that the radios should be covered under DX. However recent reports imply that the Brazilians might not be taking the measures necessary to achieve monetary stability and are delaying the start of discussions which will lead to a bilateral agreement on debt rescheduling with ECGD. I recommend that you endorse the DTI proposal but that we impose administrative delay on indications of cover.

Background

2. Mr Mountfield reported in his minute of 11 October that EGC had considered proposals to include two "defence" contracts under the DX facility introduced recently for Brazil. Defence contracts which do not generate foreign exchange earnings do not qualify for export credit support under DX. The Philips contract for the supply of an Integrated Radio Communications System for the Federal and State Police is a borderline case.

3. As Mr Mountfield explained there have been similar cases in the past which have been decided on their merits. But the decisions are rather inconsistent. DTI argue that the radios are for civil purposes and their use will contribute to reducing crime; there is a prospect of follow-on orders and the transfer of technology which might contribute to Brazil's foreign exchange earnings.

4. There have been recent reports which confirm that the Brazilians are reluctant to start negotiations on debt rescheduling. This is apparently because their new Constitution requires the government to seek Congressional approval of all rescheduling agreements. They are due to conclude negotiations and sign bilateral agreements by 31 March 1989; they cannot afford to delay the commencement of negotiations.

5. The Bank of England are concerned about the serious current economic uncertainty in Brazil. They advise that inflation remains the overriding problem with an increase at an unprecedented rate of 27.3 per cent in October, following 21 per cent and 24 per cent in August and September respectively. Prices have increased by 533 per cent between January and October 1988 and by 715 per cent in the 12 months to October. The PSBR is growing because of their reluctance to embark on a programme of fiscal and monetary retrenchment. The IMF target of 37 per cent of GDP for the broad PSBR in 1988 is likely to be overshoot substantially as inflation might be nearer 900 per cent in the year to December 1988 than the 600 per cent agreed in July's IMF programme. Brazil is reported to have been within 4 out of 5 of its IMF performance criteria at end-September 1988, but the deterioration in the domestic financial and inflatory situation means that it is certain to overshoot the end-December targets. The Bank concludes that Brazil might not be able to meet the IMF requirements at the first review of the SBA in February 1989.

6. We introduced DX cover in August before a bilateral was signed, which is a normal prerequisite, because of claims that other export credit agencies were proposing similar action. In the event the others held back, and only ECGD offered cover

x immediately the IMF declared that the SBA was effective. (France re-opened cover because they understood FRG was about to do so, and has now closed down. UK did so because we were told France was about to reopen. All parties are now trying to improve co-ordination in such cases.) In view of the Brazilians' reluctance to pursue the appropriate measures leading to a bilateral rescheduling agreement and the Bank of England's concerns that the economy is not under proper control, we should exercise a degree of caution by avoiding any further commitments. In the circumstances ECGD should apply administrative delay to applications for cover. We will pursue this further with EGC representatives shortly. In the meantime it would be appropriate for you to refer to our concerns and suggest a degree of caution in your reply to Alan Clark.

7. The second prospective defence contract involves the supply by MEL (Philips Electronics Ltd) of avionics systems for aircraft used by the Brazilian Airforce. The Secretary of State for Defence will be writing shortly seeking your agreement to offer cover for that contract under the Section 2 special defence allocation. We remain of the opinion that cover should not be extended for defence contracts in Brazil. Such a course would be contrary to the purpose of DX cover which is essentially to encourage sales designed to improve the balance of payments of the debtor country. I will submit further on that when we receive the Ministerial appeal.

Conclusion

8. I recommend that cover for the radios for the police should be provided under DX, but that no indication of cover should be given until there are positive indications of economic reform and a commitment to a bilateral debt rescheduling agreement. These points and the prospect of applying administrative delay on all applications for cover should be considered further within EGC as soon as practicable. We will make arrangements for a meeting shortly.

TJONES

G T W JONES

DRAFT LETTER FOR THE CHIEF SECRETARY TO SEND TO THE MINISTER FOR TRADE

cc Parliamentary Under Secretary of State FCO
Minister of State for Defence Procurement

ECGD COVER FOR BRAZIL

Thank you for your letter of 24 October in which you sought my agreement to include cover for the Philips Communications Systems Ltd contract for the supply of integrated radio communications system to the Federal and State Police, under the DX facility. I have also seen Tim Eggar's letter of 4 November.

This is a borderline case but, on balance, I agree that the prospective contract should be included for cover under the DX facility. However, in view of the current reports of the Brazilian reluctance to start negotiations on the bilateral rescheduling agreement with ECGD and the concerns expressed by the Bank of England about the economic situation, I have asked my officials to consider quickly within EGC the advisability of ECGD applying administrative delay to applications for cover. In the circumstances I think it would be sensible to adopt that course until the position is clearer. I suggest therefore that Philips should not be given an indication of cover for the time being.

I am copying this letter to



cc:
Chancellor - 2
Sir Peter Middleton
Sir G Littler
Mr Lankester
Mr Mountfield
Mr Robson
Mr Bottrill
Mr G T W Jones
Mr Call

Treasury Chambers, Parliament Street, SW1P 3AG

The Hon Alan Clark MP
Minister for Trade
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1H 0ET

Dear Alan,

27th November 1988

ECGD COVER FOR BRAZIL

Thank you for your letter of 24 October in which you sought my agreement to include cover for the Philips Communications Systems Ltd contract for the supply of integrated radio communications system to the Federal and State Police, under the DX facility. I have also seen Tim Eggar's letter of 4 November.

This is a borderline case but, on balance, I agree that the prospective contract should be included for cover under the DX facility. However, in view of the current reports of the Brazilian reluctance to start negotiations on the bilateral rescheduling agreement with ECGD and the concerns expressed by the Bank of England about the economic situation, I have asked my officials to consider quickly within EGC the advisability of ECGD applying administrative delay to applications for cover. In the circumstances I think it would be sensible to adopt that course until the position is clearer. I suggest therefore that Philips should not be given an indication of cover for the time being.

I am copying this letter to Tim Eggar and David Trefgarne

Yours truly,
John Major

JOHN MAJOR

[Handwritten mark]